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U.S.—JAPAN INTERDEPENDENCIES

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

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U.S.-JAPAN INTERDEPENDENCIES

TUESDAY, DECEMBER 17, 1991

UNITED STATES CONGRESS
JOINT ECONOMIC COMMITTEE
WASHINGTON, D.C.

The Committee met, pursuant to notice, at 10:30 a.m., in room 2359, Rayburn House Office Building, Honorable Lee H. Hamilton (vice chairman of the Committee) presiding.

Present: Representative Hamilton and Senator Sarbanes.

Also present: Richard F Kaufman, General Counsel.

OPENING STATEMENT OF REPRESENTATIVE HAMILTON, VICE CHAIRMAN

Representative HAMILTON. The meeting of the Joint Economic Committee will come to order.

This morning we begin a series of hearings on U.S.-Japan interdependencies. It has often been said that our relations with Japan constitute the single most bilateral relationship that we have.

The focus of these hearings will be on changes in the relationship.

Some say that the prospects are good for continued cooperation and fruitful economic relations between our two countries. Others express concern about continuing, even worsening, trade and related economic frictions.

All agree that U.S.-Japan interdependency is growing in an increasingly interdependent global economy.

What does interdependency mean, from an American perspective? Are the current trends favorable or unfavorable to the United States? Is the United States becoming too dependent on Japan?

Does the United States have an appropriate economic strategy for the post Cold War World in which the two leading industrial powers find themselves?

We are fortunate to have before us this morning a distinguished panel of experts on Japan to address these and a number of related questions.

Mr. Stephen D. Cohen is a professor in the School of International Service, the American University, author of a recent book, "Why the United States is Losing the Battle with the Japanese."

Mr. Charles Morrison is Director of the International Relations Program at the East-West Center in Honolulu, a frequent writer and commentator on U.S. relations with Japan.

Mr. Gary Saxonhouse is a professor of economics, University of Michigan, who has written extensively on the Japanese economy. I am informed that he is late because of a plane cancellation. If he comes in this morning, we will be glad to hear from him. If not, we will try to work him into the schedule tomorrow.

So gentlemen, we are very pleased to have each of you here. I would like it if you would take about ten minutes or so to set forth your oral statement and then we will turn to some questions.

Mr. Cohen, we will begin with you and then Mr. Morrison, and then we will have questions.

You may proceed, sir.

STATEMENT OF STEPHEN D. COHEN, PROFESSOR, SCHOOL OF INTERNATIONAL SERVICE, THE AMERICAN UNIVERSITY, WASHINGTON, DC

Mr. COHEN. Thank you, Mr. Chairman.

While the American and Japanese economies are becoming increasingly interdependent, this situation does not necessarily imply a desirable, stable and equally beneficial relationship.

Interdependence between countries should be based on approximately equal opportunities, benefits and responsibilities, as well as on comparable goals, strategies and practices. Such symmetries are in short supply in U.S.-Japanese economic relations.

The status quo in existing interdependencies, in my opinion, is neither desirable nor equally cost-effective. The assertion that there would be "mutually assured damage" if economic relations were severely disrupted, or severed, cannot assure that the relationship will be able to avoid serious frictions, especially at a time when American attention is drifting away from a Cold War struggle with the Soviet Union towards economic issues.

The pursuit of national economic strength, to some degree, is becoming more of a zero-sum game. Significant gains accrue to the country that dominates global markets in a major technology, such as electronics.

Conversely, significant costs are imposed on competitively inferior countries that must import technologically sophisticated goods, or must compete on the basis of stagnant real wages or a depreciating currency.

The Japanese understand this aspect of contemporary international competition better than anyone. Few Americans are even aware of it.

Interdependence between the United States and Japan exists on several different levels, and relative strengths and weaknesses can therefore be measured by different criteria.

By my count today, the United States is winning three out of four of these levels, but the fourth is the most important single dimension of interdependence.

Let me outline the three areas of interdependence where the United States is ahead.

First, in the largest sense of the international political and economic context, Japan is more dependent on the United States than vice versa. Since 1945, the United States has been Japan's only close political friend and military ally.

Japanese foreign policy has revolved around maintaining American friendship, giving into one U.S. economic demand after another rather than risking straining its strongest and most important legitimizing link with the outside world.

Furthermore, even a hint of a shift toward a protectionist trade policy in Washington can cause panic in all of Japan's financial markets.

Their industries need our market more than American industries need theirs. For all of their talk of rising industrial strength, Japan as a whole is still not prepared to function independently of the United States in global political and economic affairs.

Second, when analyzed in terms of pure economic theory, asymmetry and bilateral interdependence also favors the United States.

Economists believe that the real wealth of nations comes from importing goods, not from exporting.

However, Japan's trade policy is still firmly rooted in the mercantilist tradition of wrongly equating the maximization of trade surplus in manufactured goods with maximization of national welfare.

The Japanese seem quite content in exporting substantial amounts of real economic resources in return for paper money. A large percentage of the dollars earned by Japan's trade surplus is then invested back in the United States, the effect of which is to provide a subsidy of the representative hamilton. American penchant for spending more than we collectively produce as a country.

When Japan's contribution to military burden sharing is added in, the Japanese can be said to have assumed the role of chief foreign underwriter of American economic prosperity and overseas military power.

The resulting U.S. dependence on capital renders the question of relative advantage, in this particular sector of interdependence, unusually murky.

Cultural influence is a third sector of interdependence where the United States is winning. When measured in terms of motion pictures, books, music, fast food, sports, and lifestyles in general, the United States has an overwhelming surplus.

The downside of this situation is that the income and royalties from resulting sales are meager in comparison to the dangerous naivete they generate among most American.

The Japanese propensity for grafting American culture atop their own values has fueled the propensity of most Americans to think that the rest of the world differs mainly in terms of how far other countries have progressed on the road to full Americanization.

Pictures of Japanese eating pizza and wearing NFL football jerseys while touring Tokyo Disneyland create the false impression that there is no lasting problem because the two cultures are destined to meet in the middle.

I seriously doubt this is true.

Furthermore, in economic terms, the United States would be immensely better off acquiring a comparative advantage in manufacturing technology, in place of its existing leadership in producing marketable forms of fantasy.

Now, let me talk about where Japan is ahead in interdependence.

When the bilateral relationship is analyzed in terms of real world ability of industrial sectors to compete, the result is an interdependence decidedly in Japan's favor.

This, the fourth level of interdependence, is the most important aspect of the bilateral relationship, for it is the one that will most heavily determine a country's increases in its domestic living standards and in its levels of influence and power on the international scene.

The battle for leadership in the all-important high-technology sector between the world's two strongest, most talented and most dynamic economies is arguably the most important contest in international relations for the 1990s and beyond.

This is the new Cold War. The economic costs of coming in second will be enormous.

The United States, regrettably, is losing badly to Japan in the industrial battle. No end to this situation is in sight.

Since the late 1960s, the inability of one American industry after another to compete successfully with its Japanese competition has been—and will

likely continue to be—the major source of bilateral frictions between the two countries.

This imbalance has not generated an effective American response. Instead, it has spawned, one, a nonstop torrent of irrelevant rationalizations about the tolerable, if not desirable, consequences of Japan's rising economic strength; two, oversimplified explanations as to its causes; three, exaggerated and irrelevant proposals to retaliate against Japan; and four, erroneous forecasts as to why the bubble of the Japanese economic miracle is about to burst.

In order to better understand the costs to this country of its asymmetrical interdependence with Japan, it is necessary, I think, to have a better sense of how deep the U.S. industrial competitiveness problem is.

I believe that there is a serious systemic disequilibrium in the U.S.-Japanese economic relationship. It is not self-correcting. A 20-year bilateral negotiating effort between the two governments continues to be largely irrelevant because of a misguided effort to address symptoms instead of causes.

A policy of attitudinal and management mismatch perpetuates a competitive asymmetry that is making the United States increasingly dependent on Japanese companies for the important products and technologies of the future, as well as on Japanese investors for capital inflows to finance a perennial current account deficit in our balance of payments.

In terms of pure industrial competitiveness in the modern world economy, it is not at all clear that our cowboy traditions will win out over samurai practices.

Since the end of World War II, Japan has consciously maintained a mutually reinforcing mix of official economic policies, corporate strategies, and innovations in production technology that are aimed at maximizing the size and strength of its industrial sector.

When this mix was combined with pre-existing supporting social values, such as group loyalty and devotion to work, a willingness to make short-term sacrifices to achieve long-term goals, and perhaps most importantly, a collective, even if unconscious, desire to regulate the nature and extent of incoming foreign influence on the Japanese society, the result has been an awesome domestic and international economic machine.

Industrial strength through the cultivation of a producers-oriented economy maximizes Japanese leverage and minimizes Japanese vulnerability, vis-a-vis a world that is viewed as being mainly unfriendly, uncaring and unknowing about Japan's special needs.

The persistent bilateral trade surplus which Japan enjoys with the United States remains a very flawed beacon of the problem.

The size of the disequilibrium is less important than its causes and persistence. The product makeup of the bilateral disequilibrium is also important. The causes of the disequilibrium are sufficiently extraordinary, but they have not been and are not going to be neutralized by such conventional economic responses, such as more Japanese market opening measures, more voluntary export restraint agreements, more Japanese GNP growth, more dollar depreciation, more Japanese leisure time, more Japanese foreign direct investment, or more governmental promises. All of these traditional means of inducing trade equilibrium have been tried, and they have failed.

The key to benefits from international trade is a country's terms of trade—the ratio of an overall export price index to an import price index.

To the extent that Japan's exports emphasize high-value added, high-tech goods while U.S. exports emphasize low-value added, low-tech goods, the American terms of trade will continue to deteriorate vis-a-vis Japan.

The result is that we will have to export an increasing volume of real wealth to pay for the same volume of imports, and higher-skilled, better paying jobs will continue to gravitate to Japan.

Even a bilateral surplus with Japan, based on the exchange of low tech for high-tech goods, would still be a second best form of interdependence.

Three separate, albeit interrelated, problems comprise the heart of the U.S.-Japanese competitiveness problem.

One, inadequate macroeconomic policies in the United States to promote more saving, higher productivity increases, and more capital formation. In addition, we have the problem of improving the inadequate educational system.

The second problem is inadequate efforts by the American industrial sector to lower production costs, improve quality, introduce new products, and provide after-sales service to the extent necessary to successfully compete head-to-head with Japanese competitors in the U.S. and foreign markets.

Three, a Japanese market, except for imports of high-value added manufactured goods, is still not as open or accessible as markets in other industrial countries.

The fact that overt Japanese import barriers are relatively low is less important than the reality of significant indirect barriers and the country's idiosyncratic import patterns.

It should be emphasized that the first two of these problems are attributable to American shortcomings. The Japanese did not create them and they cannot cure them for us.

It is not my intention here to argue about relative guilt. Potential costs of not dealing effectively with our competitiveness problem is of far greater importance.

In the new world order, no country can remain a bona fide superpower without a strong expanding industrial base at home to sustain the incredible costs of being an international superpower.

A dynamic industrial base, in turn, requires product innovation, superior manufacturing skills, well-trained labor, low-cost production, excellent after-sales service, and last but not least, access to all large foreign markets to assure production economies of scale.

The United States is trailing Japan in all of these categories.

The competitive imbalance would be far worse in the absence of the current unpleasant economic triumvirate in the U.S. economy: stagnant real wages, a weak currency and a recession.

Despite a widespread belief that it is morning in America, I think that it is time for a wake-up call. As bad as the existing competitiveness problem is with Japan, a number of key economic indicators suggest it is likely to get worse rather than better in the future.

For example, Japan is now substantially outspending the United States in investment in new plant and capital equipment, in absolute terms.

If one wants to view the glass as being half-full, the Japanese have a strong vested interest in the continued prosperity of the American economy and will do nothing intentionally to jeopardize it.

There is neither need for concern nor need for remedial policy actions if one wishes to cling to the ancient belief that owing to an immutable relative allocation of land, labor and capital, all countries have preordained comparative advantage in some things and not others and should conduct foreign trade accordingly.

However, if one recognizes the growing evidence, mainly from Japan, that shrewd corporate strategies and effective industrial policies create induced

competitive advantage in high-tech industries based mainly on knowledge creation, then the United States is ill-advised to rely solely on the invisible hand and to be content with its current matrix of interdependencies with its strongest foreign competitor.

No economic and political superpower should willingly and happily perpetuate dependence on imported capital to sustain real growth.

No powerful country should willingly risk being forced to lure hesitant foreign investors to finance its saving-investment imbalance by watching interest rates surge or its exchange rate deteriorate.

No country should watch helplessly while its most important Japanese industrial competitors continue to enjoy the benefits of operating from a home market protected by informal barriers from the full pressure of foreign competition.

But every global superpower should try to determine the limit of the number of advanced industries and technologies for which it can safely cede global leadership to another country and safely rely on increased import dependence.

It is appropriate to talk about how American consumers, farmers and many industrial and service companies benefit from U.S.-Japanese interdependence. They do.

But policymakers and private citizens should be more focused on the rising costs of an American high-technology sector increasingly faltering in its efforts to maintain its dwindling research and manufacturing advantages over Japan.

Policymakers and private citizens should listen to those who point out that there is money to be made in a prosperous, large Japanese market that is continuously removing old import barriers almost as fast as new ones are revealed.

But they should be more focused on the apparent unwillingness of the Japanese to let imports dominate market share in Japan for any capital goods industry targeted for domestic development, a list that includes almost all important technologies.

Americans should not underestimate the managerial and technical excellence of Japanese industrial companies. But they should never forget about the suspiciously low market shares in Japan, even of American high-tech companies with a good product and a willingness to assume the long-term effort needed for a successful marketing effort in that country.

Americans should have access to high-quality Japanese goods, but not ignore the potential for Japanese companies to delay delivery of state-of-the-art components to their American customers, some of whom are direct competitors.

Americans should be grateful that Japan has supported us in the Gulf war, but they should question the cost of an increasing dependence on Japan for the components that allow advanced U.S. weapons systems to function.

The United States should praise Japan for its increased willingness to share the burden of military and foreign aid expenditures, but it should not assume that these activities can ever fully compensate for the larger problem of diminished relative American industrial competitiveness.

Last but far from least, policymakers should welcome a decline in the U.S. multilateral and bilateral trade deficits, but they should focus on the causes of the decline rather than on numbers.

When looking at the bilateral deficit, even if it declines, it is imperative to concentrate on product composition. The U.S. standard of living will be adversely affected to the extent that low-value added U.S. exports become

an ever larger source of payment for imports of high-value added goods from Japan.

In conclusion, Japan should be used mainly as a standard of excellence and not as a scapegoat.

The increasing economic malaise felt by all but the wealthiest Americans is based on a sub-par economic performance that looks even worse when held up to the mirror of a brilliant performance by Japan's industrial sector.

The main prerequisite for a more sustainable and equitable interdependence is a greater convergence in the industrial and trade performances of the United States and Japan.

A second prerequisite is access to the Japanese market, equivalent to openings found in other industrial countries.

If the U.S. competitiveness disequilibrium is not narrowed, the bilateral relationship will be subjected to increasingly detrimental strains and recriminations.

Both sides must work to remedy the problem. But most of the effort needs to be forthcoming from the United States, from both our official and private sectors, because it is America's inadequate response to Japan's industrial excellence that is causing the lion's share of the problem.

Thank you.

[The prepared statement of Mr. Cohen follows:]

PREPARED STATEMENT OF STEPHEN D. COHEN

Mr. Chairman and members of the Committee, I am honored to accept your invitation to appear here today and talk about what has become the world's most important bilateral relationship.

While the American and Japanese economies are becoming increasingly interdependent, this situation does not necessarily imply a desirable, stable, and equally beneficial relationship. Interdependence between countries should be based on approximately equal opportunities, benefits, and responsibilities, as well as on comparable goals, strategies, and practices. Such symmetries are in short supply in U.S.-Japanese relations.

The status quo in existing interdependencies, in my opinion, is neither desirable nor equally cost-effective. The assertion that there would be "mutually assured economic damage" if economic relations were severely disrupted or severed cannot assure that the relationship will be able to avoid serious frictions, especially at a time when American attention is drifting away from the cold war struggle with the Soviet Union and towards economic issues.

Japan is content to be largely dependent on the United States for military defense, scientific breakthroughs, raw materials, and cultural fads. Its unwillingness to be dependent on us for the production of sophisticated high-technology goods produces an interdependence asymmetry that is becoming increasingly costly to the American economy and U.S. foreign policy. The alternative to correcting this situation is more serious problems in the long run.

The pursuit of national economic strength to some degree is becoming more of a zero-sum game: significant gains accrue to the country that dominates global markets in a major technology, such as electronics. Conversely, significant costs are imposed on competitively inferior countries that must import technologically sophisticated goods or must compete on the basis of stagnant real wages or a depreciating currency. The Japanese understand this aspect of contemporary international competition better than anyone. Few Americans are aware of it.

Interdependence between the United States and Japan exists on several different levels, and relative strengths and weaknesses can therefore be measured by different criteria. By several key criteria, the United States remains on the losing end—and that is the main substance of my testimony. First, however, let me briefly acknowledge the United States' strengths and accrued benefits that are excessively hailed by those who would have us believe that the United States is doing just fine, that on balance it has little to fear or regret in what is a relationship that allegedly provides an adequate array of benefits to both countries.

In the largest sense of the international political and economic context, Japan is more dependent on the United States than vice versa. Since 1945, the United States has been Japan's only close political friend and military ally. Japanese foreign policy has revolved around maintaining American friendship, giving into one U.S. demand after another rather than risking straining its strongest and most legitimizing link with the outside world. Furthermore, even the hint of a shift toward a protectionist trade policy in Washington can cause panic in all of Japan's financial markets. Their industries need our market more than American industries need theirs. For all of their talk of rising industrial strength, Japan as a whole is still not prepared to function independently of the United States in global political and economic affairs. Nevertheless, there is little to be gained in real terms from assuming that in a worst case scenario, i.e. a runaway escalation of tensions, Japan would either blink first or be hurt more than we would if the alliance fell apart and/or a trade war broke out. A doomsday scenario is largely irrelevant: no one wants it and it is unlikely to occur. There is nothing desirable about a situation in which the United States would only be relatively less hurt, for it would still pay a terrible price in such circumstances. "War games" are best played against hostile countries, not a critically important political ally and economic partner.

When analyzed in terms of pure economic theory, the asymmetry in bilateral interdependence also favors the United States. Economists believe that the real wealth of nations comes from importing goods, not from exporting. However, Japan's trade policy is still firmly rooted in the mercantilist tradition of equating the maximization of its trade surplus in manufactured goods with the maximization of its national welfare. The Japanese seem quite content in exporting substantial amounts of real economic resources—far above what is needed to pay for extensive imports of raw materials, food, and fossil fuels—in return for paper money. And they seem quite content to ignore potential long-term damage to their national security of rising enmity by many of their frustrated trading partners who view them as adversarial traders.

A large percentage of the dollars earned by Japan's trade surplus is invested in the United States, the effect of which is to provide a subsidy to the representative hamilton. American penchant for spending more than we collectively produce and for wallowing in a large trade deficit. Further adding to the irony is the fact that some of Japan's dollar earnings are used for travel to the United States and Europe, thereby enabling Japanese tourists to see for themselves how, despite their diligent work ethic, living standards in other industrial countries are higher and most consumer goods prices are lower than they are in Japan. When Japan's contribution to military burden sharing is added in, the Japanese can be said to have assumed the role of chief foreign underwriter of American economic prosperity and overseas military power.

The resulting U.S. dependence on Japanese capital renders the question of relative advantage in this sector of interdependence unusually murky; both sides seem to be successfully maximizing different values. The psychic income gained by the Japanese from watching the rise of their economic power, as well as Japan's sociological emphasis on contributing to the group rather than seeking self-gratification, partially explains the odd Japanese willingness to subsidize, at least for now, U.S. living standards. Conversely, in the United States, the irresistible allure of serving the immediate interests of the consumer and an exaggerated trust in the theory of free trade and in the benefits of imports perpetuate economic behavior patterns largely alien to those prevailing in Japan.

Cultural influence is a third sector of interdependence where the United States is "winning." When measured in terms of motion pictures, books, music, fast food, sports and games, clothing styles, dances, and lifestyles in general, the United States has an overwhelming export surplus. The downside of this situation is that the not inconsequential income and royalties from resulting sales are meager in comparison to the dangerous naivete among Americans that it inspires. Japanese hunger for grafting American culture atop their own values adds fuel to the propensity of most Americans to think that the rest of the world differs mainly in terms of how far other countries have progressed on the road to full Americanization. Pictures of Japanese eating pizza and wearing NFL football jerseys while touring Tokyo Disneyland create the false impression that there is no lasting problem because the two cultures are destined to "meet in the middle." I seriously doubt that this is true, as I seriously doubt that having the more exportable culture is anything more than a marginal economic advantage and "soft" political power. In economic terms, the United States would be immensely better off acquiring a comparative advantage in manufacturing technology in place of its existing leadership in producing marketable forms of fantasy.

When the bilateral relationship is analyzed in terms of real world ability of industrial sectors to compete, the result is an interdependence decidedly in Japan's favor. This is the most important aspect of the bilateral relationship, for it is the one that will most heavily determine a country's increases in its domestic living standards and its levels of influence and power on the international scene. The battle for leadership in the all-important high-technology sector between the world's two strongest, most talented, and most dynamic economies is arguably the most important contest in international relations for the 1990s and beyond.

This is the new cold war. The economic costs of coming in second will be enormous. The United States, regrettably, is losing badly to Japan in the industrial battle. No end to this situation is in sight. The most recent warning comes from Congress's Office of Technology Assessment in a new report entitled *Competing Economies: America, Europe, and the Pacific Rim:*

U.S. manufacturing is falling behind the competition. The standard of comparison is Japan If there are no major changes in government policies of developed nations, we expect U.S. manufacturing competitiveness to continue to sink, compared with Japan.

Since the late 1960s, the inability of one American industry after another to compete successfully with its Japanese competition has been—and likely will continue to be—the major source of bilateral frictions between the two countries. This imbalance has not generated an effective American economic response. Instead, it has spawned a non-stop torrent of irrelevant rationalizations about the tolerable if not desirable consequences of Japan's rising economic strength, over-simplified explanations as to its causes, exaggerated and irrelevant proposals to retaliate against Japan, and erroneous forecasts as to why the bubble of the Japanese economic miracle is about to burst.

In order to better understand the costs to this country of its asymmetrical interdependence with Japan, it is necessary to have a better sense of how deep the U.S. industrial competitiveness problem is. I believe that there is a serious, systemic disequilibrium in the U.S.-Japanese economic relationship. It is not self-correcting. A 20 year bilateral negotiating effort between the two governments continues to be largely irrelevant because of a misguided effort to address symptoms instead of causes.

A policy, attitudinal, and management mismatch perpetuates a competitive asymmetry that is making the United States increasingly dependent on Japanese companies for the important products and technologies of the future, as well as on Japanese investors for capital inflows to finance a perennial current account deficit in our balance of payments. The cowboy and samurai societies have produced the two best economic systems on earth, but they have been moving in opposite directions. In terms of pure industrial competitiveness in the modern world economy, it is not at all clear that the cowboy traditions will win out.

Japan, since the end of World War II, has consciously maintained a mutually reinforcing mix of official economic policies, corporate strategies, and innovations in production technology aimed at maximizing the size and strength of its industrial sector. When this mix was combined with preexisting, supportive social values, such as group devotion to work, a willingness to make short-term sacrifices to achieve long-term goals, and (perhaps most importantly) a collective, even if unconscious, desire to regulate the nature and extent of incoming foreign influence on Japanese society, the result has been an awesome domestic and international economic machine. Industrial strength through the cultivation of a producers-oriented economy maximizes

Japanese leverage and minimizes Japanese vulnerability vis-a-vis a world that is viewed as being mainly unfriendly, uncaring, and unknowing about Japan's special needs.

In sharp contrast, the United States has unconsciously maintained a relatively debilitating mix of official economic and social policies, excessively short-term business strategies, and a strong preference for maximizing self-gratification through consumption that collectively has precluded an effective, credible response to the twin challenges of Japan's rising industrial strength and its "inhospitable" environment for imports of manufactured goods. We emerged from World War II so strong economically, so determined to contain communism, and later so desirous of creating a more equitable society that considerations of industrial competitiveness were a minor after-thought at best.

The persistent bilateral trade surplus which Japan enjoys with the United States remains a very flawed beacon of the problem. The size of the disequilibrium is less important than its causes and persistence, as well as the product composition of bilateral trade. The causes are sufficiently extraordinary that they have not and are not going to be neutralized by conventional economic responses: more Japanese market-opening measures, more voluntary export restraint agreements, more Japanese GNP growth, more dollar depreciation, more Japanese leisure, more Japanese foreign direct investment, or more governmental promises. All of these traditional means of inducing trade equilibrium have been tried, and they have failed.

A diminution of the U.S. bilateral deficit will not necessarily signal the end of the problem. The real costs to the American economy are not going to disappear, for example, if the Japanese embark on a clever public relations gambit of massively increasing their imports of raw materials, scrap paper, used clothing, and other low-tech goods to artificially reduce the arithmetic size of their bilateral surplus.

The key to benefitting from international trade is a country's terms of trade, the ratio of an overall export price index to an import price index. To the extent that Japan's exports emphasize high-value added, high-tech goods, while U.S. exports emphasize low value added, low-tech goods, the American terms of trade will deteriorate vis a-vis Japan. The result is that we will have to export an increasing volume of goods to pay for the same volume of imports, and higher skilled, better paying jobs will continue to gravitate to Japan. Even a bilateral surplus with Japan under such circumstances would still be a second-best form of interdependence.

Three separate, albeit interrelated problems comprise the heart of the U.S.-Japanese competitiveness problem:

1) Inadequate macro policies in the United States to promote more saving, increased productivity and capital formation, and a better educational system.

2) Inadequate efforts by the American industrial sector to lower production costs, improve quality, introduce new products, and provide after-sales service to the extent necessary to successfully compete head to head with Japanese competitors in the U.S. and foreign markets.

3) A Japanese market that, for imports of high value-added manufactured goods, is still not as open or accessible as markets in all other industrial countries. The fact that overt Japanese import barriers are relatively low is less important than the reality of significant Japanese indirect barriers and the country's idiosyncratic import patterns.

It should be emphasized that the first two of these three problems are attributable to American shortcomings. The Japanese did not create them, and they cannot cure them for us. It is not my intention here to argue about relative guilt. The potential costs of not dealing effectively with our competitiveness problem is of far greater importance. In the new world order, no country can remain a bona fide superpower without a strong, expanding industrial base at home to sustain the incredible costs of such international status.

A dynamic industrial base, in turn, requires product innovation, superior manufacturing skills, well-trained labor, low cost production, excellent after-sales service, and, last but not least, access to all large foreign markets to assure production economies of scale. The United States is trailing Japan in all of these categories. The current competitive imbalance would be far worse in the absence of the current unpleasant economic triumvirate of stagnant real wages, a weak currency, and a recession in the United States economy.

Since competitiveness must be measured in terms of a country's being able to increase its people's standard of living, the American economy is representative hamilton. to fare poorly—except for the top 20 percent of income earners. Since a genuine global superpower should be able to offer Eastern Europe significant financial aid instead of just technical assistance and since a genuine superpower should be able to launch a war without having to announce beforehand that it could not do so without the financial support of its allies (as was the case in the Gulf War), the American foreign policy performance, like its economic performance, is beginning to show wear and tear.

Despite a widespread belief that it is morning in America, I think it is time for a wake-up call. As bad as the existing competitiveness problem is with Japan, a number of key economic indicators suggest that it is likely to grow rather than narrow in scope. Japan now substantially out-spends the United States in investment in new plant and capital equipment in ab-

¹For details, see Chapter Nine of the author's book, *Cowboys and Samurai—Why the United States Is Losing the Battle with the Japanese and Why It Matters* (HarperCollins, 1991).

solute terms. When Americans happily greeted the news that the Japanese economy in the late 1980s was shifting from export-led to investment-led growth, we once again failed to realize that our demands on Japan for policy change were once again leading to a more efficient Japanese economy. Other indicators of what I call the ominous trend line include the probability that Japan will catch up in absolute terms with United States R&D outlays in commercial technology (as opposed to military, space, health, etc.) by the end of this decade. In addition, cash-rich Japanese companies can—and do—buy their way out of technological and creative weaknesses through equity investments in small, start up American firms unable to get favorable treatment from American banks or venture capital lenders.

In wondering about the fate of a country that is dependent on another to do much of its saving and advanced industrial production for it, I should like simply to quote Senator Daniel Patrick Moynihan's terse axiom: "It is an iron law of history that power passes from debtor to creditor."

Conclusions

If one wants to view the glass as being half full, the Japanese have a strong vested interest in the continued prosperity of the American economy and will do nothing intentionally to jeopardize it. There is neither need for concern nor need for remedial policy actions if one wishes to cling to the ancient belief that owing to an immutable relative allocation of land, labor, and capital, all countries have preordained comparative advantage in some things and not others and should conduct foreign trade accordingly.

However, if one recognizes the growing evidence (mainly from Japan) that shrewd corporate strategies and effective industrial policies can create "induced competitive advantage" in high-tech industries built mainly on knowledge creation, then the United States is ill-advised to rely solely on the invisible hand and to be content on its current matrix of interdependence with its principal foreign competitor. I personally think that the United States should follow a more prudent policy that would seek to prevent the growing threat that an unstable glass, be it half empty or half full, will topple over and spill its contents.

No economic and political superpower should willingly and happily perpetuate dependence on imported capital to sustain real growth. No powerful country should willingly risk being forced to lure hesitant foreign investors to finance its saving-investment imbalance by watching interest rates surge or its exchange rate deteriorate. No powerful country should watch helplessly while its most important Japanese industrial competitors continue to enjoy the benefits of operating from a home market protected by informal barriers from the full pressure of foreign competition. But every global superpower should try to determine the limit on the number of advanced industries and technologies for which it can safely cede global leadership to another country and safely rely on increased import dependence.

It is appropriate to talk about how American consumers, farmers, and some industrial and service companies benefit from U.S.-Japanese interdependence. They do. But policymakers and private citizens should be more focussed on the rising costs of an American high-technology sector increasingly faltering in efforts to maintain its dwindling research and manufacturing advantages over Japan.

Policymakers and private citizens should listen to those who point out that there is money to be made in a prosperous, large Japanese market that is continuously removing import barriers almost as fast as new ones are revealed. But they should be more focussed on the apparent unwillingness of the Japanese to let imports dominate market-share in Japan for any capital goods industry targeted for domestic development because of its commercial potential, a list that includes almost all important technologies.

Americans should not underestimate the managerial and technical excellence of Japanese industrial companies. But they should never forget about the suspiciously low market shares in Japan even of American companies with a good product and a willingness to assume the long-term effort needed for successful marketing in that country. Americans should hail access to high quality Japanese goods, but not ignore the potential for Japanese companies to delay delivery of state of the art components to their American customers, some of whom are direct competitors.

Americans should listen to those who express gratitude to Japan's willingness to provide much needed capital to offset insufficient American saving. But they should also worry about the resulting dependency on the whims of foreigners and on the spectacle of a Treasury Department effectively having to temper its views on Japanese trade policies, lest the Japanese financial community retaliate to a hard-line U.S. trade stance by staying away from the next Treasury bill auction.

Americans should be grateful that Japan supported us in the Gulf War. But they should question the cost of an increasing dependence on Japan for the components that allow advanced U.S. weapons systems to function. The United States should praise Japan for its increased willingness to share the burden of military and foreign aid expenditures, but it should not assume these activities can ever fully compensate for the larger problem of diminished American industrial competitiveness.

Americans should welcome Japanese foreign direct investment, but not forget that much of it is a defensive reaction to threats of American protectionism against Japanese imports. Much of Japan's foreign direct investment is nothing more than a consolation prize that reduces the price Americans pay for their declining ability to compete in cars, steel, televisions, semi-conductors, machine tools, computer components, and so on. Policymakers should also question the reasons for and consequences of Japanese suppliers rushing here to serve their Japanese clients who have set up assembly operations in the United States, thereby creating an off-shore version of a suppliers' keiretsu. The proliferation of these suppliers coming to the United States suggests that either our components makers still are not on par with their Japanese competitors or the Japanese may be creating a Japanese-managed, high-productivity economy within the U. S. economy.

Last, but far from least, policymakers should welcome a decline in the multilateral and bilateral trade deficits, but they should focus on the causes rather than the numbers. When looking at the bilateral deficit, even if it declines, it is imperative to concentrate on product composition. The U.S. standard of living will be adversely affected to the extent that low valued added U.S. exports become an ever larger source of payment for imports of high-value added goods from Japan.

One of the oddest aspects of bilateral interdependence is that Japanese economic strengths collectively produce the brightest spotlight on American economic weaknesses. No matter how one views the U.S. relationship with Japan, there is no good reason for not correcting internal weaknesses caused by inadequate governmental policies and managerial performances. Japan should be used as a standard of excellence, not as a scapegoat. The increasing economic malaise felt by all but the wealthiest Americans is based on a sub-par domestic economic performance that looks even worse when held up to the mirror of a brilliant performance by Japan's industrial sector.

The prerequisite for a more sustainable and equitable interdependence is a greater convergence in the industrial and trade performances of the United States and Japan. If the U.S.-Japanese competitiveness disequilibrium is not narrowed, the bilateral relationship will be subjected to increasingly detrimental strains and recriminations. Both sides must work to remedy the problem. But most of the effort needs to be forthcoming from the United States—by both the official and private sectors—because it is our inadequate response to Japanese industrial excellence that is causing the lion's share of the problem.

Representative HAMILTON. Mr. Cohen, we thank you. We now go to Mr. Morrison.

Mr. Morrison, please proceed.

STATEMENT OF CHARLES E. MORRISON, DIRECTOR OF INTERNATIONAL RELATIONS PROGRAM, EAST-WEST CENTER, HONOLULU, HAWAII

Mr. MORRISON. Thank you very much.

I very much agree with the conclusions of Mr. Cohen, at the last point.

Before beginning, I would like to mention that I am not only with the East-West Center in Honolulu, but I also have an association with the Japan Center for International Exchange in Tokyo. That is a nongovernmental, nonprofit organization based in Japan.

I was asked to comment on the noneconomic aspects of interdependence, and I would like to divide my comments into three basic areas.

One has to do with the general notion of interdependence. Another set of comments has to do with political security interdependence per se, and a third set of comments has to do with U.S. policy and changes that I think need to be made.

Regarding the general notion of interdependence, I think it is important to point out that it is a less threatening way of saying dependence. It is a recognition that a dependence has an element of mutuality, and there is an implied tradeoff between prosperity, or economic welfare, and security.

By becoming more interdependent, you cooperate and can make use of the resources of others, but you have less political control. And so all governments try to reduce the security costs or the lack of control in the process of becoming more interdependent.

The Japanese, for example, have long had a policy of trying to reduce their food dependency. They are trying to reduce their extreme energy interdependency by relying more on nuclear energy and reprocessing.

Of course, we try to reduce our dependency on goods related to national security, high-tech and others.

The second point I want to make is that the gains of interdependence are not necessarily equally shared. Much of our problem with Japan comes from a feeling that they are gaining more from interdependence than we are.

This wouldn't have mattered to us, perhaps, 25 years ago, but now that we are relatively equal in our economic and technological attainments, I think this question of relative shares does matter to us.

Third, although we can treat U.S.-Japan relations as a case study in interdependence, the important thing to remember is that each country is interdependent with the world as a whole. But, for each, the other country has become a symbol for the rest of the world.

And so, when Americans are thinking of making the changes and have to consider our competitiveness in ways that we didn't before, as Steve Cohen was saying, when we look at the country that seems to be putting the pressure on us to make changes to alter labor practices, to alter government-business relationships, to put more emphasis on hard work and education, it seems to be Japan.

When the Japanese think about what country is putting pressure on them to change procurement practices, to open their rice markets, and to do many other things that relate to their growing interdependence with and responsibility toward the rest of the world, they think of the United States, and rightly so.

This puts a heavy political burden on the U.S.-Japan relationship.

Each of us would rather have the other adjust rather than make adjustments ourselves. The differences in our two systems are deeply rooted, they will take a lot of time to change, and in the interim, we have to cope with the inevitable frictions, and we have to try not to let them get out of hand.

Now, let me turn to the question of political security interdependence.

First, the Japanese have long been dependent on us in the security sphere. We are becoming more dependent on the Japanese.

The Japanese made a conscious decision in the early 1950s that they would emphasize economic rehabilitation and rely on the United States for defense and foreign policy leadership.

That is still the position of the Japanese today.

The U.S.-Japan security alliance is something that is entirely voluntary with the Japanese, and they continue to support that alliance not just because it provides physical security, but because it is a guarantee with a good relationship with the United States.

This relationship with the United States was part and parcel of a whole set of political and institutional reforms that were made at the end of the war, and to jeopardize that part might be to jeopardize a system which has been very beneficial to the Japanese.

The U.S. relationship is also very important in terms of Japan diplomacy toward the rest of Asia. Asian countries are still suspicious of the Japanese and concerned about Japan's growing political security role.

The association with the United States acts in the same way that NATO and the European Community do for Germany to contain and check, if necessary, within a broader context, Japan's growing political role in the region.

For the United States, we have also been dependent on our Japanese military bases for the credibility and effectiveness of our forward posture in the Asia-Pacific region. The Japanese alliance also ensures that Japan, which is certainly the largest economy in Asia, potentially the largest military power, is a strategic ally of the United States. It is a strategic asset of inestimable value and something that we have been willing to pay for.

Today, as our resources seem much more limited in terms of the global responsibilities that we face, we need allies more than ever. The Gulf War clearly demonstrated that. Japan has become very important as one of those allies.

Should we promote U.S. interdependence with Japan in the political security sphere?

I think it is very important that we try to develop a new international order that depends less and less on the will and resources of a single actor and more on the sharing of responsibilities and the development of effective institutions.

Japan's interests, or the interest of any other ally, are not identical with the United States's, but they are compatible enough so that we can work together with the Japanese.

The Bush Administration and past administrations have tried to promote increasing interdependence and equity in the relationship, sharing burdens and responsibilities in the political security sphere.

In its Japanese policy, the slogan of this Administration has been "global partnership." That is an aspiration. It is not yet a reality.

Japan failed in two, perhaps premature, tests of partnership. One was the Gulf War and the other the GATT ministerial in December of 1990. And that failure reflects, to a considerable degree, the weakly developed state of internationalist thinking in Japan.

Asia will be the test of our ability to work with the Japanese in sharing international responsibilities. Again, I think our interests in Asia are basically similar, but they do diverge.

There are some recent pluses in cooperating in Asia. In the Philippines, the Japanese provided a very massive aid program in the hopes that that would help the Filipinos continue the U.S. base agreements. That did not work, of course.

In the case of the North Korean nuclear effort, Japan has aligned its position with the United States and South Korea, and it has considerable bargaining leverage because Japan is the country that the North Koreans look to in the hopes for aid and economic relations to substitute for the loss of their support from the Soviet Union.

On the negative side, I think there are differences in the way in which we and the Japanese basically look at the evolving political situations in socialist countries. I would comment, perhaps, a little later on the question of economic organization in East Asia, whether that regional cooperation is based on a broad grouping including the United States or on a smaller group of Asian countries.

Let me get, then, to the policy recommendations.

First, I think it is important to promote our cooperation on the basis of global partnership, understanding that that partnership is not just a question of sharing burdens, as defined by the United States, but a sharing of decisionmaking.

Japan has felt neglected and not given an adequate role in sharing policy responsibilities.

It is perhaps one of the hangovers, if you will, of the Cold War period, that in the last two or three years, we have almost seen the Soviet Union as our main dialogue partner with respect to global issues. That will, of course, no longer be the case.

Just to give you an example of that, when we made a decision about a year and a half ago to change our policy toward Cambodia, one Japanese foreign ministry official complained to me that Soviet Foreign Minister Schevernadze learned first, the ASEAN and the Chinese learned second, and the Japanese learned third.

I don't know if that's accurate, but it is reflective of Japanese thinking and fear that they are neither being adequately involved nor being paid attention to. That is one reason why I think the President's trip next month to Japan is of such importance.

Second, we cannot be the only power with a political security relationship with Japan. Japan is going to take on more responsibilities in Asia. It is going to need to have a relationship with trust with those other Asian countries.

I believe that we should be promoting some kind of multilateral security dialogue in the region, partly to promote the relationships of countries that have not had a history of being involved in a regional nation-state system based on sovereign equality. Japan has not had that experience; China has not had that experience.

Last summer Japan proposed that there be a security dialogue based on the ASEAN Post-Ministerial Conferences. I think there are problems with that particular vehicle, but the demonstration of Japanese interest is something we should make use of.

Third, in developing a partnership with Japan and Asia, we should not just give the region over to Japan. We have to remain involved ourselves, and in a leadership role.

There have been many weaknesses in our position. I do not think we have adequately articulated a vision of what we think the new regional order should be like in Asia and the Pacific at the end of the Cold War.

Our economic performance, as Steve was pointing out, is also inadequate. This is very frustrating for our government policymakers because they cannot shape investments of our private companies and channel them to places that they might think that they should be channeled to.

But it does mean that our economic position in much of the region has eroded vis-a-vis that of Japan, and this has had an inevitable consequence for Asian perceptions of our commitment, interest and will in that region.

Fourth, Japan's relationship with the United Nations needs to be normalized. It is an issue for the Japanese, as well as to the Germans, that the so-called enemy clause remains part of the U.N. charter. Japan probably should be a member of the U.N. Security Council.

These things are very difficult to do, obviously, but our own position supporting changes should be clear.

Finally, Japan will obviously need to play a major, if not leading, role in the rehabilitation and reconstruction of the former Soviet republics.

Japan has a special problem in this regard, and that problem is the territorial issue over some islands north of Japan that the Soviet Union took at the end of World War II. Japanese inhabitants were expelled. Only Russian inhabitants remain there.

Japanese claim that as a matter of historical right and justice, these islands should be returned to them. For a long time this was an obstacle in any kind of progress in Japanese-Soviet relations.

My feeling is that both sides are becoming more flexible. Both sides have domestic problems in making an accommodation, however. I believe there might be a U.S. role to be played in helping them come to an accommodation that would be in our interest.

Finally, no matter what policies we adopt or changes we make, the final responsibility for Japan's political security role rests with the Japanese. The Japanese have not played an international leadership role.

They have not prepared their own society for such a role and that is something they urgently need to do.

I think there is an analogy, to some extent, in Japan's present position with ours prior to Pearl Harbor.

We were a great economic power in the 1930s, but did not play a responsible international political and security role. We were shocked into doing so as a result of World War II.

The Japanese are today a great economic power. There is no crisis that has forced them into taking a more responsible role of leadership in political security affairs.

I think they need to, but in this case, hopefully, it will evolve gradually and responsibly.

Thank you.

[The prepared statement of Mr. Morrison follows:]

PREPARED STATEMENT OF CHARLES E. MORRISON

Thank you for inviting me to testify on the subject of U.S.-Japan relations in the context of growing interdependence. I would like the Committee to understand that I do not have an academic background in Japanese studies, but I have been doing work related to U.S.-Japan relations for more than 15 years. My first major experience with Japan-related issues came in the 1970s when I served as a legislative assistant, covering trade and foreign policy among other areas, for Senator William v. Roth, Jr, a member of this committee. Since 1980, I have concurrently held research positions in Asia-Pacific international relations at the East-West Center in Honolulu and the Japan Center for International Exchange in Tokyo. The former was established by the Congress in 1960 to promote understanding and relations among the peoples of Asia and the Pacific, and the latter is a non-governmental, non-profit institution that promotes research, dialogue, and exchange related to Japan's international role. I am principally based in Hawaii.

Clearly, I have a strong professional and personal stake in a healthy, U.S.-Japan relationship. My home state of Hawaii is also uniquely dependent on good U.S.-Japan relations. A serious breakdown would have a much stronger negative impact on our economy than that of any of the other 50 states. From these perspectives, therefore, I would like to commend the Committee for undertaking a serious, analytical examination of the relationship—its importance, its problems, and its future—at a time when increasingly vocal groups on both sides of the Pacific are questioning the relationship.

Interdependence in U.S.-Japanese Relations

I was asked to discuss primarily non-economic aspects of U.S.-Japan interdependence. I would like to begin with some general thoughts about the notion of interdependence and U.S.-Japan interdependencies.

First, "interdependence" is a less threatening way of saying "dependence." It simply recognizes that the dependence is mutual. Inevitably, interdependence implies a trade off between prosperity and security. For example, considering just one dimension of interdependence, purchasing raw materials or goods from the cheapest or most productive source even if it is abroad, presumably increases national economic welfare, but security may be decreased because of the lack of ultimate political control over access to imported goods.

It is logical for all nations, therefore, to try to minimize the security costs of interdependence. Japan and the United States both have policies to do so. Japan, for example, which depends upon foreign sources for 50 percent of its caloric intake of food and feedgrains, has long had a formal policy of maximizing food security. It is trying to reduce its high energy dependence by major investments in nuclear power and reprocessing. The Japanese also chide us for allowing the "hollowing out" of key industries and say this is something they want to avoid, even though it is clearly a consequence of the greater international division of labor. The United States also seeks to minimize dependence for items related to national security, such as energy, raw materials, and high-tech goods, and we are uneasy about our growing dependence in many other areas, including our dependence on foreign capital. Aside from these policies to reduce dependence, there are, of course, also strategies to minimize its risks. Such strategies include diversifying sources and stockpiling.

Despite policies to lessen or slow the growth of dependence, in the absence of a crisis the process usually continues. This is simply because of the high welfare costs of reversing course. This, I suspect, is more true of the United States as a more consumer-oriented society than of Japan, a more producer-oriented society.

Second, while interdependence may mean economic gains for both parties, these are not necessarily equally shared and therefore relative standing may be affected. I believe that much of our concern with the growth of interdependence with Japan reflects our feeling that Japan gains more from this interdependence than we do. Relative standing has become more important now that Japan is our equal in technology and living standards and thus an economic challenger. Suppose some new activity would benefit both countries, but Japan is perceived to benefit twice as much as we do. Should we go ahead? I think that many Americans would answer differently today than they would have a quarter century ago.

Third, while U.S.-Japan relations can be examined as a case study in interdependence, we should keep in mind that our growing interdependence is with the rest of the world as a whole, not only with Japan. One key source of friction in U.S.-Japan relations, it seems to me, is that in many ways each country has understandably become the symbol of "the rest of the world" for the other. For this reason, the bilateral relationship has had to bear many of the political burdens of what each country finds problematic about its adjustments to a world in which traditional barriers of time and space have dramatically shrunk.

In this world, having lost our once tremendous competitive advantage in technology, U.S. businesses and policymakers now have to take foreign practices and policies, once thought domestic in character, into account in our own policymaking. For example, we need to think about our savings rates, labor practices, antitrust policies, R and D policies, and government-business relationships from the perspective of international competition. And there are many micro-ad-

justments at the firm level that mean jobs lost or sent overseas. If there is any country that is symbolic of the pressure of international competition and forcing tough adjustments on us, it is, of course, Japan. One of our reactions is to demand that Japan be more like us.

Japan is also facing difficult policy and company adjustments as a consequence of its changed role in the international economy. The rest of the world will no longer tolerate nor can Japan afford cozy government procurement practices, totally closed sectors of its economy, and other features of its economy that discriminate against outsiders. Other countries have a legitimate interest in Japan's distribution system, spending on infrastructure, and financial regulations. Difficult changes are also needed to accommodate to the standards of the rest of the world, and the country most associated with the pressure for change is the United States. Japanese often lash back by pointing to U.S. economic weaknesses, forgetting that it is not just the United States that is critical of Japanese practices.

For both countries, the other is not only a large element in the global economy, but also a model of a different capitalist economy. It can be debated which of the two is more out-of-step—the United States with its high consumption, low savings, laissez faire government/business relations, and huge current account deficits or Japan with its high savings, emphasis on established business relationships, governmental paternalism, and huge current account surpluses. But clearly, both will need to make adjustments. For both it is much easier politically to demand that the other make the adjustments. And, any process of accommodation or harmonization of deeply rooted economic systems and business cultures and practices will take a very substantial period of time during which there will be a constant frictions. In the short-run, there is no easy or simple answer; we are in the continual business of managing tensions, and this is enormously frustrating and wearing on the relationship.

U.S.-Japan political-Security Interdependence

Now let me turn to my principal subject—political-security interdependencies. I will try to develop several points: first, U.S. dependency on Japan in this area is growing, while Japan's dependency on U.S. leadership remains high. Second, it is in the U.S. national interest to increase its political-security interdependence with Japan under the rubric of developing a "global partnership." Third, that Asia will be the principal test of our interdependent political-security relationship, and in this arena success is not guaranteed. And fourth, that the United States needs to make certain policy shifts in order to a promote increased sharing of burdens and international policymaking influence.

Turning then to the point of growing political-security interdependence, Japan's dependence on the United States dates from the so-called Yoshida Doctrine of the early 1950s. The Japanese government pursued a conscious policy of emphasizing economic rehabilitation and relying on the United States for foreign policy leadership and defense. This was a matter of sheer survival at first, but it later became a matter of voluntary choice. Japan prospered so well under the Yoshida line that it had little incentive to change the status quo, either with respect to the 1960 security treaty or more generally with respect to overall U.S. foreign policy leadership. For many years, this was compatible with U.S. interests. Nurtured in this way through most of the post-World War II era, Japan today has all the economic capabilities for a strong international leadership role, but lacks the political will. Japan continues to stress the value it places on the U.S. alliance. Prime Minister Kiichi Miyazawa, in his first policy statement on November 8 stated: "The relationship with the United States is the cornerstone of Japanese foreign policy. Both Japan and the United States share the same basic values, and we have strong and friendly relations grounded in the Japan-U.S. security arrangements and our close interdependence."

For Japan, the U.S. alliance is more than a guarantee of physical security—in fact, I think that element is rather small in Japanese thinking. It is rather part and parcel of a whole set of new institutions that came into being after World War II, which the Japanese associate with democracy, basic human rights, and unprecedented prosperity. For many Japanese, to cut lose from the U.S. security relationship could also jeopardize the entire postwar system.

Moreover, the U.S.-Japanese alliance is enormously important in Japan's still complicated and problematic relations with its Asian neighbors. The alliance is a guarantee to these neighbors that Japan is not seeking to develop an independent political-security role in Asia—in fact, it is not even providing for its own defense. Therefore, it serves as the equivalent for Asia and Japan of NATO and the European Community for Europe and Germany. That is, it provides a multilateral context in which to channel, contain, and, if necessary, check the energies of the region's strongest power.

The United States increasingly relies on its Japanese alliance. As early as the Korean War, it was clear that the military bases in Japan and ability to use these were essential to the effectiveness and credibility of the U.S. forward-deployed forces in Asia. Moreover, the Japanese alliance strategically links the United States to what could otherwise be Asia's most formidable military power. This is a strategic asset of inestimable value, and one for which we have been willing to pay.

Recent developments have left the United States the world's only superpower. But we are ever more conscious of the limitation of our resources when facing global problems.

This brings me to the second point—that it is in our interests to foster the interdependent political-security relationship with Japan. The United States has played an extraordinary, needed, and costly international role during the Cold War years. But it is quite proper in this era to seek new arrangements to maintain the international order that depend less upon the resources and will of a single actor and more upon shared responsibilities of friendly societies and effective institutions. Japan's interests and values and those of the United States are certainly not identical, but they are compatible enough so that we can rely more on the Japanese without unacceptable risk.

It has been the policy of U.S. Administrations to encourage a broader acceptance by Japan of international responsibilities. The Bush Administration uses the rubric of "global partnership," a phrase introduced at the Palm Springs Bush-Kaifu summit in March 1990. This theme has been constantly reiterated, for example, in the visits of the Secretary of State and the Secretary of Defense to Japan last month, and will, of course, be a major emphasis of the President's Japan visit on January 7-10.

The Japanese internationalist establishment eagerly embraced the concept of global partnership, but it remains more an aspiration than a reality. In the first tests—the Gulf crisis and the Brussels GATT Ministerial—Japan's performance fell well-short of not just U.S. expectations but also those of Japan's internationalists. The United States has also fallen short of Japan's expectation to be treated and consulted as a full global partner. More on this later.

Japan is one of our most cooperative allies. It has shared costs without demanding much of a share in setting international policies. Its foreign assistance program, for example, is now equal in size to ours, and the priorities under that program, while basically reflecting Japan's national interests, have been influenced by ours. Of our allies, Japan has the most generous program of host-country support for U.S. forces. Japan's financial contribution to the Gulf War effort, at \$13 billion, was the largest outside the directly affected Arab countries.

These contributions, however, reflect bureaucratic decisions, often wrung after placing extraordinary diplomatic and political pressures on Japan. For this reason, they do not often get much credit in the United States. Nor do they reflect broad-based Japanese public or political understanding of the international need for such actions. They are, therefore, more often regarded as sources of tensions and conflict than as sterling examples of cooperation. One of the most important challenges in U.S.-Japan relations is to develop cooperative activities based upon broadly understood and compatible national interests. In other words, U.S.-Japan cooperation in the political-security sphere needs to be more spontaneous and less artificial. It will not be as long as Japanese tend to look at almost every issue, including the recent Gulf crisis, through the prism of U.S.-Japan relations.

The critical test of U.S.-Japan political-security interdependence will take place in Asia. Japan is, of course, a country with global interests and reach. As such, it needs to have thought through clearly its national interests in the evolving situations in the Middle East and the territory that used to be the Soviet Union. But in many respects, Japan looks upon Asia as its primary security environment and its most legitimate area of foreign policy concern. And despite the unhappy historical legacy of Japan's relations with its neighbors, it is in Asia that there is the most likely prospect of an independent Japanese political role. Japan will not be welcomed in the region as a military power, but it exercises great and increasingly influence as the region's principal economic model, largest source of investment capital and technology, and major donor of concessional assistance. In many Asian countries too, Japan is increasingly being seen as having attractive social and political institutions in comparison with Western models.

Although Japan and the United States have similar basic interests in Asia, there is considerable scope for rivalry between us. We do not look upon China, Korea, and Vietnam in exactly the same way. The United States gives more attention to value issues, such as human rights, whereas Japan and most other Asian countries accord a high priority to stability. We fear that a Japanese-dominated Asia would be inimical to our interests, while Japanese increasingly resent U.S. efforts to shape and delimit Japanese policy toward the region. A certain degree of distance is probably healthy in the relationship, and in any case seems inevitable as the principal threat requiring tight solidarity has virtually disappeared.

U.S. Policy

Let me now turn to some thoughts about U.S. policies aimed at promoting a cooperative and interdependent political-security relationship with Japan.

First, I believe we should continue our efforts to promote cooperation on the basis of "global partnership." Progress toward partnership, however, cannot be measured simply in terms of sharing burdens, as we so often do, but also in terms of sharing decisionmaking. It seems to me that we have been more willing to accept an influential Japanese role in policymaking on international economic issues, such as the developing country debt issues, than on political-security issues. This, of course, is not simply our fault, but also theirs—Japanese policies have been more reactive than proactive.

We can do more to strengthen our consultations with Japan, especially on issues in the Asia-Pacific region. One of the legacies perhaps of the Cold War has been to still to think of global

political-security questions in bilateral, U.S.-Soviet terms, and as long as the Soviet Union had an effective center of political leadership and foreign policymaking, to make them a principal dialogue partner. In contrast, Japan has often felt neglected. I remember a Japanese Foreign Ministry official complaining to me that in mid-1990 when the U.S. made a policy shift on Cambodia, we consulted first with the Soviet Union, second with ASEAN and China, and then only with Japan. I cannot comment on whether this was an accurate description, but it reflected Japanese sensitivities. Similarly, in the Gulf crisis, the Japanese felt asked to ante up for the bills, but not involved in the decision-making processes. They have felt that the President and Secretary of State have not given Japan the time and attention the principal Asian ally and a global partner should receive. That is one reason why the Secretary's recent trip and the President's forthcoming trip are so important.

Second, as we continue to deepen our own bilateral dialogue on political-security issues with Japan, we should promote Japan's political security contacts on a multilateral basis. In the new regional order in Asia, Japan is bound to be a much more important actor, but it is also a country without significant experience in interacting with its neighbors within a system rooted in the sovereign equality of states. Based upon history, and Japan's failure to squarely face that history, Japan's neighbors are rightly concerned about how Japan's role might evolve should the United States pay less attention to Asia.

In recent years, there have been a number of proposals to establish broad political-security consultative mechanisms in the Asia-Pacific region. The most recent was a proposal this summer by former Japanese Foreign Minister Taro Nakayama to initiate an informal security consultative process in conjunction with the ASEAN Post-Ministerial Conferences. This proposal is not entirely satisfactory because it would not cover Northeast Asia well, but it is a demonstration of Japan's willingness to participate in such dialogues.

The United States has been hesitant to encourage any new institutionalized Asia-Pacific dialogue in the political-security arena. Such a dialogue would not in any immediate future be a substitute for, but rather a supplement to the U.S. security presence. Nor would it be a problem-solving mechanism, since problems like those in the Korean peninsula and Cambodia are more amenable to negotiation and active engagement by smaller groups of directly interested parties. However, it would serve as a means of developing a greater sense of regional standards of international behavior, and encourage the establishment of a multilateral framework within which the Japanese (and Chinese) political-security roles could be responsibly developed in conjunction with a strong and active U.S. security and diplomatic presence.

No one should interpret such an approach as abandoning Asia to the Japanese. Rather the approach is one of working with Japan and other Asian countries in establishing new institutions and patterns of relations appropriate to the post-Cold War era and predicated on the long-term engagement of the United States as a leading Asia-Pacific power.

Third, and moving to the global arena, I believe that Japan's participation in the United Nations system needs to be normalized. Increasingly more prominence has been given in Japan to the so-called "enemy clause" in the United Nations Charter as evidence that the international community is still unwilling to accept Japan (as well as Germany) as trustworthy powers. This should be rectified, and both countries, of course, should also be permanent members of the U.N. Security Council. Unfortunately, in Japan these questions diverts debate away from the positive contributions Japan should be making to international system and reinforces Japanese fears of nonacceptance and discrimination by the world community.

The difficulties of making changes in the U.N. Charter should not be underestimated. At the same time, it seems to me that the United States should be actively exploring how to remove antiquated language and, if needed, reshape that international institutions to reflect the realities and needs of today. However difficult, our own willingness to do so should not be in doubt. Fourth, Japan should be a major, if not the leading, contributor to the stabilization and rehabilitation of the new European and Eurasian republics. There is a special problem, the unresolved "Northern Territories" occupied by the Soviet Union at the end of World War. The few Japanese inhabitants were expelled, so that these islands today are inhabited only by Russians. But for Japan the claim is a matter of historical rights and international justice. During the Cold War, Japan made progress on the islands a precondition for improved relations, while the Soviet refused even to acknowledge a Japanese claim.

Today, there is considerable more flexibility on both sides. The Russians have a strong incentive to improve relations with Japan, while the Japanese increasingly recognize a broad stake in a long-term, mutually beneficial Russo-Japanese relationship. However, both sides have domestic political problems in reaching an accommodation. The United States has an interest in removing this legacy of the World War, and may be able to play a constructive role as a broker in an accommodation.

Japan's Responsibilities

It should be emphasized that the growth of mutually beneficial interdependence in our political-security relations is not simply a matter of U.S. policy, but depends critical upon Japanese policies. The Japanese elite has been slowly coming to the realization that as a major economic power, Japan must play a larger international political-security role. But the necessary founda-

tion in educational effort and infrastructural support for such a role has not been laid. This is only been too evident in the representative hamilton. political failure of Japan to pass legislation to facilitate participation of its Self-Defense forces in U.N. peacekeeping activities.

The United States, like Japan, was once a great economic power, that shirked its global responsibilities. It took a major crisis to make us internationalists. From the very same events—Pearl Harbor and World War II—held different lessons for Japan. Some of these lessons—the need for democratic institutions and abhorrence of aggression—have been truly inculcated. Other “lessons”—that Japan should focus on its own economic interests and minimize its international political role—are no longer appropriate. Both the United States and Japan need to be internationalists. Hopefully, we will both have the wisdom and foresight to recognize that we have a common stake in the global and regional institutions and work together effectively in supporting them.

Representative HAMILTON. Thank you very much, gentlemen. We will proceed to questions.

I have been informed that Professor Saxonhouse may not make it this morning because of the plane, although there is a possibility he will come in towards the end of the hearing.

I think any member of Congress is impressed when he or she deals with their constituencies the extent to which Japan is on the minds of our constituents. It really is quite extraordinary.

You have all seen polls indicating that the American people are more concerned about Japan than they are about the Soviet Union or about Iraq or any other country in the world. And they are concerned, of course, about Japan because of the economic challenge.

The President of the United States is going to go to Japan and has re-scheduled his trip for some time in January. He will sit down with the Prime Minister, Mr. Miyazawa, and my question is, what should he say to him? It is political and economic.

Mr. MORRISON. It certainly is.

I am very glad that the trip is back on schedule, that the President is going to see Mr. Miyazawa. Mr. Miyazawa is very experienced, not just in politics but in international statesmanship.

He has been a foreign minister of Japan. He has been head of the Finance Ministry. He has been with the Economic Planning Agency. He speaks fluent English, but because of Japanese nationalism he may speak to Mr. Bush in Japanese.

He is also the head of the second largest faction of the Liberal Democratic party, but like his predecessor, his political effectiveness is weakened by the fact that he basically relies on the support of another faction.

So—

Representative HAMILTON. Is he off to a shaky start?

Mr. MORRISON. He is off to a shaky start. The particular example of that was the failure of the Diet to pass the bill that would have allowed Japanese self-defense forces to participate in U.N. peacekeeping operations.

That was a problem of very stiff opposition, as well as ineptness of the government's strategy for trying to pass that bill.

Compromises that should have been made, could have been made, with at least one of the other opposition parties, were not made.

The point I am trying to make, though, is that the ability of any President to deal with any Prime Minister in a single trip, as opposed to a long-term diplomatic effort with Japan, is limited. We cannot expect great results from that one trip.

What we do need, however, is a clear strategy with respect to the Japanese over a period of time, of what we expect and what we are willing to accept from them, in terms of their advice.

Now, I think there are several things that we should try to get out of this trip.

One is definitely a renewal and reinvigoration of the so-called structural impediments initiative. That was a relatively successful effort, by standards of U.S.-Japan relations, to address some fairly important questions.

These questions have to do with basic elements in the economies that affect the export-import picture.

Representative HAMILTON. What good did those talks do?

Mr. MORRISON. One of the practical results was the increased Japanese spending on infrastructure. Another was the acceleration of changes in law allowing development of large-scale department stores.

But most of all, I think that the structural impediments initiative was based on a spirit of mutuality, of Japanese saying to us what they thought were the problems with our economy, and us saying to the Japanese what we thought were the problems with their economy.

That is very different from, say, Super 301, where we determined unilaterally that something is unfair. We set up unilaterally a negotiating deadline, and then we say unilaterally that we will retaliate against you unless you make this change, that change, and the other change.

Another very important aspect of the President's trip, which does not relate to his negotiations with Mr. Miyazawa, is his ability to interest U.S. companies in making investments and being active in the Japanese market.

That doesn't necessarily mean directly. Japanese companies have been very successful in using Southeast Asia's lower labor cost countries as a basis for export to the United States. Our companies should be doing that, too, with respect to Japan.

The Japanese market is one that is still more closed than our market, but it is one of enormous opportunities.

U.S. exports to Japan have doubled in the past five years.

Representative HAMILTON. Should the President of the United States say to the Japanese Prime Minister: Mr. Prime Minister, your markets are closed, we can't get into them. You have to open them up.

Mr. MORRISON. He should say that your markets are still not adequately open by international standards, that we certainly believe that your markets are not as open as our markets. There are many things that you have to do.

Unfortunately, Mr. Miyazawa will say, yes, we will do those things, but how that is followed up in any concrete form with the Japanese bureaucracy is still a matter of concern.

Representative HAMILTON. What do you mean by that? Do you mean that the Prime Minister will make commitments and then he won't be able to follow through on them?

Mr. MORRISON. I think that is a very frequent occurrence in U.S.-Japan relations.

Representative HAMILTON. He means well, but he can't produce. Is that it?

Mr. MORRISON. It is not just the Prime Minister, it is the internationalist—

Representative HAMILTON. The system?

Mr. MORRISON. It's the internationalist establishment of Japan.

One good example of that is the rice market. There are many Japanese who believe that the rice market should be opened as a matter of supporting the GATT system. But it is an incredibly sensitive political issue in Japan.

Representative HAMILTON. You think it is helpful for the President and, of course, others to keep pressing the Japanese to open up the markets? This general strategy, which has been going on for a long, long time, is a good strategy, right?

Mr. MORRISON. It is. It is a strategy that seems unsuccessful when we compare it to what we would like. It has been successful if we compare it to what Japan was like ten years ago.

I do not support all the ways that we try to open up Japan, but I do think it is very important for us to keep the pressure on Japan.

I would like, as much as possible, to multilateralize that pressure through APEC, the Asia-Pacific Economic Cooperation Process, and through the GATT. And to take as much as possible of the burden, the tremendous burden, that this has placed on the U.S.-Japan relationship.

Representative HAMILTON. Should the President of the United States say to the Prime Minister, you have to help us in GATT?

Mr. MORRISON. Yes.

Mr. COHEN. May I?

Representative HAMILTON. Mr. Cohen, yes, let's get into this. Tell me what the President ought to say to the Prime Minister.

Mr. COHEN. Well, I'll tell you what he ought to say, but in almost every case, I can pretty much guarantee that he will not say it.

First, rather than—

Representative HAMILTON. How can you guarantee that?

Mr. COHEN. Because the Bush Administration, I think, continues to believe in the basic magic of the marketplace, and that the invisible hand essentially is the one that should make all of the decisions.

Furthermore, I think that he is not going to want to rock the boat so close to the anniversary of Pearl Harbor. The new Prime Minister, as Charles mentioned, is off to a shaky start, and there is the simple tradition of presidents talking to Japanese prime ministers and dealing mainly with symbolism rather than what I regard as the nitty gritty.

It would take a 180 degree turn in the economic philosophy of the White House, as I understand it, for me to say that I think the President will actually say what I would like him to say.

Representative HAMILTON. Okay, you tell me what you would like him to say.

Mr. COHEN. Well, I would like him to say that the United States is expanding its definition of national security to include economic security and industrial competitiveness. As part of this wider view of national security, we the United States intend to do a better job of promoting industrial competitiveness, because we believe that part of the problem is our inability to perform as well as the Japanese have, in terms of increasing productivity and strength in the high-tech sector.

Second,—

Representative HAMILTON. Now hold on there. That is a speech you ought to give to the American businessman, right?

Mr. COHEN. Absolutely. He shouldn't wait until he goes to Tokyo to give those particular remarks.

Representative HAMILTON. I want to understand that point. You believe that the competitiveness problem between the United States and Japan is principally the responsibility of the private sector as well as the governmental sector. Right?

Mr. COHEN. Principally; let's say at least 51 percent. A big part of the problem is still Japan, but I think the fault lies mainly in our own country—the private and government sectors.

What he must add to that is that if we don't have full access to the Japanese market for high-tech, high-value added goods, American industry will continue to be at a disadvantage.

One of our competitive problems is that the Japanese market operates in such a manner that our more advanced technologies and our better companies still tend to have a problem, again, selling high-tech, high-value added goods there.

The history of U.S.-Japanese competition in basic manufacturing is simply this: If you allow your Japanese competition the advantage of operating from what is essentially a protected home market, eventually they are going to either pass you by or outright destroy you.

Representative HAMILTON. Okay, let me stop you there. You put in your statement tremendous emphasis on what you called the high-technology sector.

Mr. COHEN. Yes.

Representative HAMILTON. As the key. And, if I understand your statement correctly, the Japanese are beating us badly in that area.

Mr. COHEN. Yes, and it's likely to get worse rather than better.

Representative HAMILTON. And it's likely to get worse. Now, why are we getting beat so badly in that high-technology sector? Is it because of Japan's blocking us to their markets, or is it because of our inherent weaknesses, or both?

Mr. COHEN. I think it is probably the nature of the Japanese system, both the corporate system supporting government policy and, in my opinion, perhaps the most important "X" ingredient is the Japanese determination that goes back 2,000 years to minimize their dependence on the external world.

Representative HAMILTON. Now what does the President say to the Prime Minister with respect to this high-technology sector, which you think is critical?

Mr. COHEN. He should say that there are certain technologies which we view to be critical to the national security. The model to this, in some respects, is the semi-conductor agreement.

The United States made it clear that the Japanese were simply not going to be allowed to erode—wipe out may be too strong a term—the U.S. semi-conductor industry. There would have to be a deal that, in effect, allowed the U.S. semi-conductor industry to continue.

There are, I think, certain technologies that are important. This gets into the dirty "I" word—industrial policy—which again the President is not going to talk about.

But rather than telling the Japanese, "You must open your markets," I think what the President should make clear—not just to the Prime Minister but to the entire Japanese government—is that there are certain key technologies that we feel are part of our national security interest and that the Japanese can respond whichever way they want, but we simply will not tolerate a U.S. market share in Japan for technology X, Y or Z that is 10 percent, where the same American goods have market shares of 40, 50 and 60 percent elsewhere.

Representative HAMILTON. And what does it mean, "we will not tolerate"? The fact is, that is the circumstance, right? We don't have access, so what do we do about it.

Mr. COHEN. I don't think the President should make threats. I think he should make it unequivocal that it is in our interest.

For a given technology that we deem to be important for our future, if there are sufficient suspicious data—again, looking at market share in Japan—far lower than elsewhere, if we look at American companies that are constantly having the door slammed in their face, I think at that time we should be prepared to retaliate on a limited basis.

I am getting into the subject of results-oriented and managed trade, which is very dangerous because it is open to generalizations and a sound-bite out of context, and I sound like I am endorsing managed trade in principal.

However, philosophically, I have no problem with the selected use, vis-a-vis Japan, of saying that, in certain cases, we find the market so suspiciously difficult to penetrate that if the Japanese don't respond with greater purchases which result in higher U.S. market shares, then we would be prepared to retaliate elsewhere.

My economist colleagues would say this would be cutting off our nose to spite our face, and in the short run that is probably true.

But this country's problems with Japan are largely due to the fact that we are overly conscious of the short run. We don't seem to have any consciousness whatsoever of the longer term, something I think the Japanese have been guided by since their decision after World War II to take a long-term view and become a major industrial country rather than a country that is based on comparative advantage, which back in 1945 meant labor-intensive, low-tech goods for the next 30, 40, 50 years.

Representative HAMILTON. Okay. What else are you going to have the President tell him?

Mr. COHEN. Certainly, I think the President should talk about the Uruguay Round of Trade Negotiations. I think the President should say, at some point, we the United States and the Europeans are going to reach a deal on agriculture, at which time Japan may well have the make or break decision as to whether these Uruguay Round of Trade Negotiations succeed.

Representative HAMILTON. Are we disappointed in the Japanese role in GATT thus far? And do we have reason to be?

Mr. COHEN. I think that American trade negotiators believe that if the Japanese had made concessions on agriculture, namely rice, this would have put pressure on the Europeans to make concessions and this would have expedited the process.

Representative HAMILTON. Is that your impression, Mr. Morrison?

Mr. MORRISON. Yes. I think we were very disappointed last year in Brussels. The Japanese view is, "Let's wait until the others make all the accommodations and then we will come in and do only what we have to do."

The debate has shifted from whether or not to open up the market to how, whether it is by tariffication or quotas. But the basic point is that by waiting until the end, they get no credit and haven't themselves contributed to moving the process forward.

Representative HAMILTON. Is it your impression, generally, that the Japanese domestic market is more closed to foreign investment and trade than the market of any other industrialized country?

Mr. COHEN. I think that if you look at certain statistics, the answer is definitely yes. If you look at foreign direct investment as a percentage of corporate assets, Japan by far has the lowest percent of foreign direct investment of any other major industrialized country.

Now, with both investment and trade, barriers—formal or informal—are only part of the problem.

One problem, for example, of foreign direct investment in Japan is simply the costs of acquiring land and of building. That certainly scares foreign investors away.

My feeling is that, in general, the Japanese economy still works so differently that both the ability to export and to invest there are confronted by so many difficulties, problems and long-term hassles that it is often simpler just to walk away. It is not a simple matter any more of the government liberalizing in Japan.

To me, the problem has gotten a lot worse. Once upon a time, we could put pressure on the Japanese government, and they could liberalize various overt barriers.

As the SII suggests, we have arrived at much more subtle indirect barriers in Japan, which are going to be a long time coming, in terms of correction,

because they are an inherent part of the Japanese culture, which I continue to believe is not on the same wavelength as the United States.

Representative HAMILTON. So what you're saying, Mr. Cohen, is that over a period of years now—a decade or more—we have been putting pressure and pressure and pressure on Japan to open up its markets. They have been promising us that they are going to open up those markets. To some extent, they do open up the markets and the situation gets worse and worse.

Mr. COHEN. Yes, because we have been arguing about the wrong things. We have been mired for 20 years on a product-by-product negotiation, which works in Japan's favor but not in ours, because, as I suggest, there is a systemic problem between two countries with vastly different priorities and economic strategies. Having this one-by-one effort to reduce a tariff here, reduce a non-tariff barrier there—

Representative HAMILTON. Is not going to get the job done.

Mr. COHEN. I think empirically that is the case.

Representative HAMILTON. Mr. Morrison, do you agree with that?

Mr. MORRISON. Yes, I do, basically.

Let me kind of go back to a couple of things, though.

At the very beginning, you were asking what the President should say to the Prime Minister. And I think what Professor Cohen was saying and emphasizing on in his statement was that much of the problem rests in developing our own economy to be more competitive.

A lot of the public, when they think about the President's trip and travels, in general, believe that he is paying too much attention to foreign affairs and not enough to domestic affairs.

The implication of this, I think, is that you shouldn't separate foreign affairs from domestic affairs. He should be picking up and learning things in Japan that are object lessons that he can bring back.

We are very interested in not just his message to the Japanese, but his message when he comes back about his domestic agenda, competitiveness and so forth.

The second thing I would like to say is that there are government policies and then there are traditions or business practices and cultures that are deeply rooted and different in the two countries.

On the policy side, the Japanese were in a very different position at the end of World War II. They developed a lot of policies that promoted production, restricted consumerism, promoted savings and so forth, which are now very deeply ingrained in their system. And that is what this structural competitiveness issue is about. But the changes are not going to happen overnight.

Representative HAMILTON. Mr. Morrison, are you optimistic or pessimistic about the U.S.-Japanese relationship?

Mr. MORRISON. In broad terms, I have always been accused of being too optimistic, and I guess I am. I am optimistic in the sense that I do think there are tremendous interests in both countries in cooperation. I think a lot of Americans—

Representative HAMILTON. You think those common interests will override the tensions?

Mr. MORRISON. Basically. But that doesn't guarantee it. I think there are a lot of people who are benefiting from this relationship in both countries.

The number of people who benefit are, maybe, a few hundred thousand who sell Japanese goods or who are employed by Japanese companies, or what not. The number of people who think actively about the relationship may be in the thousands. The number of specialists are really very few.

Representative HAMILTON. Mr. Cohen, are you optimistic or pessimistic?

Mr. COHEN. In terms of the larger political sense, I see no explosion or rupture coming. I think if one believes in the straw that breaks the camel's back, at some point we will watch our industrial competitiveness sinking so badly that someone running for national political office may be able to package the resulting fears and dissatisfactions in such a way that the American public believes it.

I don't see economic corrections coming. We have had 20 years of damage control. I see no reason why we can't have 20 more years of muddling through with damage control.

Theoretically, if the Japanese want to continue financing our consumption patterns and our overseas military expenditures, this sordid little game can continue indefinitely.

Representative HAMILTON. Are you worried about the Japanese buying up America?

Mr. COHEN. No, simply because there is so much America to buy up that we don't have to worry about it.

Representative HAMILTON. You don't see any reason to put any restriction on Japanese investment in America?

Mr. COHEN. Not on Japanese investment per se. But there are areas where foreign direct investment, in general, may be a problem in terms of buying a defense industry, or buying a company that is the sole producer of some technical product, or some very specialized product.

If you say restrictions on Japanese foreign direct investment, no. If you scratch the adjective Japanese, then there are limited areas where we should impose restrictions.

But let me add that the problem with foreign direct investment is part of a larger problem. The United States has to attract foreign capital in this country to finance our trade deficit because we are not competitive and are consuming more than we are producing.

Representative HAMILTON. Japanese investment in the United States has actually declined substantially, hasn't it?

Mr. COHEN. In the one year. I am not sure that that is a trend, but foreign direct investment, as I wrote in my testimony but didn't state in my summary, is a kind of a consolation prize for the United States.

We have Japanese automobile plants in this country only because we are unable to compete in the international marketplace with Japan.

The Japanese don't particularly want to engage in foreign direct investment in this country. They tend to build factories here only after the U.S. government has threatened import protection—foreign direct investment is a classic way of avoiding trade barriers.

Representative HAMILTON. Do you believe that one of the reasons Japan has had such astounding economic success is because of the nuclear umbrella that the United States has provided and the fact that the Japanese spend such a relatively small share of their GNP on defense?

Mr. COHEN. I think that is one of many reasons.

Representative HAMILTON. Do you agree with that, Mr. Morrison?

Mr. MORRISON. I agree with part of it and not with part of it.

I agree with the part that we have provided the political stability in which Japan has thrived. I think that the share of spending on GNP is probably not too relevant. The Koreans—

Representative HAMILTON. Is not relevant?

Mr. MORRISON. Well, the Koreans spend 5 or 6 percent of their GNP on defense; the Taiwanese spend a very high amount. And economic growth

has been just as fast, if not faster, than in Japan. I am not sure what the relationship between defense and growth is.

Representative HAMILTON. Okay. Senator Bingaman?

Senator Bingaman. Thank you very much. I'm sorry I wasn't here for some of your previous statements, but let me ask a few questions along these same lines.

The information I have been given is that of the three large industrial centers in the world today—U.S., Japan and Europe—we import something approaching 20 percent of the manufactured products we consume. Europe imports something in that range, I believe. Japan imports 3 percent of the manufactured products they consume, and that has been the case for a long time.

Can you indefinitely go on with that kind of arrangement in the world trading community, where one country has, for whatever series of reasons, much less in the way of manufactured imports than the rest of the industrialized world?

It seems to me that, long-term, that inevitably works to our disadvantage in a very major way and puts us out of the business of manufacturing a lot of essential products.

Mr. COHEN. The short answer to your question is yes, it can continue indefinitely, simply because the United States and Western Europe will allow it to continue indefinitely.

Whether it makes sense, whether it is good for the long-term stability of the international system, I think the answer there is somewhat different.

I have been following U.S.-Japanese bilateral relations for more than 20 years, and back in the early 1970s, I was hearing the warning that the Japanese were going to cause the liberal international system to topple because they were playing by different rules.

One of the recurring themes in U.S.-Japanese relations is that the same statements are made over and over: The Japanese are going to trigger off a trade war or that the Japanese economic miracle is about to burst—we tend to hear the same things year in and year out.

The fact of the matter is, ideologically, we still believe in liberal trade. Ideologically, we still believe in consumerism. What the result is, in terms of economic policy, is that we talk and complain, but we simply don't act effectively.

Senator Bingaman. Let me ask, in the case of automobiles.

We had a hearing the other day in this same Committee on the issue of automobiles, and it is pretty clear that the ability of Japanese firms to sell into our markets at the prices they sell is a result of the fact that they charge substantially more for the same product in Japan, and their profits are derived from their sales in Japan, not from their sales in the United States and not from their sales in Europe. In fact, they lose money. As a general matter, they lose money on their sales in the United States. They lose money on their sales in Europe at this time, although they are gaining market share.

They make substantial sums on their sales in Japan where there is not a lot of competition by foreign automobile manufacturers.

It strikes me, and some of the testimony that we had during that hearing confirmed this, that, again, allowing the sale into our markets at substantially less than the break-even point is inevitably going to lose more and more market share for U.S. manufacturers.

At some stage, we will be looking to sell what we can in the way of equity to the Japanese or to other firms around the world, just like McDonnell-Douglas is looking to sell 40 percent of their equity to Taiwan at this point.

I would be interested in any comments you have on that.

Mr. MORRISON. I haven't seen those figures, and I don't know the source of them.

Senator Bingaman. Well, the source was Chrysler Corporation in their testimony, and the other witnesses indicated that they didn't disagree with the charts.

Mr. MORRISON. Well, I think that the car market in Japan is fairly competitive. You think that they are expensive in Japan.

One thing that has always impressed me was how the government inspection system makes it impossible to keep a car more than five years. After five or seven years, you just have to junk your car and buy a new one, and that all seems to be for the benefit of the Japanese manufacturers.

On the more general question of the share of manufacturing—I am not an economist—I assume that there is some relationship between the share of manufactured imports and your basic endowments in land and labor and so forth.

The Japanese would probably be likely to have less of a share of manufactured goods in their exports than a country that had a broader economic base, in terms of endowments.

But there is a question—

Senator Bingaman. I don't understand what you just said.

Mr. MORRISON. What I am saying is that the United States has a lot of land so that it can grow wheat and soybeans, and it has a lot of minerals—or at least it did have at one point. When you consider what your people will be manufacturing and selling abroad, probably your competitive advantage will not be so concentrated in a few particular manufacturing sectors as it is in the case of Japan.

But since I am not an economist, I am obviously not explaining it very well.

Senator Bingaman. I still don't understand why they would import such a small percent of their manufactured products relative to other industrialized nations.

Mr. MORRISON. I think they are an outlier in that respect, but I am not sure if there is some figure where they should be, but are not, and whether it would be exactly the same as ours or the Europeans.

The point I really wanted to make was whether Japan itself can afford to have such a small share of manufactured imports.

In fact, what has happened since the mid-1980s is that as wage levels have increased in Japan and particularly as Japan's labor force ages—Japan will have the oldest labor force of all the advanced countries in a few years—it has become less and less cost-effective for the Japanese to manufacture many things in Japan that they were manufacturing 10 years ago.

Things are starting to be imported from other countries in Asia now because of that. And who knows, in 25 years Japan may not be a major manufacturer of automobiles at all.

Japan has lost industries like the aluminum industry and other industries over the years because they are no longer competitive in those industries, and so they have to buy from abroad.

I think that process will continue, although there are many factors that slow it down.

Senator Bingaman. You are not suggesting that Toyota is going to be out of business in 25 years?

Mr. MORRISON. Possibly in Japan, there will be less—

Senator Bingaman. You are saying that maybe Toyota will determine that they should shut down Toyota City and begin producing Toyotas in Thailand and—

Mr. MORRISON. I would feel more confident of that if I saw a lot of Korean cars in Japan, which I don't see at the moment.

Senator Bingaman. In fact, the automobile industry worldwide is suffering from substantial overcapacity. Is it not? And that is why General Motors is going to announce that they are closing six plants this week, as I understand it.

The problem is, as the plants get closed worldwide to accommodate to the fact that there is tremendous capacity, it is our plants that are getting closed, not Japanese plants.

Because of the pricing of the product in foreign markets, they are able to go ahead and keep their production and sales going. Whereas, our companies cannot sell overseas at a loss because they have no place to make up the profit. They are competing here and can't sell at a loss. They can't make any excess profit here. Accordingly, they can't sell for a loss overseas.

Mr. COHEN. May I respond to that?

Senator Bingaman. Sure.

Mr. COHEN. You have a good principle on which you are talking, but I think you are using the wrong product as an example.

A point that I tried to hit home with a couple of times in my testimony was, if you give the Japanese a protected home market, they are going to impart great bodily damage to their foreign competitors, mainly for the reason that you alluded to.

If the domestic market in Japan is relatively protected, they can charge higher prices in Japan, use that as their profit base, and have minimal to nonexistent profits overseas.

It just is not correct to think that the automobile industry is an example of that. Automobile prices for Japanese-made cars in this country tend to be relatively high for the simple reason that the "voluntary" export restraints that the U.S. government imposed on Japan back in 1981 are still in effect.

One of the worst things that the U.S. government ever did for the automobile industry in this country is convincing the Japanese to "voluntarily" restrict exports of automobiles. The resulting shortage of Japanese cars in this country, relative to consumer demand, caused prices of Japanese cars to shoot up.

Eventually, the Japanese figured out, if they have an export quota to the United States, what they should do is stop concentrating on the cheap, low end of the market and move upscale to sell more expensive cars that have a higher unit profit margin.

So what has happened in this country is that in the beginning of the 1980s, the Japanese were looking at the low end of the market. As we come into the 1990s, the Japanese have moved up to the category of European luxury cars.

I don't believe that Japanese automobile producers are successful in this country mainly on the basis of price. I believe that they are successful in this country on the basis of quality.

And indeed, I think, whereas many Japanese companies do what you just said, the automobile industry cannot do it because they are continuing to operate from an export quota which artificially limits the number of Japanese cars sold in this country.

On the trade statistics, I would reinforce your suspicion that Japan's unusually low percentage of imports of manufactured goods suggests that

something is unusual in the Japanese market. That number is so low relative to other countries that it is suspicious.

The other thing that is unique with Japan's relative impact statistics, if you look at the European countries, if you look at the United States, manufactured goods as a percent of imports, or imports of manufactures as a percent of total domestic production, have been growing in connection with the growth in world trade and as part of interdependence.

If you look at Japan's key trade statistics dealing with imports of manufactured goods, they have been flat in relative terms. And if you use your base periods carefully, you can show that whereas other countries are increasing the relative share of manufactured imports to total imports, in Japan the number for a while actually was going down.

Senator Bingaman. Let me ask about one other subject, and that is the IMS proposal.

The Japanese came forward about two years ago with a proposal for the intelligent manufacturing system—an international consortium, as I understand it.

The original proposal was that they would pick up 60 percent of the cost. The United States would pick up 20 percent. Europe would pick up 20 percent. We would commit to a total of \$10 billion for the decade—the decade of the 1990s.

This is my recollection of their proposal.

And we would work in that combined international cooperative effort to define state-of-the-art manufacturing capabilities, to the extent possible, to try to regularize or standardize some of those and share information as to what is being done.

That proposal was, first of all, ignored by our Administration for a long time. Then, they went to the Society of Mechanical Engineers and asked them if they were interested in this, and then after they said that they would be glad to be involved, I think our Department of Commerce became interested.

The Administration has essentially had a policy of stalling any real progress on IMS since we became engaged in discussions with them on it. I think the Europeans have had a very explicit policy of stalling any real progress on that.

I have felt for some time now that that was a misguided approach, that advanced manufacturing is one area where we can very usefully cooperate with the Japanese, and we should get on with trying to do that and see if we can't draw up an agenda that would make sense for the United States as well as for Japan.

I would be interested in any thoughts either of you have on this IMS thing, whether we are pursuing a policy that makes sense, or whether we are doing the wrong thing.

Mr. COHEN. I am not an expert on that particular subject. I have read some of the pros and cons and it is almost a damned-if-we-do and damned-if-we-don't situation.

I guess the bottom line is that we can't afford to stay out of such a global venture, but I guess there are two caveats.

One, the private sector would have to demonstrate enthusiasm for the participation. I frankly don't know if that private sector enthusiasm is there.

In addition, I hope that if we did become part of this effort, we would do it with our eyes wide open. The Japanese are absolutely brilliant in adapting other people's ideas and technology, and absolutely brilliant in taking basic science and transferring it into commercial applications.

If we didn't go in there with the idea that we are the United States of America and we don't have to watch what other countries are doing here, then I think it probably makes sense.

Again, I think the bottom line is, if this does go forward, especially with any European/Japanese cooperation, we literally could not afford to stay out of it.

Senator Bingaman. Where I come from on this thing is, we have an open system. We have thousands of Japanese graduate students in engineering in this country today in our best universities, and working with our best scientists in our laboratories of all shapes and sizes.

That is the way we do science and technology in this country. It is an open system except in those very narrow areas that we determine are defense or national security sensitive.

So the theory that we are going to keep the Japanese from finding out what we are doing in all these areas by not cooperating in the IMS strikes me as absurd.

I mean, we have no restrictions on their access to our universities. We have no restrictions on their ability to come in and buy high-technology firms in this country. We have no restrictions on their ability to joint venture with U.S. firms that want to participate internationally.

And yet, at the governmental level, we are not willing to sit down and discuss a joint technology development project. It seems crazy.

Mr. MORRISON. Without knowing any of the specifics of this particular proposal, it seems to me that this is the kind of thing that we should be facilitating as much as possible.

In fact, one of your witnesses tomorrow is a specialist in Japanese-American science and technology cooperation.

I think one of the basic problems has been that we have put such emphasis in basic science and they have put such emphasis on commercial applications. If this is something which can give us a little more familiarity in the way the Japanese operate and promote contacts among people in the science and technology field, with more emphasis on how basic science can be applied, this should be something that we should be quite positive about.

Of course, there may be many specifics that we have to be careful about in negotiating any agreements, but as far as demonstrating a positive interest in the general field of science and technology, I would hope that that would be a major emphasis of the President's trip to Japan and in our policy.

Senator Bingaman. Thank you very much.

Representative HAMILTON. I had a series of public meetings in Indiana last week. I was not surprised but impressed with the frequency with which the Japanese problem arose.

As you have been talking this morning, my mind was reflecting on a number of the complaints that I had.

What I am really interested in, I guess, is how you would respond to my constituents about the Japanese problem. In other words, you can help me out with a little political problem here.

Constituents talk, among other things, about the loss of jobs. We are losing jobs because of the Japanese competition. They are concerned about Japanese investment, buying up Honolulu, buying up Los Angeles, buying up South Carolina or whatever.

They are concerned about the very small amount of money that, comparatively, the Japanese have put into the GNP defense. They think we have defended Japan during the entire post-World War II period and that Japan has had a free ride with regard to security.

They are not happy with regard to what they perceive as the lack of support of Japan in the Gulf war. My constituents may be a little behind the curve because the Japanese eventually, I think, contributed generously. But they were slow doing it and it left the impression, at least, that they were not enthusiastic about that effort.

They are upset about the lack of a forceful role of Japan in bringing the GATT negotiations to a conclusion, and, of course, the trade deficit drives them to deep distraction.

The automobile imbalance and the lack of reciprocity in the markets—the feeling that we have limited access to the Japanese market and they have complete access to our market.

I just ran down through some of the complaints, and some of them we have mentioned before.

But what do you say now to Americans about this American-Japanese relationship, who have these complaints? How do you respond to these people?

Mr. COHEN. Well, I guess the first thing I would say is that I am glad I am not a politician, having to respond to what are some obviously very valid complaints and fears.

I guess, in context of what you just said, I would suggest that you talk about a ranking of the problems.

For example, I think the amount of money that the Japanese gave to us in the Gulf war is quite adequate and certainly, if it was another billion or two, it was not going to change the Japanese competitive situation.

The Japanese, as I said, are not buying up America. But when it comes to Japan, there are some very valid concerns, but mainly the number one ranking problem, the number one response, is that the American economy in general, and the American industrial sector in particular, simply have not responded well enough to the fair competitive dimensions of Japan.

Representative HAMILTON. Why can't we just say to Japan, "We will give you access to our markets only to the extent that you give us access to your markets?" No more, no less.

What is wrong with that kind of an approach? What is right with it?

Mr. COHEN. I think what the Japanese would wind up doing is buying a lot of low-tech, low-value added products that really are not what America's economic future is all about.

One of the things that worries me, quite frankly, is that the Japanese will engage in a clever public relations gambit and simply buy \$20-30 billion worth of used clothing and scrap paper and other basically marginal economic products to balance the trade account.

Once that trade account got balanced, even through such an artificial means, most politicians and Americans would become much less concerned about the whole thing.

The arithmetic of the trade balance just isn't all that important. It's what the two countries are trading back and forth.

If I were going to play the role of apologist for Japan, I would say that we can't ask for equal access because the Japanese market in certain things is open. There are a lot of American companies that are doing very well there.

However, they are not all that successful in the advanced high-technology area that I think is vital for America's economic and industrial future.

So, as long as you are very specific—and it gets back to what I said before—I think there are certain aspects of our industrial sector, certain technologies, that should be protected by means of telling the Japanese, if we

can't have access to your market equivalent to your access to our market, then we are going to retaliate, on a case-by-case basis.

Representative HAMILTON. What sectors are you talking about?

Mr. COHEN. The sectors in electronics, computers, semiconductors, composite materials, advanced combinations of biology and electronics—biotechnology.

Despite the reluctance to even consider the idea of an industrial policy in certain parts of the U.S. government, it is not all that hard to look at what scientists and engineers are saying are really the important emerging technologies of the future.

If you look at something like semiconductors, basically the DNA for all electronics, to me, it is pretty clear that this is a strategic industry, and that without too much difficulty—and again this would be completely against the grain of White House ideology—if we identify certain strategic critical technologies that have already been identified in a number of areas, including the Commerce Department and the Department of Defense, we tell the Japanese that in these areas we have to have equal market access. And if we don't get it, we will then consider retaliation.

But, again, the idea that the Japanese market is not open, I think, is incorrect. The Japanese tend to open their markets completely to the extent that an industry is no longer a targeted industry of the future.

I think the Southeast Asian countries have found out in recent years that the Japanese market has become far more open to the labor-intensive, low-tech kinds of goods that many of the Asian LDCs export.

Representative HAMILTON. Let me ask you, do you admire the way the Japanese have targeted sectors in their economy and made it such a successful economy? Do you admire it to the extent that you think we ought to copy it?

Mr. COHEN. Yes and no.

I admire it because the Japanese, I think, are the model of how to engage in good, productive, efficient government policy. The Japanese pretty much created the model of how government and business can cooperate without causing problems.

I mean, if industrial policy government intervention was the key, the Soviet Union, or what is left of it, would not be in the economic shambles that it is.

What the Japanese, I think, basically figured out after World War II is how to have the right kind of friendly, cooperative relationship between government and business. That is largely based on Japanese culture and history, which simply cannot be replicated in this country.

Representative HAMILTON. How do you describe the Japanese economy? In a sentence or two, is it a market oriented economy?

Mr. COHEN. It is a producers' economy, based largely on market principles.

But I think the people—many of them my economic colleagues—who say a market is a market, a capitalist economy is a capitalist economy; therefore, the Japanese market has to operate just like the American economy—I think that is wrong.

Representative HAMILTON. And would you describe the American economy as a consumer economy?

Mr. COHEN. It's a consumers' economy. The Japanese are a producers' economy, and both countries are deliriously happy.

We are consuming ourselves silly. The Japanese are working six days a week, busting—

Representative HAMILTON. Producing themselves silly?

Mr. COHEN. And they are getting the psychic income of watching their industrial strength rise, and we are getting the psychic income of, again, maximizing our consumption.

The cowboy mentality is that we have this unlimited frontier, self-gratification of the individual. The Japanese samurai society is based on long-term goals, subordination of the individual to the group, and the differences, I think, are in evidence. Simply getting the Japanese to reduce a tariff here and a tariff there just doesn't work.

Representative HAMILTON. Mr. Cohen, help me out with my problem with my constituents. What do I tell them?

Mr. COHEN. Tell them to vote for anybody who is suggesting major changes in American economic policy that would more likely than not make the U.S. industry more competitive.

Anybody who suggests that it is morning in America and that the status quo is fine would not be correct. It seems to me, it would not be too difficult to suggest to at least the bottom 80 percent of the income earners that something has been very wrong.

Our real wage today is about what it was in 1973. It doesn't seem to me too difficult to convince most Americans that the U.S. economy needs a new direction and, to some extent, new policies.

Representative HAMILTON. Save more, invest more.

Mr. COHEN. That is part of it. Part of it is forcing our industrial sector to take a longer term time horizon.

Much of our problem is simply management, which is outside of the Beltway. Much of America's problem is simply not correctable inside the Beltway.

Let me say quickly, fiscal policy-wise, if you could convince American managers through fiscal measures to take a longer term time horizon, this is something that would be very useful.

Representative HAMILTON. Mr. Morrison, can you help me out with my constituents?

Mr. MORRISON. I think constituents and Americans generally have at least two things that they should be worried about. One is dependence, especially upon foreign capital, and the other is unfairness. I think those are legitimate concerns.

Representative HAMILTON. The other is what?

Mr. MORRISON. Unfairness. Different standards. I think both of those are legitimate concerns.

It is very hard to say, okay, we will only be as open to you as you are to us.

Professor Cohen mentioned the semiconductor agreement—I think that was in 1986. We were looking for \$300 million in Japanese imports, which is a very small amount, against which to retaliate. The people who were most concerned were American companies that were using those chips and so forth in manufacturing computers. So it was very hard to find \$300 million of Japanese imports that didn't hurt ourselves just as badly as it hurt the Japanese producers, and that is one of the aspects of interdependence.

On the question of loss of jobs, that is a problem of international trade, in general. The loss of jobs is something that is very visible because it is concentrated in particular factories and industries. The gains from trade tend to be very dispersed. Therefore, it is very hard to show and demonstrate that somehow international trade gains more jobs than it loses jobs.

I have been very impressed with the newsletters of yours, which I have seen over the years, because very few Congressmen really spend a lot of effort trying to educate constituents about these sorts of things.

On investment, we have a very peculiar situation here, where investment at the local level is often very much welcomed, but investment at the national level is something that causes tremendous concern.

I remember being involved in a project where someone from a neighbor state of yours, Kentucky, had looked at attitudes of the people in Kentucky toward Japanese investment. He found that if you asked people, would Japanese investment help you personally, most of them would say yes.

Does it help Kentucky, should we try to bring in Japanese investment? Yes, indeed, the governor should be bringing in Japanese investment.

Well, what about Japanese investment, does it help the United States? Oh, no, it is very dangerous.

So we do have a little bit of a schizophrenic attitude toward that.

Representative HAMILTON. One of the things that we hear a lot about concerning the Japanese economy is that they are very, very good at the commercialization process and we are not. We are very good at research, but we can't take the products of research and quickly get them into manufacturing.

Is that a fair criticism of the American economy and a strength of the Japanese economy, clearly?

Mr. COHEN. Clearly the answer to that is yes.

Representative HAMILTON. If you look at the benefits that flow from research and technology between the United States and Japan, do you have any impression as to which country benefits the most?

Mr. COHEN. Right now, I think it is probably a dead heat.

Representative HAMILTON. Senator Bingaman mentioned all of these Japanese students. You get the idea, and I guess I have that impression too, that we have an enormous number of Japanese students in this country who are benefiting from the fruits of our research, presumably taking them right back to Japan, and I am hard pressed to think of any American student studying in Japan.

I know we have some, but just thinking about my own personal knowledge of students, I am not sure I personally can name any American student that is now studying in a Japanese university.

Mr. COHEN. Well, they are there, and the thing I keep reading is that the Japanese would like more, but, once again, we get into the language problem. There are not enough Americans willing to learn Japanese.

If you are an engineer, or a scientist, or a graduate student going over to Japan to do what you just suggested, I would guess that a knowledge of the Japanese language is essential.

And I keep reading about vacancies, not only of graduate students but of working engineers that could go over to Japan. There are spaces there, but they are simply unfilled.

To some extent, the Japanese language is a nontariff barrier. Now, obviously, it is just as difficult for the Japanese to learn English, but obviously English has a more global use.

But the amount of time that it takes for someone to become conversant in the Japanese language is probably the biggest reason that there are not more Americans doing research in Japan.

Representative HAMILTON. Mr. Morrison, should we now withdraw American troops from Japan?

Mr. MORRISON. I don't think we should withdraw them now. However, I think that we should be looking for the day when American troops are no longer so much needed.

Representative HAMILTON. We've been looking a long time towards that day.

Mr. MORRISON. Well, that's right. It has been 45 years or more since the end of the war.

Representative HAMILTON. How many do we have there?

Mr. MORRISON. In Japan, about 50,000, I think.

Representative HAMILTON. That many.

Why do we need tens of thousands of American troops in Japan?

Mr. MORRISON. I think that the main reason for having overseas presence in Asia now relates to the overall stability at a time of major change at the end of the Cold War period.

The potential for Japanese-Chinese rivalry in an arms control race is out there somewhere, and so what we should be trying to do is to develop institutions so that these countries, which have never gotten along together, will be able to get along well together, and gradually reduce our own role in the region.

We should have been thinking about that much longer ago than now.

Representative HAMILTON. Is there sentiment in Japan for the United States to get out, militarily, of Japan?

Mr. MORRISON. Not significant. In Okinawa, there may be, but outside of that, the American troop presence is fairly well disguised. It does not create a political problem for the Japanese, which it did in the 1960s and 1970s.

Representative HAMILTON. Would you be willing to see a scheduled reduction of American forces in Japan, to say, cutting it in half over a period of several years?

Mr. MORRISON. Well, in April 1990, the Defense Department adopted a strategic framework for looking over the next 9-10 years and the U.S. force deployments in Asia. It is very fuzzy after next year, and I think that is probably a good idea.

I think we should have a vision of where we are going and the kinds of institutions we want to build up to substitute for the U.S. troop presence, but that we should be envisaging withdrawals, clearly, on a flexible basis, not on a basis of particular numbers and years.

Mr. COHEN. Could I add a thought to that?

I think one of the ironies of the post-Cold War period is that globally there is more of a desire for American overseas military presence than before.

With the unification of Germany, with the growing economic power of Japan, my guess is neither the Europeans nor the Asians, as a whole, would welcome a wholesale withdrawal of American troops.

In Asia, as our economic power and influence tend to dwindle, it seems to me that one bit of leverage that we do have is our military presence there.

Representative HAMILTON. So you favor maintaining the present level there indefinitely?

Mr. COHEN. Not necessarily the present level, but I oppose the idea that we should target a total withdrawal, because Japan doesn't need our troops to defend itself. I would rather see some U.S. troop commitment in Japan, not necessarily to protect Japan per se, but rather to show the flag, to have Air Force and Marine troops in the Pacific.

Representative HAMILTON. But you see some merit to reducing that presence?

Mr. COHEN. Reducing slowly, but surely not eliminating.

Representative HAMILTON. Let me ask you about what the Japanese economic strategy—

Mr. MORRISON. Can I go back to one thing?

Representative HAMILTON. Certainly. Go ahead.

Mr. MORRISON. Something we passed up that I did want to comment on, and that is our open university system.

Things that look one way to us often look very different in Japan. The Japanese have had a perception that the low number of international foreign students they have in the Japanese universities is a weakness for Japan.

Having foreign students is a tremendous strength to our economy. It makes people familiar with our technology, our products, our institutions. We have something like 200,000 Asians a year studying in this country, and it gives us an enormous constituency all over and throughout Asia.

The Japanese don't have such a constituency. There is an overseas Chinese constituency for the Chinese. There is a Western constituency of the elites who have been educated in the West. But the Japanese have had to do without that, and that has been a weakness in their position.

Representative HAMILTON. You are arguing that we get more out of the Japanese students here than—

Mr. MORRISON. I think we get a lot out of the Japanese students here, and I do think we should have a much bigger presence in Japan—our students.

The number of foreign students in Japan is increasing rapidly, but most of those come from China, Korea, Taiwan and Southeast Asia.

Representative HAMILTON. Do you favor giving Japan a seat on the Security Council?

Mr. MORRISON. Yes.

Representative HAMILTON. Do you favor expanding their influence in the IMF and the World Bank?

Mr. MORRISON. Yes.

Representative HAMILTON. Do you, Mr. Cohen?

Mr. COHEN. Yes.

Representative HAMILTON. Both—

Mr. COHEN. Assuming they want all three. I know they want the latter two—the Bank and the Fund.

Representative HAMILTON. I am beginning to run out of time here. I am interested in getting a comment from you about the Japanese strategy in Asia, particularly.

Do the Japanese now more and more look at Asia as the preferred market for Japanese goods and investments, and are they looking less and less to the United States and Europe?

Mr. COHEN. I think Southeast Asia is a hedge against further American protectionism. I think Southeast Asia is looked at by the Japanese as a source of relatively low-priced labor to make components for more sophisticated Japanese products.

Representative HAMILTON. Will the United States gradually decline in importance as a trade partner to Japan?

Mr. COHEN. Relative to what it is today, yes. But will it still be by far the most important, yes.

Everything is relative. I don't think the Japanese will reduce substantial dependence on the U.S. market for a long, long time.

Mr. MORRISON. There is a process of Asianization of trade flows, so the trade within Asia now is as great as trade across the Pacific. That is something that is quite new.

So gradually you will find a diversification, with no one country being larger in the export picture than any other country.

Representative HAMILTON. Are you impressed that the Japanese economic power is providing them with more leverage in international affairs? And can you give me specific examples of it?

Mr. COHEN. Well, I think in the emerging new world order, economic power more and more is going to be the standard of average international power and influence, and the Japanese clearly are rising in that direction.

One example is Eastern Europe where the U.S. government has basically told the East European governments, we can give you some technical assistance, but Uncle Sam is basically broke; go see the Germans and Japanese for cash.

To me, that is a rather unseemly suggestion for a great power, but I think more and more it is an example of how our economic problems translate into the international political arena.

The ideology of the 21st century is how government and business can cooperate within a capitalist society, and the Japanese may well have much more to offer the world in terms of that ideology than we do.

Mr. MORRISON. Prime Minister Mahathior's proposal for an East Asian economic group—

Representative HAMILTON. Malaysia?

Mr. MORRISON. Yes, of Malaysia. It is based on Japanese leadership, and it is an example of how Japanese economic power is being looked at differently in Asia.

Representative HAMILTON. More favorably?

Mr. MORRISON. More favorably, and looking to Japan for aspects of the leadership role that we did provide.

Representative HAMILTON. They are trying to get economic dominance in East Asia today?

Mr. MORRISON. No, they are not trying to get economic dominance. They do want us to be involved. But I think that Asians are looking for benefits from Japan.

Representative HAMILTON. But is Japan, as part of their strategy, trying to achieve economic dominance?

Mr. MORRISON. No, I don't think Japan has a conscious plan to dominate the region. In fact, they would like us to be involved because it would lessen the appearance of their dominance.

Representative HAMILTON. I have just run out of time, and I have a stack of questions I haven't gotten to.

You have both been very good witnesses. We have appreciated the opportunity to visit with you.

I'm sorry that Mr. Saxonhouse was not here. We will try to integrate him in the hearings tomorrow morning with the other witnesses.

Both of you have made excellent contributions. We thank you and the Committee stands adjourned.

[Whereupon, at 12:15 p.m., the Committee adjourned, subject to the call of the Chair.]

U.S.—JAPAN INTERDEPENDENCIES

WEDNESDAY, DECEMBER 18, 1991

UNITED STATES CONGRESS
JOINT ECONOMIC COMMITTEE
WASHINGTON, D.C.

The Committee met, pursuant to notice, at 10:05 a.m., in room 2359, Rayburn House Office Building, Honorable Lee H. Hamilton (vice chairman of the Committee) presiding.

Present: Representative Hamilton and Senator Sarbanes.

Also present: Richard F Kaufman, General Counsel.

OPENING STATEMENT OF REPRESENTATIVE HAMILTON, VICE CHAIRMAN

Representative HAMILTON. The Joint Economic Committee will come to order today.

We continue the hearings on U.S.-Japan interdependencies.

The experts we heard from yesterday agreed that it is vitally important to strengthen the alliance between our two countries, despite the trade frictions and other differences.

This morning we have a distinguished panel of experts on Japan, augmented by one person who was not able to testify yesterday because of a cancelled flight. Dr. Saxonhouse, we are glad you could join us this morning.

Dr. Martha Caldwell Harris is Director of the Office Of Japan Affairs, National Research Council, and is presently engaged in a number of studies of U.S.-Japan science and technology relations.

Dr. Mike Mochizuki is Assistant Professor of International Relations, University of Southern California at Los Angeles. He specializes in politics and national security in Japan, and in U.S. relations with that country.

Lionel H. Olmer is a partner in the law firm of Paul, Weiss, Rifkind, Wharton & Garrison. He previously served as Undersecretary of Commerce for International Trade, and prior to that, worked for the Motorola Corporation.

Dr. Gary Saxonhouse is a Professor of Economics, University of Michigan, who has written extensively on the Japanese economy.

Lady and gentlemen, we are delighted to have you with us and we will begin.

We will just go across. Dr. Harris, we will begin with you.

I ask each of you to keep your statements fairly brief, if you would. Shoot for about ten minutes and then we will open it up for discussions.

You may proceed, Dr. Harris.

**STATEMENT OF DR. MARTHA CALDWELL HARRIS, DIRECTOR,
OFFICE OF JAPAN AFFAIRS, NATIONAL RESEARCH COUNCIL**

Dr. HARRIS. Thank you, Mr. Chairman, for this opportunity to testify on U.S.-Japan interdependencies.

I will focus my remarks this morning on the scientific and technological dimensions of interdependence between the United States and Japan. My comments are my own personal views, but they are based in great part on my experiences over the past three years as staff director for the National Research Council's Committee on Japan.

The Committee has been working to develop more effective ways for United States organizations, and for the United States as a country, to deal with Japan as a technological superpower.

This effort involves both bilateral discussions with Japanese science and technology leaders, as well as a program of studies, meetings and briefings designed to contribute to developing U.S. policy. Harold Brown is the chairman and Erich Bloch the vice chairman of the Committee.

To summarize briefly the perspective I bring to this discussion: scientific and technological interdependence is deepening, bringing new conflicts and significant challenges, as well as new opportunities.

Structural differences in the organization of the research and market systems of the United States and Japan create a context which reinforces Japan's strength in commercialization of technology and American strengths in fundamental research.

If we are unable to develop coherent strategies to ensure that scientific and technological interdependence brings significant economic benefits to the United States as well as to Japan, the unresolved conflicts that stem from differential impacts may well have negative implications not only for Japan and the United States, but for other countries as well.

So the question is: Can we make interdependence work? How can we define making it work?

I think one key element of this answer is whether the United States can obtain significant benefits to offset the risks that also go along with interdependence.

Another is to ask whether the United States and Japan can together leverage their capabilities to address global issues more effectively than either could independently.

I want to very briefly address three questions now.

First, what is the nature of U.S.-Japan science and technology interdependence today? Second, what will it be like in the future? And finally, what should we be doing and thinking about it?

Scientific and technological relations between the United States and Japan are growing rapidly through a variety of linkages—some old and some new.

These linkages seem to be spreading most rapidly among companies. U.S. companies continue to license more technology to Japanese companies than vice versa, but Japanese companies are also licensing technology.

Joint ventures and collaborative R&D represent deeper interactions. Hitachi and Texas Instruments last month announced plans to broaden their existing R&D alliance to develop jointly and manufacture 64M DRAMS over the next ten years.

Some of the joint ventures established in years past, such as Yokogawa-Hewlett Packard, are expanding into new areas, and new joint ventures are being established between competing firms like Motorola and Toshiba.

Another trend worth noting is the establishment of parallel consortia involving a number of United States and Japanese firms to develop new technology in fields like HDTV and the High Speed Civilian Transport project.

Technological linkages can also be formed through mergers and acquisitions. Some Japanese firms like Kubota have been using these channels in an effort to diversify into new businesses, with mixed success.

Technology linkages also occur through the rotation of technical personnel among companies, such as the two-way exchange of personnel that takes place in the Boeing and its Japanese partners in the project to develop the 777.

Interrelated to the traditional channels are faculty and student exchanges, and we see a number of new programs set up in Japan to bring American researchers there.

Some Japanese companies are now beginning to host American researchers, and Japanese companies are also sponsoring more research in American universities, some of them even setting up labs on or near American campuses.

And finally, we have government-to-government level linkages that are being formed in science and technology, some under the umbrella of the U.S.-Japan Agreement, others on an agency-to-agency basis that have been in existence for many years.

Of course, these arrangements include cooperation in defense technology, as well as international projects like the Intelligent Manufacturing System, which will involve countries besides the United States and Japan in advanced manufacturing research and development.

Now, these linkages make up a very dynamic network of human relationships, and they exist within a context of structural differences.

The comparative weakness of basic research at Japanese universities, the comparative strength of Japanese companies in technology commercialization, and the more coherent policy approach developed by Japanese business and government leaders are key aspects of the differences in context.

The structural differences tend to, I believe, reinforce a traditional pattern of knowledge transfer from Japan to the United States. So we have to ask, is technological interdependence helping or hurting us?

Now, one way to answer this question is to say, what changes have there been in the nature of this interdependence over the past decade?

Today, the United States depends more on Japan for components, both military and civilian. We look more to Japan for capital investment to support our R&D for some types of consumer products and for many advanced manufacturing technologies.

On the other hand, Japan still looks to the United States for some kinds of new technology—for example, in software—and for basic research, and to our market.

Now, although we can describe this as a situation of mutually beneficial interdependence, it is also important to note Japan's growing capabilities in continuing competitiveness vis-a-vis the United States.

So Japan appears to be acquiring the capability to become more independent of the United States.

Another way to answer the question of whether the trends are positive or negative, is to ask what are the impacts of these trends on the American partners and the United States as a country.

Unfortunately, as is often the case in situations of complex interdependence, we do not have all of the information that we would need to reach a definitive conclusion in this regard.

Aggregate data on foreign direct investment are helpful, but they give us only clues as to what the impacts are, in terms of training, R&D and relationships between Japan, Japanese firms and suppliers and universities in the United States.

Press reports and other sources give us only inklings as to what is going on here.

Now, competition is a major feature of this growing interdependence between the two countries, and the question that I think that we have to ask is whether technological interdependence is leading to the creation of the technological superpower—that is, Japan—that will ultimately turn interdependence into U.S. dependence.

I don't have an answer to that question now, but I think that that is a question that we have to ask.

Now, I want to talk very briefly about future prospects.

Given that this kind of competition is deepening, that it is part of the context for technological relationships that will involve a more complex array of actors, that will include relationships that span the gamut from basic science to commercialization, what are the prospects for the future?

The most dangerous prospect would be one in which this technological competition leads to the elimination of entire U.S. industries or capabilities, while Japan, on the other hand, gains ground in areas of comparative weakness, like aerospace, for example, and software.

If technological linkages were to result primarily in a transferring of technology and economic resources back to Japan, this would be the outcome. And this is the image of those who see Japan as a predatory nation.

An alternative image sees Japan as exercising a new kind of soft power in the technology realm. It is primarily Japanese companies that are exercising this power through globalization, along with localization.

The essential elements of this contrasting image are the Japanese companies that are doing business around the world. They fit in and contribute substantially to the community and to the host country.

Focusing specifically on technology, this means value-added production, implying skilled work forces working to upgrade the capability of work of local suppliers, supporting host-company basic research, and establishing a significant R&D presence abroad.

This image sees Japan as achieving the status of a military superpower while using economic power to constructive ends through economic assistance and effective participation in international organizations.

Which image is likely to be the reality of the future?

In order to answer this question, we would need to know a great deal about the intentions and capabilities of policymakers in both countries.

I would say that Japan's approach has been fairly coherent in developing a technology policy that features investing heavily in industrial R&D and extending this traditional emphasis on commercialization now to more generic technologies likely to be the foundation for future industrial competition.

U.S. officials have repeatedly called for a new partnership with Japan, but in the science and technology area, we have yet to translate this principle into the specifics of what we want in terms of desired outcomes and goals.

Indeed, there is a good deal of debate about whether we are on the right track.

My guess is that the future will not be like either of these two images. It is not going to be either the worst-case scenario or the best.

We are going to find ourselves somewhere in between, needing to both compete and cooperate with Japan at all levels, to work hard to make interdependence really work.

Now, faced with this situation, what should we do? What are the policy implications?

Some may say that, given this state of affairs, perhaps we need to reduce our dependence on Japan in critical areas. Action to reduce dependence on Japan—Japanese-supplied components, for example—might be justified by some if there is no alternative for a supplier. But it would be very difficult to implement a strategy like this of reducing dependence across the board. The globalization of technology precludes such an autarchic path in the century ahead.

Others may say that we should just sit back and accept interdependence as a fact of life. But the message, I think, that I would like to leave with you today is that interdependence is something that we must work on in order to develop more effective approaches to maximizing the long-term gains.

If we do not, we may not achieve the potential benefits and may even see a weakening of the U.S. scientific and technological position as a result.

In order to formulate a more coherent approach, there are some questions that have to be addressed, and I will mention them just briefly.

First, corporations and universities will need to consider the long-term value of their technology in developing alliances with Japanese partners, particularly when the technology has been supported by public funds.

We must also learn to negotiate and structure linkages so that there is a two-way flow of resources and real reciprocal access. And we must evaluate the impacts of these linkages on the participants and the United States as a country.

We need a vision of scientific and technological interdependence that clarifies the desired outcomes and provides a framework for maximizing goals.

Now, I know that time is running short, so I won't elaborate on all of these points, but I would say that one important issue is to improve our abilities to analyze the linkages as they are being formed, and to look at the impacts that they have. And I think that the private sector can play an important role here.

The outcome may well be to show that Japanese corporations are making a significant contribution, and when that is the case, that should be recognized. And these judgments and assessments about the contributions of foreign-based firms may be important in forming analyses and judgments about whether they should participate in joint R&D projects.

I think we also need to think about ways to change our corporate culture at both the university and corporate levels, to develop technology-based strategies, and continue to pursue discussions with Japan that contribute to an opening of opportunities for American investment in Japan and American access to Japan's science and technology base.

At the national level, there is a need to build a consensus across agencies and stakeholders on competing with Japan as a technological superpower. We will be faced in the future with new challenges as these linkages bring different impacts to various groups within our society—users and producers, for example.

Lacking a framework of how we want to make interdependence work in the future, these divisions among U.S. industries may well grow.

In this regard, I should mention that the Committee on Japan of the National Research Council plans an overview study on how to maximize U.S. interests through expanded scientific and technological relations with Japan.

I have emphasized in my remarks this morning the bilateral dimensions of the U.S.-Japan science and technology relationship, but of course we need to consider the broader global context: the demise of the Soviet Union, the growing integration of Europe, and the delicate state of the GATT trade talks.

All of these will have impacts on the U.S.-Japan relationship, so we are challenged to leverage our resources together to address broad global questions in the areas like the environment and security.

If we can achieve this complementarity of science and technology resources in a new global context, it will be a strong sign that interdependence is really working.

Thank you.

[The prepared statement of Dr. Harris follows:]

PREPARED STATEMENT OF MARTHA HARRIS

Thank you, Mr. Chairman for this opportunity to testify on "United States-Japan Interdependencies." I will focus my remarks this morning on the scientific and technological dimensions of interdependence between the United States and Japan. My comments are my own personal views, but they are based in great part on my experiences over the past three years as staff director for the National Research Council's Committee on Japan. The Committee has been working to develop more effective ways for U.S. organizations, and for the United States as a country, to deal with Japan as a technological superpower. This effort involves both bilateral discussions with Japanese science and technology leaders as well as a program of studies, meetings and briefings designed to contribute to developing U.S. policy. Harold Brown is the chairman and Erich Bloch the vice of the Committee.

To summarize briefly the perspective I bring to this discussion: Scientific and technological interdependence is deepening, bringing new conflicts and significant challenges, as well as new opportunities. Structural difference in the organization of the research and market systems of the United States and Japan create a context which reinforces Japan's in commercialization of technology and American strengths in fundamental research. If we are unable to develop coherent approaches to ensure that scientific and technological interdependence brings significant economic benefits to the United States as well as to Japan, the unresolved conflicts that stem from differential impacts may well have negative implications not only for Japan and the United States, but for other countries as well.

Scientific and technological relations between the United States and Japan are growing rapidly, through a variety of linkages—some old and some new. These linkages seem to be spreading most rapidly among companies. U.S. companies continue to license more technology to Japanese companies than vice versa, but Japanese companies are also licensing technology. Joint ventures and collaborative R&D represent deeper interactions. Hitachi and Texas Instruments last month announced plans to broaden their existing R&D alliance to develop jointly and manufacture 64M DRAMS over the next 10 years. Some of the joint ventures established in years past (such as Yokogawa-Hewlett Packard) are expanding into new areas, and new joint ventures are being established between competing firms like Motorola and Toshiba. Another trend worth noting is the establishment of parallel consortia involving a number of United States and Japanese firms to develop new technology in fields like HDTV and the High Speed Civilian Transport project. Technological linkages can also be formed through mergers and acquisitions. Some Japanese firms like Kubota have been using these channels in an effort to diversify into new businesses—with mixed success. Technology linkages also occur through the rotation of technical personnel among companies (such as the two-way exchange of personnel that takes place in the Boeing and its Japanese partners in the project to develop the 777).

University-based linkages are also expanding. The traditional channels are training of foreign students and faculty/researcher exchanges. The number of Japanese students in the United States continues to grow, and new programs have been established in Japan with government support, such as the Summer Institute at Tsukuba University, for American students in technical fields of study. Some Japanese corporations are now hosting U.S. students interns and longer-term research scientists in their laboratories. Japanese companies are establishing deeper ties to U.S. universities through sponsored research as well as new mechanisms—building laboratories on or near U.S. university campuses and supporting large research programs (like Shiseido's at Massachusetts General Hospital). Whether Japanese firms will become significant participants in R&D consortia based at U.S. universities remains to be seen.

Finally, there are a variety of government-to-government projects in science and technology. Last month marked the 30th anniversary of the U.S.-Japan Cooperative Science Agreement which sponsored many technical exchanges over the years. There are many agency-to-agency agreements, in addition to the umbrella U.S.-Japan Science and Technology Agreement, that have continued over many years. Cooperation in defense technology has taken place under the rubric of licensed production in Japan. The FSX project for joint development of a new fighter plane and announcements of projects (the ducted rocket engine) that will feature technology transfer from Japan represent new types of relationships. Particularly striking are the proposals by Japan to established international R&D collaboration in fields like advanced manufacturing, micromachines, and next generation computing.

These linkages makes up a dynamic network of relationships in science and technology, a network of human ties as well as organizational relationships. These are channels for exchange of knowledge and technical expertise growing within an overall context of structural differences between the two countries. The comparative weakness of basic research at Japanese universities, the comparative strength of Japanese companies in technology commercialization, and the more coherent policy approach developed by Japanese business and government leaders are key examples of such differences. The structural differences have important implications for the outcomes of interdependence because they tend to reinforce a traditional pattern of knowledge and technology transfer from the United States to Japan.

Is scientific and technological interdependence helping or hurting us? One way to answer this question is to identify changes in the nature of interdependence in the past decade. The United

States as a country today depends more on Japan for components for advanced technology products, both civilian and military. We look to Japan more today for investment capital to support R&D and for some types of consumer products and manufacturing technologies. Japan still looks to the United States for new technology, particularly software, for basic research, and as a large market for its new products that represent applications of technologies. Although this can be described as a situation of mutually beneficial interdependence, it is also important to note Japan's growing technological capabilities and continuing competitiveness vis-a-vis the United States in key sectors such as automobiles and semiconductors. Japan thus appears to be acquiring the capability to become more independent of the United States.

Another way to answer the question of whether the trends are positive is to ask about the impacts of these linkages on the American participants and on the United States as a country. Unfortunately, as is often the case in complex interdependence, we do not have the information that would be needed to reach a definitive conclusion. Let us consider for a moment the question of whether Japan investment brings with it technology transfer to the United States. Aggregate data on foreign direct investment give us only the most general picture of capital inflows. We need to know a great deal more about what is going on at the industry and firm level—about the nature of technical training, R&D, relationships with U.S.-based suppliers and universities—in order to be sure about the long-term impacts. The information that can be gleaned from trade press reports and other sources is inadequate, because of the natural tendency to report on new developments (rather than ongoing projects or those that end) and because of the proprietary nature of some of the information.)

Competition is a major feature of U.S.-Japan scientific and technical interdependence. Looking beyond the individual examples, the question is whether we are witnessing (and perhaps assisting in) the creation of a technological superpower that will compete with the United States across the board and ultimately turn interdependence into U.S. dependence.

Future Prospects

What does the future hold? U.S.-Japan technological competition will probably intensify as Japan gains market share and technological strength. Competition will be deeper, will involve a more complex array of actors, and will include basic science as well as technology development and commercialization. There are two contrasting views of the future.

The most dangerous prospect would be one in which technological competition leads to the elimination of entire U.S. industries and capabilities while Japan reaches parity in current areas of comparative weakness, such as commercial aircraft and sob. If technological linkages result primarily in transferring technology and economic resources back to Japan, this could be the outcome. Those who see Japan as a "predatory" nation fear this kind of future, particularly if it featured a major Japanese military buildup coupled with a more dependent foreign policy.

And alternative image sees Japan (primarily Japanese companies) as exercising a new kind of "soft" power. In the realm of technology, the image is one that Sony and some other large Japanese companies project today of "globalization with localization." Essential elements of this image are that Japanese companies doing business around the world fit in and contribute substantially to the local community and to the host country. Focusing on the technological dimensions, this means high value-added production, employing and training a skilled workforce, working to upgrade the capabilities of local suppliers, supporting local suppliers, supporting host basic research, and establishing a significant R&D presence abroad. This image sees Japan as continuing to eschew the status of military superpower while using economic power to constructive ends through development assistance and effective participation in international organizations such as the GATT and the IMF.

Which image of the future is likely to prevail? In order to answer this question with confidence, we would need to know the intentions and capabilities of policymakers (public and private) in Japan and the United States today and in the future.

Japanese government policy today emphasizes internationalization. Japanese companies are working with their industry associations to perfect their globalization strategies. Meanwhile, they are investing heavily in their own industrial R&D efforts and extending them to focus on more fundamental, generic technologies. In short, Japan has a comparatively coherent technology policy which is linked to an assessment of trends in international competition and evaluations that Japan must develop a knowledge-intensive economy built on the foundation of continued strength in advanced manufacturing.

U.S. officials have repeatedly called for a new partnership with Japan in which Japan takes a more active global role. Although the basic principles have been articulated, we have yet to translate them into concrete expectations of the desired outcomes of scientific and technological relationships. Indeed, there is a good deal of debate over whether we're on the right track. As specific conflicts arise, such as when U.S. industries are threatened by imports from Japan, the temptation is to use trade policy as a substitute for domestic technology policy. Resolving the problems growing out of technological competition (rather than merely easing the "frictions") will require new approaches.

My own guess is that the future will not be like either of the two images referenced earlier. Will find ourselves somewhere in between the worst case scenario of Japanese domination and

the best case scenario of positive benefits to all. Instead, we will need to both compete and cooperate with Japan at all levels, to work hard to make interdependence really work—to ensure significant benefits to the United States and mutual gain through cooperation in an effective global partnership.

Policy Implications

Faced with growing interdependence and significant certainties about impacts and intentions, what should we do? Some may answer this question by saying that we need to reduce our "dependence" in some critical areas. For example, action to reduce dependence on Japanese-supplied components may be justified when there is no domestic supplier or when the foreign supplier has few significant competitors. It will, however, probably not be possible to pursue this strategy across the board. The globalization of technology precludes an autarchic path in the century ahead.

Some may say that, since we can't make ourselves independent we might as well sit back and accept interdependence as a fact of life. My concern about that approach is that I do not believe that we will be able to maximize the potential benefits or minimize the potential risks of interdependence without a conscious policy at both the government and private sector levels. Indeed, the message I would like to leave with you today is that interdependence is a fact of life, but we must develop more effective approaches to maximizing the long-term gains. If we do not, we will probably not realize the full range of potential benefits and may even see a weakening of U.S. scientific and technological capabilities in important areas. In order to formulate approach, there are some important questions that must be addressed.

- Corporations and universities will need to consider the long-term value of their technology in developing alliances with Japanese partners, particularly when the technology has been developed with public support.
- We must negotiate and structure technological linkages to ensure that there is a two-way flow of resources and reciprocal access to innovation systems and markets.
- We must evaluate the impacts of scientific and technological linkages on the participants and the United States as a country. The results of these evaluations should be made available to policymakers in timely fashion.
- We need to develop a vision of scientific and technological independence with Japan that clarifies desired outcomes and provides a framework for maximizing goals. And we need the energy—in the government and the private sector—to achieve the vision.

Let me elaborate a bit on these general themes in terms of what can be done by government and the private sector. As a first step, we need assessments of the impacts of scientific and technological linkages. This means building a better data base. We don't know very much about the training, technology transfer, R&D, and components supply practices of foreign-based companies operating in the United States. We know very little about the extent and nature of the involvement of foreign-based companies in U.S. universities, nor do we have good statistics on researcher exchanges (particularly those involving corporations). Building a knowledge base is a necessary but insufficient step toward assessing impacts. There is a need for studies of industries and companies. Perhaps private sector associations can play a role in promoting this kind of analysis because it will help them to clarify where the problems lie and where the benefits are obvious. When Japanese corporations help to upgrade the manufacturing capabilities of companies they work with or have a stake in, these contributions should be recognized. Judgments about whether foreign-based firms should be permitted to participate in joint R&D efforts may be informed by such analysis.

Another significant challenge is to change the organizational culture of our premier R&D institutions—corporations and universities—to take a long-term perspective on the value of their technology. Corporations in particular must develop more effective, technology-based strategies for global competition. This will require more systematic efforts to monitor technology developments outside the United States, to nurture technical and management personnel who can operate effectively in Japan and with Japanese counterparts, to develop technology roadmaps and careful assessments of expected benefits and risks associated with potential strategic ally. It also means building capabilities in strategic alliances. It also means building capabilities in advanced manufacturing so that U.S. firms can profit from the innovations they produce.

In government-to-government discussions, it will probably be important to continue to emphasize the need for reciprocity in access to Japan's research and market systems. It is much easier for Japanese to tap into U.S. university research than vice versa. (A few U.S. companies are beginning to establish link to some of Japan's best university research programs, as a way to recruit new talent and learn about the research at an early stage, but there are industrial liaison programs in Japanese universities to facilitate this process.) While the ostensible barriers to foreign investment in Japan have been eliminated, many informal barriers remain that limit investment and the ability to penetrate corporate leadership and procurement practices. In view of the fact that Japan is opening a number of R&D projects to foreign participation, new avenues could be explored through industry associations and other groups to participate and diffuse the lessons throughout U.S. industry.

At a national level, there is a need to build a consensus across agencies and among stakeholders on competing and cooperating with Japan as a technological superpower. We will be faced in the future with new challenges as technology linkages with Japan produce differential benefits to U.S. interests—users and producers. Lacking a framework for making these work, divisions within and among U.S. industries may grow. I should mention, in this regard, that the Committee on Japan of the National Research Council plans to prepare an overview study of how to maximize U.S. interests through expanded scientific and technological relations with Japan. This study has been requested by Congress in the National Defense Authorization Act of FY 1992 and 1993.

We will face new challenges as the global security context is transformed. The post Cold War era ushers in a new period of multipolar politics. The United States and Japan will need to examine their security alliance, and hopefully expand it, based on a broader definition of security that extends beyond containing the Soviet threat to building peace and stability by addressing issues such as weapons proliferation and environmental problems in new ways.

The changing global context will importantly affect the U.S.-Japan relationship. Will European integration be coupled with protectionism vis-a-vis the rest of the world? Will multilateral institutions be invigorated and new rules of the game created to govern international technological competition? The answers will affect U.S.-Japan technological interdependence, but the policies developed by the United States and Japan will also have an impact on those outcomes.

The growth of scientific and technological interdependence with Japan new opportunities to work together, but also significant risks. We will need to work hard to ensure that interdependence produces concrete benefits to the American partners and to the United States as a country. We will need to develop new approaches in order to leverage the impressive scientific and technological capabilities of Japan and the United States to achieve together more than either could independently. These are the significant challenges ahead.

Representative HAMILTON. Thank you, Dr. Harris.
Dr. Saxonhouse, please proceed.

**STATEMENT OF DR. GARY R. SAXONHOUSE, PROFESSOR OF
ECONOMICS, UNIVERSITY OF MICHIGAN, ANN ARBOR**

Dr. SAXONHOUSE. Mr. Chairman, I am pleased that you have invited me to testify before you today on the extremely important matters presently being considered by your Committee.

These are times of momentous change. The dissolution of the Soviet Union that we are now witnessing appears to mark the final triumph of Western capitalism and democracy over totalitarian communism dictatorship.

Ironically, while the United States stands tall and proud when looking at the collapse of communism, when we turn around and face Japan, too often American confidence seems to evaporate.

Too many Americans do not regard Japan's spectacular success as yet another vindication of the principles on which the United States was founded.

Many regard the Japanese economy as an alien order that succeeds not because it follows Western principles, but rather because it violates them. And because it is seen as violating them, it is widely believed in the United States that American firms and workers cannot compete with their Japanese counterparts without special help.

There is something quite familiar here. Remember in the 1960s, Mr. Chairman, many Americans openly questioned whether Western values and institutions could meet the challenge of communist competition.

In 1961, Paul Samuelson's best-selling economics textbook, in discussing the communist challenge, published a graph showing how the Soviet Union might leap economically ahead of the United States by the year 2000.

Just a year earlier, in 1960, the Central Intelligence Agency reported to President Eisenhower that the efficacy of the communist system in mobilizing and allocating scarce resources was such that the People's Republic of China would by 1970 become the dominant industrial power in Asia, surpassing Japan.

Happily, the United States survived this crisis of confidence in the capacity of its institutions to deal with Soviet competition by reaffirming its commitment to open democratic institutions and decentralizing market processes.

By contrast, in facing Japanese competition in the 1970s, 1980s, and now in the 1990s, the United States too often has been ready to give up on its institutions and policies. U.S. international economic policies after 1945 marked one of the finest moments in American history. Our willingness to buy at the lowest price the best quality product, irrespective of whether it was produced at home or abroad, and our insistence on an open multilateral trading system, proved to be an enormous boon, both for us and for the rest of the world.

In recent years, facing unexpectedly vigorous Japanese competition at home and abroad, the United States too often has turned its back on its own policies and sought protection for its firms and workers.

In industry after industry, from textiles and steel, color television sets and automobiles to machine tools and semiconductors, American trade officials have successfully pressured Japan to restrain its exports to the American market.

These export restraint arrangements are costly. The increased profits for both American and Japanese firms that result are invariably less than the losses suffered by American consumers by virtue of the higher prices that they are forced to pay.

Yet, even this is a gross underestimate of the real cost of the restraints on Japanese exports. Advocates of such policies usually claim that such departures from free trade are the realistic cost of preventing still more protectionist policies in the future.

In fact, the experiences of the past 20 years show quite clearly that a dose of protectionism and managed trade just breeds more protectionism and managed trade.

Since the days of Adam Smith, David Ricardo and John Stuart Mill, economic interchange has been understood to be mutually beneficial.

It is now argued by many who should know better that Japan's economic practices are so different that traditional conceptions of economic exchange need to be revised.

As evidence that Japanese economic practices are so different, it is said, for example, that Japan imports too little, that the foreign currency prices of Japanese goods don't change in response to exchange rate changes, and that Japanese producers operating overseas rely all too heavily on Japanese suppliers.

In each of these instances of seemingly parochial Japanese behavior, I think it is manifestly wrong to say that what is observed is a result of practices necessarily deeply rooted in Japanese history and culture.

Rather, the cause may be nothing more exotic than the rational response of the Japanese economy to the restraints on Japanese exports so often the result of frenzied diplomatic activity by American trade officials and their counterparts elsewhere in the world.

If Japanese imports seem low by international standards, why, Mr. Chairman, must it be assumed that Japanese trade barriers are to blame?

Economists have long understood the intimate connection between a country's imports and its exports. If international trade flows are taken as given, then, if a country is importing too little, it is also exporting too little.

Policies which hold down exports also hold down imports and vice versa.

While it may be argued that Japanese trade barriers—whether formal or informal—are too high, no one would argue that they have been getting higher in the past two decades.

By every conceivable standard, Japanese trade barriers have come down sharply in recent years.

By striking contrast, barriers against Japanese exports have increased sharply.

If, despite this very large recent increase, the volume of Japanese imports is still seen as too low, American trade officials need only look in the mirror to find a chief culprit. The same barriers that hold down Japanese exports have also gravely weakened the international adjustment mechanism.

In the mid-1980s when *endaka*—the very rapidly appreciating yen—was very slow in raising the dollar prices of Japanese exports, too many Americans, however, were also very slow in understanding that this did not mean that Japan, in its mysterious way, had somehow repealed the laws of economics.

Rather, the very low pass-through of exchange rate changes underlines the cost to the United States, and to Japan's other trading partners, of discriminating against Japanese goods.

Forced to restrain their exports, Japanese producers just obeyed the laws of economics and raised their prices in order to restrain foreign demand for their goods.

With profit margins bloated courtesy of American trade officials, it is small wonder that even the enormous appreciation of the yen in the mid-

1980s was absorbed with only relatively modest price changes in just those many product lines where Japan was already restraining its exports.

The last half of the 1980s has also seen an enormous increase in Japanese fixed investment in the United States. Unfortunately, a substantial part of this investment has been driven by the need to substitute local production for those exports which have been restrained by virtue of American policy.

Japanese investments in the United States, unlike the investments in the United States of many other countries, are in industries in which Japan continues to retain a comparative advantage.

Restraints on Japanese exports too often forces Japan to produce abroad what it could perfectly well produce at home. Therefore, it is hardly surprising that such Japanese-owned factories abroad import as many components as they possibly can from Japan.

This is not the result of any cultural peculiarity, as is unhappily too often suggested by many of your fellow members of Congress. Rather, these components are the basis of Japanese competitiveness. Continuing to use them is a sensible economic response to a difficult situation created by foreign protectionism.

The remedy for the current difficulties in U.S.-Japanese economic relations is the polar opposite of managed trade. If Japan looks different, a good part of this difference is artificially created by counterproductive U.S. policies, which, I should add, Japanese industry and government have been all too ready to accommodate.

Drawing on the self-confidence in our institutions, which should be the obvious result of observing developments in Eastern Europe and the former Soviet Union, the United States should remember its founding principles in dealing with Japan.

Article 1, Section 4 of the U.S. Constitution forbids actions that would interfere with American exports. American trade officials should rediscover the wisdom of the Founding Fathers and refrain from asking the Japanese government to adopt policies which, if adopted in the United States, would substantively violate our own Constitution.

The United States should return to its best principles and urge the removal of any restraints on Japanese competition with American industry.

The United States should do this not out of charity. The world's largest debtor does not give charity. The United States should do this in its own best interests. The American government support for the removal of restraints on Japanese exports to the United States is not a gift to Japan at all.

While such changes in policies will unambiguously improve American welfare, the effect on Japan will be different. Paradoxically, Japan has actually benefited from most of the discrimination against its exports, which it has suffered at American hands.

Time and again, American policy, by asking Japan to restrain its imports, has just made it possible for Japanese firms to tax the American consumer with higher prices and fat profit margins.

New policies now being aired by many in this Congress, which would restrain the production of Japanese firms operating in the United States, would surely have much the same effect.

Why is it, Mr. Chairman, that so many in Congress today are so fearful of raising taxes when the proceeds go to the American government, and so ready to raise taxes when the proceeds go instead to Japanese firms. It is harder to imagine a worse ordering of policy priorities.

The extra profits generated by American trade policy for Japanese firms just intensified the long-term competitive pressure on American industries that these policies are supposedly intended to protect.

Just as 30 years ago a crisis in American confidence was resolved by a reaffirmation of the fundamental principles of capitalism and democracy, the same remedy must prevail today.

Today, such a reaffirmation means surgically removing all facets of managed trade that have crept into U.S. policy. The traditional American commitment to buying the best quality product at the lowest possible price should be reaffirmed.

If bold steps are taken—in particular, if President Bush's mission to Japan and elsewhere in Asia is successful in reinvigorating the global economy and the GATT process—there is every prospect that long, long before another 30 years have passed, the last of the 1980s and early 1990s will seem like an odd chapter in the history of U.S.-Japanese economic relations.

With concrete policy steps taken by the United States and by Japan, we should fully expect that within less than a decade, Japan will stand shoulder to shoulder with the United States as the joint guarantor of a reinvigorated and flourishing global trading system, premised on the multilateral free exchange of goods, services and capital.

What will seem odd in the future is that the United States and Japan could ever have doubted their capacity to continue to engage in mutually beneficial exchange on this basis.

Thank you.

[The prepared statement of Dr. Saxonhouse follows:]

PREPARED STATEMENT OF GARY R. SAXONHOUSE

Mr. Chairman, I am pleased that you have invited me to testify before you today on the extremely important matters presently being considered by your Committee. These are times of momentous change. The seeming dissolution of the Soviet Union this past week appears to mark the final triumph of Western capitalism and democracy over totalitarian Communism and dictatorship. In the United States, the unfolding events, first in Eastern Europe and now in the Soviet Union, have been hailed as conclusive vindication of American economic and political institutions. Indeed, the speed with which the former Communist countries have rushed to learn from American economists and American management consultants about the virtues of market mechanisms only serves to underline just how very complete is this victory.

Ironically, while the United States stands tall and proud, when looking at the collapse of Communism, when we turn around and face Japan, too often American confidence appears to evaporate. Too many Americans do not regard Japan's spectacular success as yet another vindication of the principles on which the United States was founded. Despite a preponderance of evidence to the contrary, many regard the Japanese economy as an alien order that succeeds not because it follows Western principles, but rather because it violates them. And because it is seen as violating them, it is widely believed in the United States that American firms and workers cannot without special help compete with their Japanese counterparts.

Somehow the lessons that American economists are teaching to eager audiences from Prague to Vladivostok are not considered relevant, particularly by many here in Washington, for U.S. relations with Japan. Curiously, free trade and free markets are the remedy for the former Communist states in Europe and Asia, but not for the United States in its dealings with Japan.

In the 1950s and the 1960s, many Americans openly questioned whether Western values and institutions could meet the challenge of Communist competition. In 1961, Paul Samuelson's best selling economics textbook in discussing the Communist challenge published a graph showing how the Soviet Union might leap economically ahead of the United States by the year 2000. Just a year earlier, in 1960, the Central Intelligence Agency reported to President Eisenhower that the supposed efficacy of the Communist system in mobilizing and allocating scarce resources was such that the People's Republic of China would by 1970 become the dominant industrial power in Asia surpassing Japan.

Happily, the United States survived this crisis of confidence in the capacity of its institutions to deal with Soviet competition by reaffirming its commitment to open democratic institutions and decentralized market processes. By contrast, in facing Japanese competition in the 1970s, 1980s and now the 1990s, the United States too often has been all too ready to give up on its institutions and policies. U.S. international economic policies after 1945 marked one of the finest moments in American history. Our willingness to buy at the lowest price, the best quality product irrespective of whether it was produced at home or abroad, and our insistence on an open, multi-lateral trading system has proved to be an enormous boon both for us and for the rest of the world. Regrettably too often in the recent past in its dealings with Japan, the United States has lost sight of what we appeared to understand so well in the past and what we have so readily preached to so many other countries.

Facing unexpectedly vigorous Japanese competition at home and abroad, the United States too often has turned its back on its own policies and sought protection for its firms and workers. In industry after industry, from textiles and steel, color television sets and automobiles to machine tools and semiconductors, American trade officials have successfully pressured Japan to restrain its exports to the American market. This has been done so often during the past 20 years that over 40 percent of Japanese exports to the United States are restrained by one or another arrangement.

These export restraint arrangements are costly. The increased profits for both American and Japanese firms that result are invariably less than the losses suffered by American consumers by virtue of the higher prices they are forced to pay. Yet even this is a gross underestimate of the real cost of the restraints on Japanese exports.

Advocates of such policies usually claim that some departures from free trade are the realistic cost of preventing still more protectionist policies in the future. In fact, the experience of the past 20 years shows quite clearly that a dose of protectionism and managed trade just breeds more protectionism and managed trade. Since the days of Adam Smith, David Ricardo, and John Stuart Mill economic interchange has been understood to be mutually beneficial. It's now argued by many who should know better that Japan's economic practices are so different that traditional conceptions of economic exchange need to be revised. As evidence that Japanese economic practices are so different it's said, for example, that Japan imports too little, that the foreign currency prices of Japanese goods don't change in response to exchange rate changes and that Japanese producers operating overseas rely all too heavily on Japanese suppliers.

In each of these instances of seemingly parochial Japanese behavior, it's wrong to say that what's observed is the result of practices necessarily deeply rooted in Japanese history and culture. Rather the cause may well be nothing more exotic than the rational response of the Japanese economy to the restraints on Japanese exports so often the result of frenzied diplomatic activity by American trade officials.

If Japanese imports seem low by international standards, why must it be assumed that Japanese trade barriers are to blame? Economists have long understood the intimate connection between a country's imports and its exports. If international capital flows are taken as a given, then if a country is importing too little, it's also exporting too little. Policies which hold down exports also hold down imports and vice versa. While it may be argued that Japanese trade barriers, whether formal or informal, are too high, no one would argue that they have been getting higher in the past two decades. By every conceivable standard, Japanese trade barriers have come down sharply in recent years. By striking contrast, barriers against Japanese exports have increased sharply. Indeed, imports into Japan from the United States have grown so rapidly that Japanese imports of United States products are now 1.7 percent of Japanese GNP. This may seem small, but by contrast U.S. imports of Japanese products are only 1.6 percent of American GNP. The American market share in Japan is larger than the Japanese market share here. If despite this very large increase the volume of Japanese imports is still seen as too low, American trade officials need only look in the mirror to find a chief culprit. The same barriers that hold down Japanese exports have also gravely weakened the international adjustment mechanism. In the mid-1980s when *endaka* was very slow in raising the dollar prices of Japanese exports, too many Americans, however, were also very slow in understanding that this did not mean that Japan in its mysterious way had somehow repealed the laws of economics. Rather, the very low pass-through of exchange rate changes underlines the cost to the United States and to Japan's other trading partners of discriminating against Japanese goods. Forced to restrain their exports, Japanese producers actually obeyed the law of economics and raised their prices in order to restrain foreign demand for their goods. With profit margins bloated courtesy of American trade officials, it is small wonder that even the enormous appreciation of the yen in the mid-1980s was absorbed with only relatively modest price changes in just those many product lines where Japan was already restraining its exports.

The last half of the 1980s has also seen an enormous increase in Japanese fixed investment in the United States. Unfortunately, a substantial part of this investment has been driven by the need to substitute local production for those exports which have been restrained by virtue of American policy. Japanese investments in the United States, unlike the investments in the United States of many other countries, are in industries in which Japan continues to retain a comparative advantage. Restraints on Japanese exports too often forces Japan to produce abroad what it could perfectly well produce at home. Therefore, it's hardly surprising that such Japanese-owned factories abroad import as many components as they possibly can from Japan. This is not the result of any cultural peculiarity. Rather, these components are the basis of their competitiveness. It is a sensible economic response to a difficult situation created by foreign protectionism.

The remedy for the current difficulties in U.S.-Japanese economic relations is polar opposite of managed trade. If Japan looks different, a good part of this difference is artificially created by counter-productive U.S. policies which Japanese industry and Japanese government have been all too ready to accommodate. Drawing on the self-confidence in its institutions which should be the obvious result of observing developments in Eastern Europe and the former Soviet Union, the United States should remember its founding principles in dealing with Japan. Article I, Section IV of the U.S. Constitution, forbids actions that would interfere with American exports. Surprising as it may seem to us today, this issue was thoroughly debated at the Constitutional Convention in Philadelphia over two hundred years ago. Rejecting the advice of the great James Madison, the delegates decided that the U.S. government should no more interfere with exports to foreign countries than it should interfere with trade between any of the American states. American trade officials should rediscover the wisdom of the Founding Fathers and refrain from asking the Japanese government to adopt policies which if adopted in the United States would violate our own U.S. Constitution.

The United States should return to its best principles and urge the removal of any restraints on Japanese competition with American industry. The United States should not do this out of charity. The world's largest debtor does not give charity. The United States should do this in its own best interest. The American government's support for the removal of restraints on Japanese exports to the United States is not a gift to Japan at all. While such changes in policies will unambiguously improve American welfare, the effect on Japan will be different. Paradoxically, Japan has actually benefitted from most of the discrimination against its exports that it has suffered at American hands. Time and again, American policy by asking Japan to restrain its imports has just made it possible for Japanese firms to tax the American consumer with high prices and fat profit margins. New American policies urged on many in this Congress which are designed to restrain the production of Japanese firms operating in the United States will have much the same effect. Why is it, Mr. Chairman, that so many in Congress today are so fearful of raising taxes when the proceeds go to the American government and so ready to raise taxes when the proceeds instead go to Japanese firms? It's hard to imagine a worse ordering of policy priorities. The extra profits generated by American trade policy for Japanese firms just intensify the long-term competitive pressure on the American industries these policies are supposedly intended to protect. For example, I fear ten and one-half years of protection

have left the American automobile industry less able to compete with Japan than when protection was first imposed.

It is commonplace to say that the much celebrated and much maligned Structural Impediments Initiative talks between the United States and Japan are unusual. They are said to be unusual because each side has made demands that are primarily in the interest of the other side, rather than being primarily in its own interest. Actually, there is nothing unusual about this at all. This is what is usually the case in trade negotiations. If the goal of 511 is to make Japanese economic behavior less different from other countries, however, the United States should not neglect to look to its own interests. Removing the elaborate structure of restraints that has grown up around many Japanese export industries will achieve many of the larger structural aims of 511 at the same time that American consumers are directly benefited. Unlike so many of the intractable issues being dealt with in 511, here is a case where structural changes in Japan can be directly effected by a change in American policy.

Such a change in American policy will have a negative effect on Japan's terms of trade. Japanese prices and Japanese profit margins in the United States will decline. This is a cost, however, that should be readily borne by Japan. Japanese producers will no longer be able to cartelize the American market with the help of American trade officials. There is no good reason for American consumers to subsidize Japanese manufacturers. Japanese trade officials, while protesting loudly for public consumption, have all too readily agreed to one or another export restraint. While it has been decades since the Japanese government has given large subsidies to Japanese manufacturers, too many American trade officials and too many American Congressmen appear to be all too ready to force American consumers to step into a role which the Japanese government has long since abandoned.

Just as 30 years ago, a crisis in American confidence was resolved by a reaffirmation of the fundamental principles of capitalism and democracy, the same remedy must prevail today. Today such a reaffirmation means surgically removing all facets of managed trade that have crept into U.S. policy. The traditional American commitment to buying the best quality product at the lowest possible price should be reaffirmed. If bold steps are taken, there is every prospect that long, long before 30 years have passed, the late 1980s and early 1990s will seem like an odd chapter in the history of U.S.-Japanese economic relations. With concrete policy steps taken by the U. S., we should fully expect that within less than a decade Japan will stand shoulder to shoulder with the United States as the joint guarantor of a reinvigorated and flourishing global trading system premised on the multilateral, free exchange of goods, services and capital. What will seem odd in the future is that the United States and Japan could ever have doubted their capacity to continue to engage in mutually beneficial exchange on this basis.

APPENDIX 1

THE JAPANESE-AMERICAN FINANCIAL ALLIANCE

Far from undermining American economic performance during the 1980s, growing economic intimacy with Japan helped underwrite much of whatever success was achieved by the American economy during these years. American demands for an increased standard of living, for a significantly stronger national defense and for significant increases in capital formation proved feasible in part because they went hand in hand with a dramatic shift after 1980 in the Japanese willingness to hold dollar denominated assets.

Until 1980, Japan's Foreign Exchange Control Law made it very difficult for any private entity to hold foreign currency denominated assets. This law insulated Japanese financial markets from the rest of the world and allowed Japanese financial authorities great latitude in setting domestic credit policy. When the administration of this law was revised at the end of 1980, in part as a result of continuing American diplomatic pressure, Japanese corporations, Japanese financial institutions and Japanese households, for the first time, were able to meet dollar denominated assets. This revision, which also led the way long pent-up desires to diversify their portfolios and hold for the liberalization of domestic financial transactions in Japan, was little noticed (or otherwise discounted) in the United States at the time it took place. In retrospect, few events were more important for shaping the American political economy of the 1980s.

In the absence of the opening of the Japanese market to sales of American instruments, the sky-high interest rates which would have resulted would have insured that the American defense build-up in the 1980s could only have been at the expense of the American standard of living or the American capital stock. With the opening of Japanese capital markets, the massive sale of high-yielding American financial products there, left competing Japanese financial products in the dust. American success in this Japanese market kept interest rates down in the United States even while it raised them in Japan. American access to Japanese financial markets facilitated increased spending in the United States at the same time that it constrained spending in Japan. The maintenance and continued improvement of the American standard of living came at Japanese expense.

If Japanese financial markets had not been open to the sales of American debt, the great Japanese demand for the American dollar never would have occurred. With the demand for yen

to pay for a growing American appetite for Japanese goods not counterbalanced by a Japanese demand for dollars, the first half of the 1980s would have seen an appreciating not a depreciating yen. There never would have occurred the seeming anomaly that very rapid growth in Japanese exports was rewarded by still further declines in the Japanese yen. This perverse development made possible the enormous increase in the Japanese trade surplus which went on during much of the 1980s. With Japan's Foreign Exchange Control Law unrevised, a rising yen would have choked off Japan's surplus and the large increases in imports and in domestic investment which are now such an important part of the Japanese economic landscape might have come almost a decade ago. It is important to remember that the American-Japanese financial lifeline, newly created in the 1980s, helped delay the domestic reorientation of the Japanese economy for the better part of a decade. American success at exporting financial obligations kept Japan busy at exporting goods when it might have been building up just the domestic resources and amenities now urged on it by American diplomats in the context of the Structural Impediments Initiative negotiations.

Financial Blackmail?

While the American-Japanese financial alliance shaped the 1980s bringing many achievements for the United States, sometimes at Japanese expense, it has meant a major transformation of the American balance sheet. During the years between 1980 and 1988, the United States net credit with the rest of the world deteriorated by \$800 billion. A swing of this magnitude is historically unprecedented. Quite apart from familiar concerns that foreign borrowing means that future increases in American productivity may be heavily mortgaged, this change in the American balance sheet has led to alarm that American prosperity is newly subject to the whims of Japanese and other foreign investors.

Of course, whimsey has little to do with international financial flows. In a world, where capital markets are globally integrated, and where the United States does not produce most of the world's GNP, it just isn't possible to maintain an autonomous monetary policy. It doesn't matter whether the United States is a capital exporter or a capital importer, foreign demands and foreign supplies of capital will have a very important effect on interest rates in the United States. No matter what American fiscal policies would have been in the 1980s, the financial independence many commentators long for can only be achieved if the United States adopts capital controls of just the sort that Japan took off at U.S. insistence in 1980. When such policies have been tried in the United States, they have been found wanting. Remember the ill-fated Foreign Interest Equalization Tax? Such policies would be a recipe for disaster.

If American financial autonomy is unrealistic, is it still possible that American prosperity was purchased at the cost of giving Japanese investors the financial leverage with which to influence U.S. policies? This is highly implausible. Given the large number of Japanese financial institutions, Japanese non-financial corporations, and Japanese individuals active in international financial markets, they are not much more likely to attempt to act in concert to exert pressure on American policies than are the large numbers of American, European or overseas Chinese who hold significant amounts of American financial obligations.

Concern that foreign financial consortia may somehow dictate policy to the United States, betrays a lack of understanding of the character of international financial markets. There are few markets as competitive as international financial markets. Individual participants in these markets, who find American policies ill-considered, can rearrange their financial assets accordingly. In this day and age, the typical American investor may be just as likely as any Japanese investor to exhibit concern with American policies and just as likely to act on this concern. A distinctively Japanese reaction would only be likely in the event that American policy itself sought, for whatever reason, to discourage Japanese purchase of American obligations. If it becomes American policy to discourage Japanese financing, Japanese financing will be discouraged! It is all too easy for us to be our own worst enemy. As credit tightens in the wake of U.S. financial mismanagement, it is important not to lose sight of this consideration.

The same globally integrated financial system which denies the United States financial autonomy also protects us against financial blackmail. In the hypothetical event that Japan's Ministry of Finance were to encourage Japanese financial institutions to act in concert and abdicate their prominent role in the market for U.S. long-term bonds, the effect on the American economy would still be negligible. Whether the Ministry of Finance encouraged this money to stay at home or in Europe or Hong Kong or Singapore, the now finely tuned process international arbitrage would make the equivalent funds available to American markets in short order.

APPENDIX 2

JAPANESE COMPETITION AND AMERICAN PERFORMANCE

Economic intimacy with Japan has brought benefits to the American economy well beyond the availability of Japanese finance. At the macroeconomic level, the depreciating yen which went hand in hand with the opening of the Japanese capital market to the U.S. Treasury helped

to break the back of U.S. inflationary expectations in the 1980s. The early 1980s marked the first time in almost thirty years that there was a sustained decline in the prices of imported manufactured goods. Between 1981 and the end of 1986 the price of imported goods fell continuously at an average annual rate of 1.1 percent. As late as the beginning of 1988, the price of imported goods was still lower than it had been in the beginning of 1981. These falling import prices in turn kept pressure on the prices of manufactures in the United States. For example, from the depths of the Great Depression in 1933 until 1982, the prices of producers durable equipment rose year in and year out. Since 1982 the prices of these tradeable goods have fallen almost continuously. In 1990, the prices of producer durable equipment remains a full eight percent below what they were in early 1982. In this light, it's certainly no exaggeration to suggest that cheap Japanese goods have helped to pave the way for what is now likely to be fondly remembered as the longest peacetime expansion in American history.

At the microeconomic level, Japanese competitive pressure has forced improvements in the efficiency of many areas of the American economy. The great success of the various GATT rounds of trade liberalization culminating in the final Tokyo Round agreements in 1979 (and a by no means certain encore in the Uruguay Round this year) has opened the American economy for almost the first time to the full blast of the competitive pressures of the global marketplace.

The removal of barriers at America's borders to vigorous international competition has gone on hand in hand with the deregulation of important areas of the American economy such as transportation, communication, energy and financial services. Domestic deregulation in the 1970s and 1980s removed barriers to competition which had too long sapped the efficiency of too many industries. Domestic deregulation has been at its best where the removal of barriers to competition has resulted in the entry of vigorous new competition into a hitherto complacent industry.

Like domestic deregulation, U.S. trade policy has worked to remove barriers to competition. If the test of deregulation is vigorous new entry and the destruction of artificial monopolies, foreign trade may be America's best example of success. In manufacturing industry after manufacturing industry the dramatic growth in imports over the past two decades all too clearly highlight the scale of increased competition in American markets. Japanese firms have been at the cutting edge of much of this new competition, creatively taking advantage of the new opportunities opened up by the deregulation of commerce at America's borders.

The success of trade policy in making the American economy more competitive has helped to greatly alter the use of America's Anti-Trust statutes. Recognition that much of the U.S. economy now competes in goods markets that are globally integrated has led to new definitions of market size and a sharp decline in litigation initiated by the Justice Department's Anti-Trust Division.

The benefits for the consumer which the Anti-Trust Division once hoped to achieve by pulling apart large American companies vertically and horizontally are now being delivered through the vigorous entry of Japanese and other foreign firms into the American marketplace. Not very long ago, intermediate goods and final goods industries in the United States had the power to initiate waves of cost push inflation. Labor and management could easily engage in unattractive public battles, which all too often led to lengthy strikes, as part of the process of dividing up monopoly profits earned at consumer expense. These hallmarks of an insufficiently competitive economy are happily increasingly rare. During the 1980s less than .1 percent of labor force time was lost due to work stoppages. This is just one-third the amount of the time which had been lost a decade earlier.

It is sometimes imagined that the increased competitiveness of the American economy has come at the expense of the migration of high paying jobs from the United States to Japan. There is little evidence that increased imports have resulted in a disproportionate loss of high paying American factory jobs. Indeed, just the opposite appears to be the case. The automobile and steel industries notwithstanding, the vast majority of increases in imports during the 1980s were in manufacturing industries which in the United States paid relatively low wages. During the 1980s almost half of the jobs lost to increased imports and declining exports were concentrated in the quartile of industries which paid the lowest wages.

The continuing benefits to the American economy of pulling down trade barriers can best be appreciated by examining economic performance in cases where barriers have been newly imposed. Automobiles may be the best known example here. For much of the 1980s, Japanese automobile exports to the American market were restrained by inter-governmental agreement. These restraints cost the American consumer dearly. Numerous studies indicate as a result of this agreement the prices of Japanese cars in the United States were increased by \$1000 and the prices of U.S. cars were increased by about \$1400. While rarely discussed, the automobile restraints forced on Japanese manufacturers alone cost American households annually in the 1980s, on average, as much as one-third of what the S&L bailout will cost American households annually in the 1990s.

JAPANESE DOMINATION OF THE AMERICAN ECONOMY?

Is it still possible that today's American economy, reinvigorated by increasing foreign competition, is just a transitory phenomenon? Is it possible that today's competitive American economy is just at a way station between past domination by large American firms and future domination by large Japanese firms? Such a development seems unlikely. It is no small irony that the only examples to date of Japanese producers joining together and unduly enriching themselves at the expense of American economic welfare are just those instances where they have been asked to do so by the American government itself. The restraints on the export of Japanese automobiles are just one of many such American government organized cartels of Japanese producers which over the last thirty years extend from cotton textiles, through color television sets, steel, machine tools to semi-conductors.

Absent such encouragement by the U.S. government and the Japanese government, Japanese firms have shown little inclination to collude in the American market. Even in semi-conductors where the Semiconductor Industry Association of America has regularly projected that the exit of American producers will lead to tight collusion by Japanese producers of DRAMS, aggressive price cutting continues. Despite American industry predictions that Japanese producers would use their market muscle in concert and forever keep 256K DRAMS at over \$6 a chip and 1 Megabit DRAMS at over \$12 a chip nothing of the kind has happened. Since the demise of U.S. Memories, the American joint venture which was supposedly necessary to keep Japanese producers from price gouging their American customers, chip prices rather than firming have actually collapsed. 256K DRAMS are approaching \$4 in price, while 1 Megabit DRAMS are under \$9. There continues to be every reason to believe that the prices of the current generation of chips will follow past generations and decline asymptotically towards \$3.

Regardless of American participation, the DRAM market remains ferociously competitive. It continues to deliver extraordinary product improvements while maintaining low prices and low profit margins. While American participation may not be essential to this happy result, few can doubt that American users and the American economy would be worse off if Japanese producers had not entered this industry. Given this record, the continuing pre-occupation of American trade policy and American science and technology policy with the structure of this market borders on the mysterious.

While the DRAM market may be exceptional for its performance, the overwhelming position of Japanese firms in this market is also exceptional. In general, if Japanese firms were going to dominate American economic life, there would have to be far, far greater acceleration of Japanese participation in the American economy than has taken place to date. Far from accelerating, in many areas Japanese presence already seems to have peaked. Imports from Japan as a share of the American market have been declining for the past 4 years. Of course, some of this decline in market share is being made up by the sales of Japanese firms that are now producing in the United States. For all the publicity, however, about Japanese firms setting up factories or buying out existing American firms, their presence in the American economy is still very small. Japanese firms operating in the United States account for slightly more than 1 percent of manufacturing sales in the United States and a good deal less than 1 percent of manufacturing employment. Notwithstanding the very high rates of increase in Japanese investment in American manufacturing, at current rates of activity any semblance of domination is a long way off.

Not only is Japanese investment in the United States not large, there is little evidence to date that the character of this investment poses any threat to American prosperity. For example, Japanese firms have shown no special propensity to keep high-value added activities at home while relegating menial assembly tasks to their overseas American affiliates. If anything, Japanese manufacturers have shown a greater willingness than other foreign investors to have their American manufacturing affiliates conduct significant R&D work. Honda, Mazda, Nissan and Toyota either currently have or plan to have within the next two years full engineering capability within the United States. These four firms alone have invested over \$100 million in R&D facilities in the United States and by next year will staff these facilities with as many as three thousand scientists and engineers. In light of the performance of such companies, it is hardly surprising that the U.S. Department of Commerce finds that Japanese firms operating in the United States, do significantly better than other foreign investors in providing their American employees with high paying jobs.

Japanese firms are different from other foreign investors in the American economy in the share of their components that they import from abroad and particularly in the share that they import from Japan. This might be alarming until it is remembered that more than the activities of other foreign firms, Japanese production in the United States does directly substitute for Japanese exports. Japan continues to retain (or until recently retained) a comparative advantage in most of what it is producing in the United States. Japanese manufacturing in the United States is an effort to put more value-added into the American economy, but Japanese ability to maintain and expand its market position here still rests in some significant degree on what it imports

from home. This is in marked contrast with the vast majority of European and Canadian investment in the United States.

As the character of Japanese comparative advantage shifts, there is every reason to believe that Japanese affiliated companies in the United States will follow the example of other foreign affiliated companies and buy locally produced components. There is even good reason to believe that Japanese affiliated companies will use American owned companies for most of their supplies. Even today although it is widely perceived that Japanese affiliated automakers depend overwhelmingly on parts bought from Japanese affiliated suppliers, who have followed Japanese assemblers here, a detailed GAO survey calls this perception into question. This survey found that of the 119 U.S. based suppliers used by Honda only 2 percent had Japanese affiliation. Similarly, 15 of Nissan's 121 suppliers were Japanese affiliated and 8 of the 60 suppliers used by Toyota were Japanese affiliated.

APPENDIX 4

LEARNING FROM JAPAN

Far from hurting the American economy, Japanese firms operating in the United States are helping it. Despite years of rising imports of manufactured goods from Japan, it was only when Japanese firms began to produce successfully in the United States that American firms lagging behind their Japanese competition began a dramatic reassessment of their production methods. Whatever concern Japanese firms may have about Protecting Proprietary information, it's undeniable that American managers in a number of important industries, such as automobiles, steel, machine tools and electronics, have benefitted from being able to observe Japanese methods of operation close at hand.

In the 1980s, General Motors learned from its joint venture with Toyota that spending billions of dollars for high technology does not necessarily mean high performance. The American economy was saved billions of dollars of unneeded investment as GM, observing performance in its Toyota-run Fremont, California Plant, canceled automation project after automation project. With Toyota's help it came to realize that sound management principles could often be far more cost-effective than new hardware.

Nippon Denso, a major Japanese auto parts manufacturer, supplies Mazda's Flat Rock, Michigan, plant from its own American operations down the road in Battle Creek, Michigan. Mazda's long relationship with its traditional supplier, rather than sealing in Japanese technology, has promoted its transfer to the United States. Mazda, which is 25 percent owned by Ford (a share picked up on the cheap after the celebrated Wankel Engine disaster, 15 years ago) manufactures Ford's *Probe model for the American market. Under Pressure from its long-time customer Mazda, Nippon Denso has allowed its Kalamazoo operations to be used as a training school and technology conduit for its ostensible competitors, the in-house parts manufacturing divisions at Ford.*

The quality of Japanese assembler-supplier relationships, such as Mazda with Nippon Denso, has not been lost on American observers. Traditionally, General Motors, Ford and Chrysler, when going beyond their own parts divisions for equipment, relied primarily on short period, non-exclusive contracts awarded primarily on the basis of price. Outside parts suppliers were discouraged from doing their own R&D. In, the past 4 years observation of Japanese success in the United States, however, has resulted in a dramatic change in practice. U.S. assemblers now increasingly look to single sourcing and long-term contracts with their major suppliers. With Japan's example firmly fixed in mind, major American auto parts suppliers are increasingly doing their own share to make technological improvements in their components. Many of these improvements have been demanded by the assemblers but many others have been forced upon U.S. auto parts manufacturers by competition from Japanese auto parts companies now situated in the United States and eager to become original equipment manufacturers for the Big Three. The transfer of Japanese technology and methods through Japanese transplanted firms is not confined to labor management or to assembler-supplier relations or just to the automobile, machine tool or semi-conductor industries. It extends well beyond to areas as diverse as product quality, the conduct of research and development and the relationship between a firm and its source of finance and even to industries such as transportation services and food processing. Indeed, it has been well over a century since the United States economy has been on the receiving end of so much manufacturing technology transfer.

Representative HAMILTON. Thank you, Dr. Saxonhouse.
Mr. Olmer, we welcome you back as a witness and you may proceed, sir.

STATEMENT OF LIONEL H. OLMER, PARTNER, LAW FIRM OF PAUL, WEISS, RIFKIND, WHARTON & GARRISON; FORMER U.S. UNDERSECRETARY OF COMMERCE FOR INTERNATIONAL TRADE

Mr. OLMER. Thank you, Mr. Chairman, for the privilege of appearing before you today, not as a frenzied former trade official, but hopefully as someone with a calmer perspective on the relationship between the United States and Japan, and whether or not, as you put it in your letter of invitation, interdependency is a euphemism for a growing U.S. dependence on Japan, or whether the trends are favorable to the United States.

I would like to submit a prepared statement for the record, the key points of which I will summarize briefly. I am persuaded that today the scales of dependency are in rough balance, and perhaps more so than at any other period in U.S.-Japan relations, despite serious problems that continue to be experienced by a number of American companies and certain U.S. industrial sectors.

This does, however, suggest the loss of the decisive influence that the United States had maintained over Japan throughout the postwar period.

On the other hand, in my view, "balance" is not necessarily an unfavorable condition, and the real question is whether or not equivalence, reciprocity or balance indeed exists, and whether they are sustainable.

We are at an historic watershed in U.S.-Japan relations, and I have five basic reasons for that observation.

One, the crossover in Japan's favor of economic, technological and educational trend lines, conventionally seen as critical to U.S. national welfare and international influence.

Two, the disintegration of the Soviet Union and the loss of the strategic nuclear threat that was the glue that has bound our countries closely together since the end of World War II.

Three, the prospect that world trade could be segmented into geographic spheres, the most vibrant of which, the Asia-Pacific region, could be dominated by Japan.

Four, the increasing imposition by governments of so-called local content requirements, meaning that new jobs, value-added manufacturing and unique technology must often accompany investment.

And five—and I would underscore it because I believe it is insidious and extremely important—a growing sense of resentment towards the United States by many institutions and people in Japan, based on their conviction that American criticism is unwarranted and unrelenting, a sentiment driven home to me by the observation of a Japanese friend who said that the author of *The Japan That Can Say No*—a member of Japan's Diet—would be Prime Minister if that office were won by popular election.

Against the backdrop of these watershed events, I would like to talk about three areas: the trade balance, foreign direct investment and technology.

As to the trade balance, Mr. Chairman, beyond all other criticism heaped on Japan for its huge trade surplus, for maintaining a relatively restricted investment environment resistant to foreign manufactured imports, and an underliberalized financial services market, the bold fact is that our private companies have come to depend on each other in many more ways than are revealed by government trade statistics.

Many American companies manage to succeed. Indeed, in recent years, I cannot recall instances in which U.S. industries have espoused a homogeneous position with respect to Japanese trade policies.

Companies large and small in the United States, and often well established in our folklore as American, have been on opposite sides of issues involving trade with Japan.

One company might want imposition of a quota while another would object that its own competitiveness would suffer as a result of resultant shortages.

When punitive sanctions were being sought for violations of U.S. export control laws, many of our front rank, high-tech firms pleaded with government authorities to be lenient so as not to disrupt their own supplier relationships with the offending Japanese company. And when increased tariffs on selected products were being considered because of Japan's failure to abide by the United States Trade Representative's interpretation of the bilateral agreement, USTR's candidate products drew a standing room crowd of company reps prepared to demonstrate the negative impact to the U.S. economy that would result from increasing their costs or denying them access to imports.

These examples are not anomalies or esoterica. They are the rule and not the exception to the normal conduct of international trade in today's world.

While it used to be said that access to the U.S. market was our great weapon, because without access Japanese industry would wither away, that is far too simplistic a formulation. The warp and woof of international business activity is not a zero sum game.

We would not win by stopping Japan's imports, if by "winning" we mean a calculus based on the aggregate of national interests. And likewise, we should recognize that the dislocations, inevitably to result from shutting down our market, are certain to be as severe as those resulting from sustained, one-way free access.

In 1989, U.S. multinational corporations accounted for \$193 billion, or 40 percent of total U.S. merchandise imports. In the same year, another 36 percent of the U.S. merchandise imports were accounted for by the U.S.-based subsidiaries of foreign corporations.

In effect, more than three quarters of our import bill is accounted for by two categories: imports by Japanese companies and imports by U.S. companies!

To paraphrase a 1989 General Accounting Office Report, the globalization of manufacturing has made trade balance statistics inherently unreliable. And, in fact, the U.S. trade deficit has probably been overstated.

I don't mean to obscure the problems faced by many American companies who seek to export to, manufacture in, or otherwise access the Japanese market. Many try hard and yet are not successful.

To the extent that their difficulties originate in Japanese government imposed regulation or policies, or through Japanese company behavior not sanctioned by international rules, our negotiators have a legitimate and essential role to fill, and I believe substantial progress has been achieved on behalf of many U.S. industries in recent years.

Indeed, in the last four years, while imports have increased by 30 percent in the United States, American exports have increased by 62 percent.

As to foreign direct investment, when examining the trade deficit, the focus is usually on its absolute size, but in FDI, the particular target of the investment seems to count most.

In particular, because some of Japan's FDI has touched on such sensitive areas as high profile real estate, entertainment and sophisticated technology, traditional U.S. policy regarding open investment has come under challenge.

Indeed, the contribution that Japanese FDI makes to our economy, in terms of jobs, manufacturing capacity, research and development, are often obscured.

Even by absolute standards, in 1990, Japan was in second place behind the United Kingdom, with Europe, as a whole, accounting for half again as much FDI as do all Asian nations, including Japan.

Japan's \$83.5 billion investment in property, plant and equipment in the United States in 1990 employs more than half a million people and generates approximately \$20 billion in salaries.

I think that the attractiveness of FDI is frequently revealed in state and local government bidding wars to secure commitments from foreign companies to invest.

Tax holidays, bargain real estate and assistance with financing and labor relations are some of the incentives.

Last month, the Illinois state legislature passed a resolution recommending that the U.S. Congress propose a "system of coordination and cooperation between the 50 states in matters relating to incentives to foreign firms."

Illinois felt compelled because of the importance of foreign firms to that state's economy and the stark fact that, "in competition with 49 other states who are committing significant amounts of time and energy and money to attract a greater share of foreign direct investment, Illinois slipped to sixth place in 1987 among the 50 states."

As to technology, it has often been said that the transfer of U.S. technology to Japan since World War II represented a fire sale of major proportions, whereby Japanese companies received know-how at a fraction of the original cost, which was then converted into products that flooded the American marketplace to the detriment, and sometimes the demise, of the very American companies that had made the know-how available to Japan.

And, yet, American companies appear to be no less reluctant, to this day, to forge technology sharing relationships with Japan. The flow of technology between private companies has increased dramatically.

In Attachment 2 to my prepared testimony, it is revealed the extraordinary depth and scope of private company technology sharing in the semiconductor industry, a sector that has been paid special attention by the Congress and the Administration.

In more general terms, trade in technology between Japan and the United States, measured by the exchange of royalties and license fees, continues to be favorable to the United States. Our positive balance has doubled in the years between 1986 and 1990, from \$1.2 billion to \$2.3 billion.

Thus, on the one hand, it would appear that American high-tech companies continue to see significant benefit from a permissive U.S. government policy which enables them to freely transfer sophisticated know-how to Japan.

On the other hand, foreign companies have taken a commanding lead in receiving patents from the U.S. Patent and Trademark Office, as is captured in Attachment 3 to my prepared statement.

Five of the top ten companies that issued patents by the U.S.P.T.O. in 1989 were Japanese and only two were American.

Japanese residents in the United States dominated fields such as photocopying, optical recording and electronic plotters, while their U.S.

counterparts received three quarters of all patents issued for amusement games and exercise devices.

Foreigners today receive 50 percent of all the U.S. patents.

In 1990, according to the Commerce Department, there were 85 major electronic research facilities in the United States owned by foreign companies, each employing between 20 and 200 workers. Japanese companies owned 60 of those 85 and spent about \$1 billion in R&D in the United States, or 1 percent of the total U.S. privately funded R&D budget.

Although clearly not large in absolute terms, and less perhaps than U.S. companies spend in comparable areas, that is clearly not a trivial amount, and, more significantly, it has been rising rapidly.

Until the last few years, U.S. private investment in Japan, particularly R&D, was very limited. But thanks in part to U.S. negotiators, congressional pressures and the persistence of a small number of American companies, U.S.-owned factories and R&D facilities in Japan are no longer rarities.

Many, if not most, U.S. microelectronic companies have started to do R&D in Japan, sometimes with Japanese companies and sometimes independently.

I would like to call attention to an additional area involving trade and technology that is deserving of attention, because, in my view, it may give rise to future competition and become yet another source of friction between our two countries, and that is defense-related industries.

Japanese laws currently prohibit the export of defense items. However, sales of high-tech components, subsystems and parts, which ultimately find a military application today and in the future, will find and become a natural concomitant of Japan's superb competence in microelectronics.

In the contemporary environment, given the need to economize in defense spending and to get maximum value for limited resources, major American contractors may increasingly turn to overseas suppliers rather than to their traditional domestic subcontractors, particularly when the final products are benign communications, radar, command and control, or other support systems.

Through these avenues, it may be possible for Japanese companies to avoid the political considerations that would otherwise apply and currently serve to restrict their involvement in the production of weapons systems.

And, as you know, Mr. Chairman, there is considerable interest within the American government to expand cooperative ventures between Japanese and American companies in defense production.

The FSX project is just one of several in the field, and more are certain to follow.

In conclusion, let me say that the Japanese economy, in my view, has become increasingly open to American products with sustained efforts by the Administration and congressional pressures, not to mention Japan's own genuine efforts.

It is likely that a much greater free flow of goods, technology and services will take place.

That is not to suggest that a balanced trade account with Japan in the conventional sense will emerge any time soon, primarily because of the differing character of our two economies and the globalization of manufacturing.

A huge portion of the U.S. trade deficit is dependent on the nature of the U.S. multinational corporate behavior.

As to trends in technology between Japan and the United States, there are some indicators that areas in which the United States has had entrenched su-

periority and competitiveness are now being challenged severely by Japanese industry.

Local content requirements, which are attached to FDI and imposed at the federal level, could lead to expedited investment in value-added employment in the United States, as has happened in machine tools, for example.

But this could be self-defeating if subjected to bidding wars at the state level and to mirror imaging internationally.

In any event, Mr. Chairman, and in conclusion, I would like to say that managed trade cannot substitute for a sound domestic economy, a healthy capital investment by individual corporations, and an educated and motivated work force.

Thank you again.

[The prepared statement of Mr. Olmer follows:]

PREPARED STATEMENT OF LIONEL H. OLMER

I very much appreciate the opportunity to appear before the Joint Economic Committee today to discuss important aspects of U.S.-Japan relations and to express my opinions as to whether, as you put it in your letter of invitation Mr. Chairman, ". . . interdependency has become a euphemism for growing U.S. dependency on Japan or whether the trends are favorable to the U.S."

I am persuaded that the scales of dependency are in rough balance today, perhaps more so than at any other period in U.S.-Japan relations, despite the persistence of serious problems that continue to be experienced by some American companies and a few industry sectors which seek access to Japan's markets. Although this suggests a loss of the decisive military, foreign policy, and economic influence that the United States had maintained over Japan throughout the post-war period, "balance" is not necessarily an unfavorable condition. After all, we should prefer that relations with our principal allies are guided by "equivalence," where neither party is supplicant or benefactor. The real question is whether balance and equivalence do indeed exist, and whether they are sustainable.

We are at an historic watershed in U.S.-Japan relations; allow me to suggest some of the factors which bear on this observation:

- the crossover, seemingly in Japan's favor, of economic, technologic and educational trends critical to U.S. national welfare and international influence;
- the disintegration of the Soviet Union and the consequent loss of the strategic nuclear threat that has bound our countries closely together since the end of World War II;
- the prospect that world trade may be segmented into geographic spheres, the most vibrant of which, the Asia-Pacific region, could be dominated by Japan;
- the increasing imposition by governments of "local content" requirements, meaning that new jobs, value-added manufacturing and unique technology must often accompany investment; and
- a growing sense of resentment towards the United States by many institutions and people in Japan based on their conviction that American criticism, which they see as unrelenting, is not justified—a sentiment driven home to me by the studied observation of a Japanese friend, to the effect that Shintaro Ishihara, author of *The Japan That Can Say No*, would be Prime Minister if that office were won by popular election!

The fundamental premise of Ishihara's book and that of his subsequent commentaries is that America is no longer a country to emulate, and that we are a decadent society, no longer capable of supporting our foreign policy objectives without Japanese technology and financial aid. It is unsettling, to say the least, to learn that Mr. Ishihara's hostile views are so popular given the importance of the U.S.-Japan relationship.

In my testimony, against the backdrop of these watershed events, I would like to suggest three areas for examination and discussion: the trade balance, foreign direct investment, and technology.

The Trade Balance

Beyond all of the criticism heaped on Japan for its huge trade surplus, a restricted investment environment that has also been resistant to foreign manufactured imports, and an underliberalized financial services market, the bold fact is that our private companies have come to depend on each other in more ways than are revealed by monthly U.S. government trade statistics. While U.S. companies do have dissatisfactions, an increasing number manage to succeed.

During the negotiation of virtually every single trade dispute that I am aware of in recent years, there has not been a homogenous position espoused by U.S. industries. To the contrary, companies large and small, and often well-established in our folklore as "American," have frequently been on opposite sides of issues involving trade with Japan. Machine tools, office equipment, semiconductors and steel provide graphic examples.

Where one company might want imposition of a quota, another would object that its own competitiveness would suffer from the consequent shortage. When punitive sanctions were being sought for violations of U.S. export control laws, many of our front-ranked high-technology companies pleaded with U.S. Government authorities to be lenient so as not to disrupt their own comfortable, convenient, profitable and necessary supplier relationships with the offending Japanese company. And when increased tariffs were being considered because of Japan's failure to abide by the U.S. Trade Representative's interpretation of a bilateral agreement, the "candidate" products that were suggested drew a standing room crowd of company representatives prepared to demonstrate the negative impact to the U.S. economy that would result from increasing their costs or denying them access to imports.

These examples are not anomalies or bits of esoterica; they are the rule and not exceptions to the normal conduct of international trade in today's world. The machine tool voluntary export restraint (VER) program is illustrative. In the early 1980s, the U.S. machine tool industry petitioned the President, asserting that national security was threatened because of the loss of domestic manufacturing capability to support military requirements during a defense mobilization.

In the 3 years that it took the government to agree with part of the petitioner's claims, the situation in the domestic industry grew worse. Finally, the Executive Branch decided to ask the Japanese Government to "voluntarily" restrain exports to the United States of several kinds of machine tools, and Japan responded by establishing quotas to be administered by the Ministry of International Trade and Industry (MITI).

Problems developed almost immediately because many U.S. manufacturers had nowhere else to turn for supplies of machine tools. The complexities multiplied, given the impact on the competitiveness of other segments of U.S. industry where machine tools are critically important, as, for instance, the automobile sector, which is the beneficiary of another system of voluntary export restraints by Japan that was instituted in 1981 precisely in order to restore the domestic industry's competitiveness.

The machine tool VER program finally settled down a year or so after initially authorized, and certain of its consequences make my point.

In order not to be limited by MITI's quotas (and to respond to sales orders from Detroit and elsewhere), Japanese companies quickly began investing in the United States Not to be outflanked by attempts to circumvent the VER program through a "screwdriver assembly plant," the Commerce Department instituted a regulatory "point" system that had the effect of requiring the Japanese to source higher value-added components (such as numerical controls) from U.S. companies. So far, so good, one might say, except that I recall a Commerce official asking a Japanese plant manager whether the integrated circuit bearing an American company's logo had been fabricated in the United States or Malaysia. If the latter, the Japanese machine tool manufacturer would have lost just enough "points" so that it couldn't have qualified its product as being of U.S. origin. When I related this anecdote to a senior executive of the American IC company, he indicated outrage and a willingness to lobby the Commerce Department for an exception!

The final chapter has not yet been written, but the U.S. market share of world production of machine tools has gone from 38 percent in 1980, to 32 percent in 1985, 6.7 percent in 1988, and an estimated 7 percent in 1990. The domestic base of production may be more capable of responding to emergency preparedness, but if so it won't be with an American logo. U.S. subsidiaries of foreign companies have become well established domestic manufacturers. And as the VER program is about to expire, some Japanese companies have been lobbying for its extension so as to preserve the value of their investment against the fear of lower cost imports from Korea and Taiwan!

While it used to be said that "access" to the U.S. market was our great weapon because without access Japanese industry would wither away, this is far too simplistic a formulation. It should be obvious that the warp and woof of international business activity is not a zero sum game. We would not "win" by stopping Japan's imports, if by winning we mean a calculus based on the aggregate of national interest. Likewise, we should recognize that the dislocations that would inevitably result from shutting down our market are certain to be as severe as those resulting from permitting sustained, one-way free access.

In 1989, U.S. multinational corporations imported \$85 billion worth of merchandise from their majority-owned foreign affiliates, and another \$9 billion from their minority-owned foreign affiliates. Even more telling, they imported an additional \$99 billion from affiliated foreign companies for a total of \$193 billion or 40 percent of total U.S. merchandise imports. Moreover, in the same year, another 36 percent of U.S. merchandise imports were accounted for by the U.S. based subsidiaries of foreign corporations, largely in the form of parts and components used in the manufacture of higher value-added products. (See attachment 1.) In both of these categories, substantial quantities were subsequently re-exported from the U.S., adding further weight to the proposition that the significance of international commerce is not a mere reflection of the trade account balance. Or, to paraphrase a 1989 General Accounting Office report, . . . the globalization of manufacturing has made the trade balance statistics inherently unreliable, and in fact the U.S. trade deficit has probably been overstated.

Thus, the "intractable" U.S. trade deficit with Japan is largely the result of just two categories: imports by Japanese companies and imports by U.S. companies. Moreover, in 1988, Japanese-owned U.S. affiliates exported nearly \$25 billion from the U.S., slightly more than the exports by European-owned companies in the United States. In total, more than \$50 billion worth of exports result directly from U.S. imports.

I do not mean to obscure the problems faced by many American companies who seek to export to, manufacture in or otherwise access the Japanese market, who try hard and yet are not successful. To the extent that their difficulties originate in Japanese government-imposed regulation or policy or through Japanese company behavior that is not sanctioned by international rules, our negotiators have a legitimate and essential role to fulfill. I must add that I believe substantial progress has been achieved in behalf of many U.S. industries. Total U.S. exports to Japan have increased 80 percent in 4 years and manufactured products have grown by 330 percent. By no means is this sufficient to declare that no further action is necessary, but it is certainly in my view sufficient grounds for avoiding a trade war.

Foreign Direct Investment

When examining the U.S. trade deficit, the focus is usually on its absolute size; but in matters of foreign direct investment (FDI), the particular target of the investment seems to count most. For example, although the investment in U.S. property, plant and equipment by U.S. affiliates of Japanese companies amounts to less than two percent of U.S. gross national product, because some of Japan's FDI has touched on sensitive areas such as high profile real estate, entertainment and sophisticated technology, traditional U.S. policy regarding open investment has come under challenge. The contributions Japanese FDI makes to the U.S. economy—in terms of jobs, manufacturing capacity, research and development—are often obscured in the attendant emotionalism.

Even though Japan's rate of growth in FDI during the 1980s was greater than that of any other country, it started from a very low base. And even in 1990, it is in second place, behind the United Kingdom, with Europe as a whole accounting for half again as much FDI in the United States as do all Asian nations, including Japan.

Most of Japan's FDI in the United States during the 1980s went into three areas: wholesale trade (primarily the importation of motor vehicles and parts), manufacturing and real estate.

In 1990, Japan's \$83.5 billion investment in property, plant and equipment employed well over 500,000 workers and generated more than \$20 billion in salaries.

The attractiveness of FDI is frequently revealed in state and local government "bidding wars" to secure commitments from foreign companies to invest. Tax holidays, bargain real estate, and assistance with financing and labor relations are some of the incentives used to entice foreigners to put down roots in the local economy.

Last month, the Illinois state legislature passed a resolution recommending that the U.S. Congress propose a "system of coordination and cooperation between the 50 states in matters relating to incentives to foreign firms." Illinois felt compelled because of the importance of foreign firms to the state's economy and the fact that . . . in competition with 49 other states who are committing significant amounts of time, energy and money to attract a greater share of foreign direct investment," Illinois slipped to 6th place in 1987 among the 50 states in attracting foreign investment.

Technology

It has often been said that the transfer of U.S. technology to Japan in the years following World War II represented a "fire sale" of major proportions whereby Japanese companies received know-how at a fraction of its original cost which they converted into products that flooded the American marketplace to the detriment (and sometimes the demise) of the very companies which had made the know-how available to Japan. Whether or not accurate, American companies appear to be no less reluctant to this day to forge technology sharing relationships with Japan; the flow of technology between private companies has increased dramatically. Attachment 2 depicts the extraordinary depth and scope of private company technology sharing in the semiconductor industry, a sector that has been paid special attention by the Congress and the Administration. Similar relationships exist in several other high-technology fields as well as in microelectronics.

In more general terms, trade in technology between Japan and the U.S., measured by the exchange of royalties and license fees, continues to be "favorable" to the United States. Indeed, between 1986 and 1990, the positive balance has nearly doubled, from \$1.1 to \$2.3 billion.

Thus, on the one hand, it would appear that America's high-tech companies continue to see significant benefit from a permissive U.S. Government policy which enables them to freely transfer sophisticated know-how to Japan.

On the other hand, however, foreign companies have taken a commanding lead in receiving patents from the U.S. Patent and Trademark Office, as is captured most tellingly in Attachment 3. Five of the top ten companies issued patents by the United States PTO in 1989 were Japanese, and only two were United States residents dominated fields such as photocopying, optical recording and electronic plotters, while their U.S. counterparts received 75 percent of all patents issued for amusement games and exercise devices. Overall, foreigners receive about 50 percent of all U.S. patents.

As defined by the Census Bureau, U.S. trade with Japan in 1990 in "Advanced Technology" products was over \$7 billion in deficit (\$12B in exports and \$19.4B in imports). On the positive side for the United States were aerospace, weapons, bio and nuclear technology. On the negative side were computers, telecommunications and electronics. The pattern for the first 8 months of 1991 is somewhat worse. (See attachment 4.)

According to the Commerce Department, in 1990 there were 85 major electronic research facilities in the U.S. owned by foreign companies, each employing between 20 and 200 workers. Within this total, seven European companies owned 28 United States R&D facilities and 23 Japanese companies owned 60 which were concentrated heavily in semiconductor materials and equipment. This same report concludes that not enough data is available to reach a judgment as to whether or not ". . . U.S. affiliates of foreign firms have played a role in U.S. technology development or have transferred technology out of the country." What is known, however, is that Japanese firms spend about a billion dollars on R&D in the United States each

year or about 1 percent of total U.S. privately funded R&D. Although not large in absolute terms, and less than U.S. companies spend in comparable areas, it is clearly not a trivial amount and, perhaps more significantly, it has been rising rapidly.

Until the last few years, U.S. private investment in Japan, particularly in R&D, was extremely limited. Thanks in part to U.S. negotiators, Congressional pressures and the persistence of a small number of American companies, U.S.-owned factories and research facilities in Japan are no longer rarities. Many, if not most, U.S. microelectronic companies have started to do R&D in Japan, sometimes with Japanese companies and sometimes independently. This is perhaps insignificant still in macro-economic terms, nevertheless there is a noteworthy presence of U.S. manufacturing, service companies and R&D in the Japanese economy and it is growing:

U.S. Private Company Direct Investment in Japan (1989)

- Number of people employed: 388,000.
- Total assets: \$133 billion
- Sales of \$139 billion and income of \$4 billion.

An additional area involving trade and technology deserves attention because it may give rise to future competition between Japanese and U.S. companies and become yet another source of friction: defense-related industries. Japanese laws currently prohibit the export of defense items. However, sales of high-technology components, subsystems and parts which ultimately find military application may become a natural concomitant of Japan's superb competence in micro-electronics. Given the need to economize in defense spending and to get maximum value for limited resources, major American contractors may increasingly turn to overseas suppliers rather than to traditional domestic subcontractors. Particularly when the final products are "benign" communications, radar, command and control or other support systems, it may be possible for Japanese companies to avoid the political considerations that would otherwise apply and which serve to limit their involvement in the production of "weapons systems." Moreover, there is considerable interest within the U.S. government to expand cooperative ventures between Japanese and American companies in defense production; the "FSX" project, which received much publicity (and criticism on both sides of the Pacific) is representative of several joint undertakings in the military field, and more are certain to follow.

Conclusions

The Japanese economy has become increasingly open to American products, investment and services. With sustained efforts by the Administration and Congressional pressures, not to say Japan's own genuine efforts to alter past practices that result in international opprobrium, it is likely that a much greater free flow of goods, technology and services between our two countries will take place.

This is not to suggest that a "balanced" trade account with Japan will emerge any time in the foreseeable future, basically because of the different character of our two economies and the globalization of manufacturing. A huge portion of the U.S. trade deficit is dependent on the nature of U.S. multinational corporate behavior; indeed, a mere handful of American companies are responsible for 40 percent of all U.S. merchandise imports.

As to trends in technology between Japan and the U.S., there are worrisome indicators that areas in which America has had entrenched superiority and competitiveness are being challenged severely by Japanese industry. In largest part, this does not result from Japanese government subsidies or unfair trade practices, even though such practices have been experienced and are important to individual companies. They must continue to be resisted.

"Local content" requirements which are attached to FDI imposed at the federal level could lead to expedited investment in value-added employment in the U. S., but may be self-defeating if subjected to bidding wars at the state level and to mirror-imaging internationally. In any event, they cannot substitute for a sound domestic economy, healthy capital investment by individual corporations and an educated and motivated work force.

(\$ Billions)

	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
1. U.S. Two-Way Merchandise Trade:				
Total	591.8	660.1	767.6	838.9
Imports	368.4	409.8	447.3	477.4
Exports	223.4	250.3	320.3	361.5
Balance	-145.0	-159.5	-127.0	-115.9
2. U.S. Merchandise Imports by U.S. Multinational Companies from:				
"Associated" Foreign Companies	147.3	167.1	180.9	192.6
Majority-owned Affiliates	57.3	64.9	75.6	84.8
Minority-owned Affiliates	8.2	10.6	11.7	8.8
Unaffiliated Foreign Companies	81.8	91.6	93.6	98.9
3. U.S. Merchandise Imports by U.S.-Based Subsidiaries of Foreign Companies:				
All Countries and Industries	125.7	143.5	155.5	169.7
Total of 2 and 3:	273.0	310.6	336.4	362.3

JAPANESE AND AMERICAN FIRM COOPERATION IN SEMICONDUCTORS

FIRMS	COOPERATIVE RELATIONSHIP
Motorola-Toshiba	<p>Tohoku semiconductor joint venture in operation since 12/88 producing dynamic random-access memory (DRAM) and processors.</p> <p>Memory and microprocessing unit (MPU) cooperation - Toshiba provides DRAM production technology and advises on DRAM production at Motorola's American fabrication facilities while Motorola provides Toshiba with processor technology.</p> <p>Joint venture sales company established in 10/89 for sales of Motorola products in the Japanese market.</p>
Texas Instruments-Hitachi	<p>Joint development of 16M DRAM since 1288.</p> <p>Hitachi provides TI with static random-access memory (SRAM) masks and sales assistance (sales of TI products through Hitachi's sales routes); Hitachi provides original equipment manufacturer (OEM) supply of semiconductors to TI.</p>
Intel-NMBS	<p>Virtually all NMBS-produced high-speed DRAM devices are sold under the Intel brand.</p> <p>Transfer of basic production technology for NMBS's total automation technology to Intel (contract formalized 1/90).</p>
Intel-Matsushita	Joint development of the 0.5 micron linography process technology necessary for 16M DRAM production.
AMD-Sony	Agreement in 2/90 to promote the transfer of production technology through the management of AMD's Santa Clara production facilities.
LSI Logic-Kawasaki Steel	Joint venture with Nihon Semiconductor established in 9/85 to produce the slices and masks necessary for LSI's ASIC fabrication.
LSI Logic-Sharp	SRAM mask supply.
Micron Technology-Sanyo	Contract established in 10/89 wherein Sanyo became the exclusive sales representative for Micro Technology DRAM products, using Sanyo's sales routes in Japan to serve the Japanese market.
AT&T-Mitsubishi	Contract established in 2/90 supplying AT&T 256K SRAM and 1M SRAM technology to Mitsubishi in exchange for order-made production.
AT&T-NEC	Contract established 3/90 for mutual exchange of ASIC technology (AT&T receives gate and alley technology in exchange for supplying stand-out cell technology); NEC sells specially ordered 4-byte micron produced by AT&T.
Texas Instruments-Kobe Steel	KTI semiconductor joint venture established to produce wafers for ASIC CMOS Structures.

Source: U.S.-Japan Project. "Containing Frictions: Creating a Common Economic Foundation." Tokyo: International Institute for Global Peace, 1991 (June), p. 34.

Foreign Companies Take the Lead

The 10 corporations that received the most U.S. patents.

Company	Country	Number
1978		
General Electric	United States	820
Westinghouse	United States	488
I.B.M.	United States	449
Bayer	West Germany	434
RCA	United States	423
Xerox	United States	418
Siemens	West Germany	412
Mitsubishi	Japan	387
Du Pont	United States	386
Philips	The Netherlands	364
1985		
Mitsubishi	Japan	907
Toshiba	Japan	750
Canon	Japan	723
General Electric*	United States	690
Fuji Photo Film	Japan	589
Philips	The Netherlands	581
Siemens	West Germany	562
I.B.M.	United States	549
Mitsubishi Denki	Japan	543
Bayer	Germany	442

* With the patents granted to RCA, which G E acquired in 1985, the total is 898

Source: Intellectual Property Owners Inc.

What They Are Concentrating On

Fields Japanese and U.S. residents dominated in U.S. patents granted* in 1987.

JAPAN		
Field	Number of Patents by Japanese	Percent of Total Patents
Photocopying	4,076	65%
Optical and phonographic recording	1,892	64
Photography	4,153	63
Electronic plotters	2,588	60
Magnetic disk and tape* recording	4,293	57

UNITED STATES

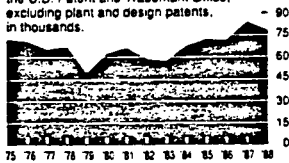
Field	Number of Patents by U.S.	Percent of Total Patents
Oil wells	3,446	88%
Fishing, trapping or vermin destroying	1,730	87
Package and article carriers	1,033	81
Amusement and exercise devices	1,622	78
Games	4,368	78

* Limited to classes with more than 1,000 patents

Source: U.S. Patent and Trademark Office

Total Patents Granted

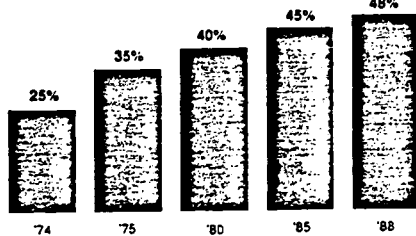
Number of patents granted each year by the U.S. Patent and Trademark Office, excluding plant and design patents, in thousands.



Source: U.S. Patent and Trademark Office

The Foreign Share Rises . . .

Percent of U.S. patents issued to residents of foreign countries.



U.S. TRADE WITH JAPAN IN ADVANCED TECHNOLOGY PRODUCTS BY ADVANCED TECHNOLOGY FIELDS: YEAR 1990

Item	Balance	Exports	Imports
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Total.....	-\$7,353,033,427	\$12,074,941,310	\$19,427,974,737
Aerospace.....	\$3,593,046,993	\$4,080,340,447	\$487,293,454
Bio technology.....	\$177,169,253	\$178,521,117	\$1,351,864
Computer Manufacturing.....	-\$510,462,128	\$593,055,052	\$1,103,517,180
Computer & Telecommunications..	-\$8,823,387,641	\$4,232,548,395	\$13,055,936,036
Electronics.....	-\$1,815,520,890	\$933,473,838	\$2,748,994,728
Life Science.....	-\$56,474,585	\$690,118,058	\$746,592,643
Material Design.....	-\$44,859,604	\$437,090,320	\$481,949,924
Nuclear Technology.....	\$726,341,679	\$728,174,666	\$1,832,987
Opto-Electronics.....	-\$688,199,445	\$110,076,392	\$798,275,837
Weapons.....	\$89,312,941	\$91,543,025	\$2,230,084

U.S. TRADE WITH JAPAN IN ADVANCED TECHNOLOGY PRODUCTS BY ADVANCED TECHNOLOGY FIELDS: JANUARY TO AUGUST 1991

Item	Balance	Exports	Imports
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Total.....	-\$5,465,559,188	\$7,292,124,609	\$12,757,683,797
Aerospace.....	\$1,718,406,923	\$2,110,409,211	\$392,002,288
Bio technology.....	\$120,924,120	\$122,485,237	\$1,561,117
Computer Manufacturing.....	-\$375,006,011	\$444,041,606	\$819,047,617
Computer & Telecommunications..	-\$4,641,631,920	\$2,779,231,131	\$7,420,863,051
Electronics.....	-\$1,450,720,968	\$745,260,509	\$2,195,981,477
Life Science.....	-\$398,084,386	\$194,209,920	\$592,294,306
Material Design.....	\$23,910,249	\$321,558,255	\$297,648,006
Nuclear Technology.....	\$413,914,451	\$415,195,554	\$1,281,103
Opto-Electronics.....	-\$939,846,983	\$95,378,926	\$1,035,225,909
Weapons.....	\$62,575,337	\$64,354,260	\$1,778,923

Representative HAMILTON. Thank you, Mr. Olmer.

We now go to Dr. Mochizuki. We will hear from you and then turn to questions.

**STATEMENT OF MIKE M. MOCHIZUKI, ASSISTANT PROFESSOR,
SCHOOL OF INTERNATIONAL RELATIONS, UNIVERSITY OF SOUTH-
ERN CALIFORNIA, LOS ANGELES**

Dr. MOCHIZUKI. Thank you for this opportunity to share with your Committee my thoughts about U.S.-Japan relations.

Although many have referred to the U.S.-Japanese relationship as the most important bilateral relationship in the world, our government has paid insufficient attention to it.

Of course, this is understandable given the dramatic events that have taken place during the past two years in Eastern Europe, the Soviet Union and the Middle East.

But the rise of Japan as a global economic superpower is a development no less profound and momentous than the revolutionary developments in Europe and what remains of the Soviet Union. Indeed, the rise of Japan is likely to have even greater implications in the long run for U.S. national interests and foreign policy than the collapse of the Soviet Union.

Throughout the Cold War period, we as a nation underestimated Japan's economic capabilities and potential just as much as we overestimated the strengths of the Soviet system. Now, that the Cold War is over, I hope that we do not continue to make the same mistake.

Today, I would like to address the following three questions which you posed in your invitation to testify before this Committee:

One, is the United States becoming too dependent upon Japan?

Two, is the interdependent relationship with Japan advantageous or disadvantageous for the United States?

Three, what policies should the United States pursue towards Japan?

Let me address each of these questions in turn.

First, is the United States becoming too dependent upon Japan?

The dramatic rise of the Japanese economy relative to the United States does not mean that the United States is becoming too dependent upon Japan.

What has happened during the last 20 years is rather that the U.S.-Japan relationship has moved from one of asymmetrical interdependence in favor of the United States to one of symmetrical interdependence.

Before, Japan depended upon the United States much more than the United States depended upon Japan. For Japan, the United States was the most important export market, the most important source of technology, and the ultimate security guarantor against a Soviet threat.

For the United States, Japan was an important bulwark against Asian communism and a critical base for forward military deployments. But the United States did not depend upon Japan for export markets, capital or technology.

Now, there is a greater mutuality of dependence between Japan and the United States. In economic terms, American businesses rely increasingly on Japanese investors for capital, while the U.S. treasury needs Japanese funds to help cover the national deficit.

Japan is also now an important source of technology, and many American industrial sector see the Japanese export market as critical for their development.

In terms of security affairs, the United States is also becoming more reliant on Japanese support. With the imminent loss of our bases in the Phil-

ippines, our facilities in Japan will assume even greater importance for military logistics in the Asia-Pacific region.

During the Persian Gulf crisis, the \$13 billion financial contribution from Japan was critical for implementing our policy to drive Iraq out of Kuwait by force. Furthermore, Japan has become a key supplier of dual-use technology and components for our defense contractors.

But these trends certainly do not mean that Japan is becoming less dependent upon the United States. Despite the inroads that Japan has made into Asian markets, the United States remains the largest export market for Japanese products.

America continues to be the most attractive country for Japanese foreign direct investments. The Japanese still see U.S. corporations, laboratories and universities as critical sources of technology as well as basic scientific knowledge. And Tokyo defense planners are still concerned about a Russian military threat, and therefore view the alliance with the United States as critical for their nation's security. In short, Japan needs the United States just as much as the United States needs Japan.

This mutuality of dependence or symmetrical interdependence may be hard for many Americans to accept because we have grown accustomed to being the preeminent economic as well as military power in the world and to making major policy decision unilaterally.

But in coming to terms with the reality of interdependence, we should not go to the other extreme of being alarmed about our reliance on Japan and trying to reestablish our autonomy through an isolationist "fortress America" policy.

The second question concerns whether the interdependent relationship with Japan is to America's advantage or disadvantage.

There is nothing intrinsic about a truly interdependent relationship that makes it advantageous (or disadvantageous) to one country over another. But I would like to emphasize the following: Japan has been brilliant in using the interdependent relationship with the United States to promote its national interests and to improve the quality of life for its citizens.

Unfortunately, the United States has been remarkably ineffective in using its interdependent relationship with Japan to do the same.

But we should not blame the Japanese for being so effective. We should instead blame ourselves, most of all our political and business leaders for grossly mismanaging the economy, for underestimating the Japanese economic challenge, and for neglecting the long-term social and economic health of this country.

In assessing the direct and indirect impact of economic interdependence on the United States, we need to distinguish between the aggregate impact and the differential impact.

At the aggregate level, there is no question that the United States is losing ground to Japan. In terms of per capita income, Japan has either caught up with the United States or surpassed the United States, depending upon the statistic one uses.

While Japanese real incomes have continued to increase, the real income of average Americans has actually declined during the last decade.

In terms of labor productivity, Japan's rate of growth is so far ahead of the United States that in the near future Japan's labor productivity will move ahead of the United States.

Japan is also taking the lead in a number of high-tech sectors, including those that have direct military applications. And Japan has become the num-

ber one creditor nation in the world, while the United States has become the number one debtor nation.

But just as critical as this aggregate impact of interdependence is the differential factor. By differential impact, I am referring to the social distribution of the costs and benefits of adjusting to the Japanese economic challenge.

As U.S. corporations and industries become less competitive vis-a-vis their Japanese counterparts, American workers employed by these companies and industries are the ones who suffer the most. They are the ones who are laid off and who are forced to eke out a living on social welfare payments.

It is an outrage that business executives continue to receive enormous salaries and supplementary benefits while seeking protectionist relief from Japanese competitors, especially when many of these executives are largely responsible for the failures of their corporations.

This social inequity threatens to destroy the very fabric of our society.

In underscoring the enormity of the problem, I do not want to characterize Japan as the new threat to the United States that has to be contained like the Soviet threat during the Cold War period.

Despite the deep social and cultural differences between Japan and the United States, Japan is a democracy—however imperfect—and does share many of our basic political values.

But if we do not respond more effectively to the Japanese economic challenge, the average American standard of living will lag far behind that of the Japanese before long. And it will become politically more difficult to sustain the close partnership that has emerged between our countries over the last 45 years.

So what policies should the United States pursue to correct these current trends?

First of all, there is much that the United States should do apart from its Japanese policy to improve the quality of life. We need to move beyond slogans and sound-bites and really get serious about improving the quality of our educational system.

Our Nation's colleges and universities are still the finest in the world, and more and more Japanese are seeking higher education in the United States.

But the American educational system at the pre-college level has deteriorated so much so that our young people lag far behind their Asian and European counterparts in terms of basic reading, writing and mathematical skills.

We desperately need to change the incentive structure to encourage our most talented and hardworking college graduates to go into teaching, social service or manufacturing rather than becoming lawyers or investment bankers.

We need to create productive jobs for the unemployed and harness their energy to rebuild America's basic infrastructure. And we need to guarantee basic social welfare—especially health care—so that Americans will retain a sense of social justice and hope during these difficult economic times.

Without this sense of social justice and hope, America would lose its greatest strength: the individual initiative of its citizens to improve their livelihood in an ethnically and culturally diverse society.

Second, the United States should pursue policies to turn the economic interdependence with Japan to its advantage. Let me focus on just two sets of policies: trade policy and policy towards Japanese foreign direct investment.

Regarding trade policy, we must first improve our capacity to negotiate better with the Japanese to improve market access. Compared to their Japa-

nese counterparts, American officials responsible for trade policy are much fewer in number and much less experienced in trade negotiations.

Whereas, Japanese trade officials are extremely knowledgeable about the American political process and industry and are often fluent in English, very few of our officials understand Japanese politics and economics and do not possess competency in the Japanese language.

Therefore, it is not at all surprising that we often become frustrated with Japan during the negotiating process.

Given that Japanese protectionism involves a complex web of government regulations and business practices, we should bring together the most professional and knowledgeable team of negotiators possible.

Given the enormous size of our bilateral trade and the persistence of Japanese protectionism, it is absolutely appalling that we devote so few resources to this issue and defer the task of negotiations to political appointees with little expertise about Japan.

We also need to transcend the tiresome theoretical debate between free trade and protectionism. We should acknowledge that much of our bilateral trade is either managed or protected.

When major industries such as textiles, steel, automobiles or semiconductors are hit hard by Japanese competition, even the most free-trade oriented administrations have been unable to resist political pressures for protection.

But what the United States must learn to do is to become more strategic in how protection is applied.

If the U.S. government negotiates protectionist measures with Japan, it should demand from American industry restructuring plans to improve competitiveness and equitable policies to ease the pain of adjustment for workers.

Currently, industry usually wins protectionist relief from Japanese competition without being obligated to improve its performance.

A second way to help turn the current interdependent relationship to our advantage is to regulate Japanese foreign direct investments in the United States.

Because the American market is still so critical to Japanese producers, they have invested heavily in manufacturing facilities in the United States to circumvent American protectionism.

However, there are two unfortunate aspects to this process.

First, many of these plants merely assemble components imported from Japanese manufacturers. Given the low level of local content, much of the higher value-added jobs remain in Japan.

Second, state and local governments compete fiercely for these investments by offering tax breaks and other inducements. As a consequence, these Japanese manufacturing plants gain a further competitive advantage over their American-owned counterparts.

To correct this situation, the United States should insist that more of the higher value-added components in the manufacturing process be produced in the United States by American workers.

We should also insist that when Japanese firms—especially advanced parts manufacturers—set up production facilities here, they transfer their technology to American firms through joint venture arrangements.

Although such proposals may seem radical, the Japanese themselves pursued these policies in the past to gain access to American industrial technologies.

The Federal Government should also search for ways to discourage state and local governments from offering inducements to Japanese investors. Such practices only place U.S. manufacturers at a disadvantage.

In order to give American minority groups a fair opportunity to work in Japanese-owned firms in the United States, we should enforce more effectively affirmative action and other non-discrimination laws vis-a-vis Japanese corporations.

We should also enforce more effectively our antitrust laws to prevent collusive business behavior among Japanese firms in the United States that might put American firms at a disadvantage.

Although it may be difficult to press Japan to liberalize its economic practices in Japan, we can surely do what is necessary to make Japanese firms comply with American laws and regulations when they operate in the United States.

Some might oppose the above measures by arguing that such hardline policies are likely to provoke a nationalistic backlash from Japan. But I feel that we should not be overly concerned about such a reaction.

First of all, press reports of the rise of *kenbei*—the dislike of Americans—are exaggerated. Virtually all public opinion polls in Japan indicate that most Japanese continue to see the United States in favorable terms.

Second, the United States can reduce the possibility of a nationalistic backlash by the manner in which it pursues its tough policies vis-a-vis Japan.

What is most irksome to the Japanese is the American whining about Japanese competition without any serious effort to improve U.S. economic competitiveness. But if Washington would articulate and implement an effective strategy for national economic renewal and couch the policy measures regarding Japan in this overall framework, I am confident that most Japanese would be supportive.

In the final analysis, Japan would like to see a reinvigorated America.

Finally, I would like to turn to the security dimension of our Japanese policy.

Throughout the 1980s, Washington pressured Tokyo to increase its defense expenditures to counter the Soviet military threat. But, now, with the collapse of the Soviet Union, the United States should cease applying such pressure.

Continuing to pressure Japan to expand its defense budget will have two negative consequences.

First, it will make Japan's Asian neighbors more anxious about the emergence of Japanese power in an era of Soviet collapse and American decline.

Second, it will aggravate the delicate Japanese domestic political consensus behind a more active role in international security affairs that has been emerging since the mid-1970s.

Pacifist sentiments remain strong in Japan, and the United States should not force a change away from this orientation. Rather, the United States should harness this pacifism and encourage Japan to contribute to international security in a manner consistent with it.

For example, the United States could do the following. We could suggest that Japan decrease its defense spending and reallocate the savings to fund United Nations peacekeeping activities and help pay the costs of disarming the Soviet Union and destroying its nuclear weapons.

We could encourage and assist Japan in negotiating confidence and security-building measures with its neighbors in Northeast Asia, including Russia and China.

And we could become more supportive of Japanese initiatives for making international arms transfers more transparent and for linking foreign economic assistance to the military policies of the recipient countries.

Regarding the Soviet Union, Tokyo and Washington could work together to stabilize the Russian economy. For example, Japan could assist a Western effort to stabilize the Russian ruble and steer the currency towards convertibility in exchange for a return of the disputed "northern territories" and a drastic reduction in Soviet air and naval capabilities in Northeast Asia.

Washington could help by mediating between the Russian leadership and Tokyo.

Although American policymakers have often accused Japan of not contributing to international security in a manner commensurate with its economic capabilities, we have tended to brush aside without much reflection the initiatives coming out of Tokyo.

This was the case when Japan proposed a step-by-step process for ending tests of nuclear weapons.

It was also the case when Japan presented the so-called "Miyazawa plan" for dealing with the Third-World debt crisis.

It is this kind of American dismissive attitude that provokes the greatest resentment among Japanese.

But if we are willing to take seriously Japanese initiatives in the security arena while moving decisively to revitalize the U.S. economy, then firm American policies towards Japan on trade matters or foreign direct investment will not damage the bilateral relationship.

Thank you very much.

[The prepared statement of Dr. Mochizuki follows:]

PREPARED STATEMENT OF MIKE M. MOCHIZUKI

Chairman, I would first like to thank you for this opportunity to share with your Committee my thoughts about U.S.-Japan relations. Although many have referred to the U.S.-Japanese relationship as the most important bilateral relationship in the world, our government has paid insufficient attention to it. Of course, this is understandable given the dramatic events that have taken place during the past 2 years in Eastern Europe, the Soviet Union and the Middle East. But the rise of Japan as a global economic superpower is a development no less profound and momentous than the revolutionary developments in Europe and what remains of the Soviet Union. Indeed the rise of Japan is likely to have even greater implications in long run for U.S. national interests and foreign policy than the collapse of the Soviet Union.

Throughout the cold war period, we as a nation underestimated Japan's economic capabilities and potential just as much as we overestimated the strengths of the Soviet system. Now, that the cold war is over, I hope that we do not continue to make the same mistake.

Today, I would like to address the following three questions which you posed in your invitation to testify before this Committee:

1. Is the United States becoming too dependent upon Japan?
2. Is the interdependent relationship with Japan advantageous or disadvantageous for the United States?
3. What policies should the United States pursue towards Japan?

Let me address each of these questions in turn.

First, is the United States becoming too dependent upon Japan?

The dramatic rise of the Japanese economy relative to the United States does *not* mean that the United States is becoming too dependent upon Japan. What has happened during the last 20 years is rather that the U.S.-Japan relationship has moved from one of *asymmetrical* interdependence in favor of the United States to one of *symmetrical* interdependence.

Before, Japan depended upon the United States much more than the United States depended upon Japan. For Japan, the United States was the most important export market, the most important source of technology, and the ultimate security guarantor against a Soviet threat. For the United States, Japan was an important bulwark against Asian communism and a critical base for forward military deployments. But the United States did not depend upon Japan for export markets, capital or technology.

Now, there is a greater *mutuality of dependence* between Japan and the United States. In economic terms, American businesses rely increasingly on Japanese investors for capital, while the U.S. treasury needs Japanese funds to cover the national deficit. Japan is also now an important source of technology, and many American industrial sectors see the Japanese export market as critical for their development.

In terms of security affairs, the United States is also becoming more reliant on Japanese support. With the imminent loss of our bases in the Philippines, our facilities in Japan will assume even greater importance for military logistics in the Asia-Pacific region. During the Persian Gulf crisis, the \$13 billion financial contribution from Japan was critical for implementing our policy to drive Iraq out of Kuwait by force. Furthermore, Japan has become a key supplier of dual-use technology and components for defense contractors.

But these trends certainly do not mean that Japan is becoming less dependent upon the United States. Despite the States remains the largest export market for Japanese products. America continues to be the most attractive country for Japanese foreign direct investments. The Japanese still see U.S. corporations, laboratories, and universities as critical sources of technology as well as basic scientific knowledge. And Tokyo defense planners are still concerned about a Russian military threat and therefore view the alliance with the United States as critical for their nation's security. In short, Japan needs the United States just as much as the United States needs Japan.

This mutuality of dependence or symmetrical interdependence may be hard for many Americans to accept because we have grown accustomed to being the preeminent economic as well as military power in the world and to making major foreign policy decisions unilaterally. But in coming to terms with the reality of interdependence, we should not go the other extreme of being alarmed about our reliance on Japan and trying to reestablish our autonomy through an isolationist, "fortress America" policy.

The second question concerns whether the interdependent relationship with Japan is to America's advantage or disadvantage.

There is nothing intrinsic about a truly interdependent relationship that makes it advantageous (or disadvantageous) to one country over another. But I would like to emphasize the following: Japan has been brilliant in using the interdependent relationship with the United States to promote its national interests and to improve the quality of life for its citizens. Unfortunately, the United States has been remarkably ineffective in using its interdependent relationship with Japan to do the same.

But we should not blame the Japanese for being so effective. We should instead blame ourselves, most of all our political and business leaders, for grossly mismanaging the economy,

for underestimating the Japanese economic challenge, and for neglecting the long-term social and economic health of this country.

In assessing the direct and indirect impact of economic interdependence on the United States, we need to distinguish between the *aggregate impact* and the *differential impact*.

At the *aggregate level*, there is no question that the United States is losing ground to Japan. In terms of per capita income, Japan has either caught up with the United States or surpassed the United States depending upon the statistic one uses. While Japanese real incomes have continued to increase, the real income of Americans has actually declined during the last decade. In terms of labor productivity, Japan's rate of growth is so far ahead of that of the United States that in the near future Japan's labor productivity will move ahead of that of the United States. Japan is also taking the lead in a number of high-tech sectors including those that have direct military applications. And Japan has become the number one creditor nation in the world, while the United States has become the number one debtor nation.

But just as critical as this aggregate impact of interdependence is the *differential impact*. By differential impact, I am referring to the social distribution of the costs and benefits of adjusting to the Japanese economic challenge. As U.S. corporations and industries are the ones who suffer the most. They are the ones who are laid off and who are forced to eke out a living on social welfare payments. It is an outrage that business executives continue to receive enormous salaries and supplementary benefits while seeking protectionist relief from Japanese competitors—especially when many of these executives are largely responsible for the failures of their corporations. This social inequity threatens to destroy the very fabric of our society.

In underscoring the enormity of the problem, I do not want to characterize Japan as the new threat to the United States that has to be contained like the Soviet threat during the cold war period. Despite the deep social and cultural differences between Japan and the United States, Japan is a democracy—however imperfect—and does share many of our basic political values. But if we do not respond more effectively to the Japanese economic challenge, the average American standard of living will lag far behind that of the Japanese before long. And it will become politically more difficult to sustain the close partnership that has emerged between our countries over the last 45 years.

So what policies should the United States pursue to correct these current trends?

First of all, there is much that the United States should do apart from its Japan policy to improve the quality of life. We need to move beyond slogans and sound-bites and really get serious about improving the quality of our educational system. Our nation's colleges and universities are still the finest in the world, and more and more Japanese are seeking higher education in the United States. But the American educational system at the pre-college level has deteriorated so much that our young people lag far behind their Asian and European counterparts in terms of basic reading, writing and mathematical skills. We desperately need to change the incentive structure to encourage our most talented and hardworking college graduates to go into teaching, social service or manufacturing rather than becoming lawyers or investment bankers. We need to create productive jobs for the unemployed and harness their energy to rebuild America's basic infrastructure. And we need to guarantee basic social welfare—especially health care—so that Americans will retain a sense of social justice and hope during these difficult economic times. Without this sense of social justice and hope, America would lose its greatest strength: the individual initiative of its citizens to improve their livelihood in an ethnically and culturally diverse society.

Second, the United States should pursue policies to turn the economic interdependence with Japan to its advantage. Let me focus on just two sets of policies: trade policy and policy towards Japanese foreign direct investment.

Regarding trade policy, we must first improve our capacity to negotiate better with the Japanese to improve market access. Compared to their Japanese counterparts, American officials responsible for trade policy are much fewer in number and much less experienced in trade negotiations. Whereas Japanese trade officials are extremely knowledgeable about the American political process and industry and often fluent in English, very few of our officials understand Japanese politics and economics and possess competency in the Japanese language. Therefore, it is not at all surprising that we often become so frustrated with Japan during the negotiating process. Given that Japanese protectionism involves a complex web of government regulations and business practices, we should bring together the most professional and knowledgeable team of negotiators possible. Given the enormous size of our bilateral trade and the persistence of Japanese protectionism, it is absolutely appalling that we devote so few resources to this issue and defer the task of negotiations to political appointees with little expertise about Japan.

We also need to transcend the tiresome theoretical debate between free trade and protectionism. We should acknowledge that much of our bilateral trade is either managed or protected. When major industries such as textiles, steel, automobiles or semiconductors are hit hard by Japanese competition, even the most free-trade oriented administrations have been unable to resist political pressures for protection. But what the United States must learn to do is to become more strategic in how protection is applied. If the U.S. government negotiates protectionist measures with Japan, it should demand from American industry restructuring plans to improve competitiveness and equitable policies to ease the pain of adjustment for workers. Currently,

industry usually wins protectionist relief from Japanese competition without being obligated to improve its performance.

A second way to help turn the current interdependent relationship to our advantage is to regulate Japanese foreign direct investments in the United States. Because the American market is still so critical to Japanese producers, they have invested heavily in manufacturing facilities in the United States to circumvent American protectionism. There are, however, two unfortunate aspects to this process. First, many of these plants merely assemble components imported from Japanese manufacturers. Given the low-level of local content, much of the higher value-added jobs remain in Japan. Second, state and local governments compete fiercely for these investments by offering tax breaks and other inducements. As a consequence, these Japanese manufacturing plants gain a further competitive advantage over their American-owned counterparts.

To correct this situation, the United States should insist that more of the higher value-added components in the manufacturing process be produced in the United States by American workers. We should also insist that when Japanese firms—especially advanced parts manufacturers—set up production facilities here, they transfer their technology to American firms through joint venture arrangements. Although such proposals may seem radical, the Japanese themselves pursued these policies in the past to gain access to American industrial technologies. The Federal Government should also search for ways to discourage state and local governments from offering inducements to Japanese investors. Such practices only place U.S. manufacturers at a disadvantage.

In order to give American minority groups a fair opportunity to work in Japanese-owned firms in the United States, we should enforce more effectively affirmative action and other non-discrimination laws vis-a-vis Japanese corporations. We should also enforce more effectively our antitrust laws to prevent collusive business behavior among Japanese firms in the United States that might put American firms at a disadvantage. Although it may be difficult to press Japan to liberalize its economic practices in Japan, we can surely do what is necessary to make Japanese comply with American laws and regulations when they operate in the United States.

Some might oppose the above measures by arguing that such hardline policies are likely to provoke a nationalistic backlash from Japan. But I feel that we should not be overly concerned about such a reaction. First of all, press reports of the rise of *kenbei* (the dislike of Americans) are exaggerated. Virtually all public opinion polls in Japan indicate that most Japanese continue to see the United States in favorable terms. Second, the United States reduce the possibility of a nationalistic backlash by the manner in which it pursues its tough policies vis-a-vis Japan. What is most irksome to Japanese is the American whining about Japanese competition without any serious efforts to improve U.S. economic competitiveness. But if Washington would articulate and implement an effective strategy for economic renewal and couch the policy measures regarding Japan in this overall framework, I am confident that most Japanese would be supportive. In the final analysis, Japan would like to see a reinvigorated America.

Finally, I would like to turn to the security dimension of our Japanese policy. Throughout the 1980s, Washington pressured Tokyo to increase its defense expenditures to counter the Soviet military threat. But, now, with the collapse of the Soviet Union, the United States should cease applying such pressure. Continuing to pressure Japan to expand its defense budget will have two negative consequences. First, it will make Japan's Asian neighbors more anxious about the emergence of Japanese power in an era of Soviet collapse and American decline. Second, it will aggravate the delicate Japanese domestic political consensus behind a more active role in international security affairs that has been emerging since the mid-1970s. Pacifist sentiments remain strong in Japan, and the United States should not force a change away from this orientation. Rather, the United States should harness this pacifism and encourage Japan to contribute to international security in a manner consistent with it.

For example, the United States could do the following. We could suggest that Japan decrease its defense spending and reallocate the savings to fund United Nations peacekeeping activities and help pay the costs of disarming the Soviet Union and destroying its nuclear weapons. We could encourage and assist Japan in negotiating confidence and security-building measures with its neighbors in Northeast Asia, including Russia and China. And we could become more supportive of Japanese initiatives for making international arms transfers more transparent and for linking foreign economic assistance to the military policies of the recipient countries.

Regarding the Soviet Union, Tokyo and Washington could work together to stabilize the Russian economy. For example, Japan could assist a Western effort to stabilize the Russian ruble and steer the currency towards convertibility in exchange for a return of the disputed "northern territories" and a drastic reduction in Soviet air and naval capabilities in Northeast Asia. Washington could help by mediating between the Russian leadership and Tokyo.

Although American policymakers have often accused Japan of not contributing to international security in a manner commensurate with its economic capabilities, we have tended to brush aside without much reflection the initiatives coming out of Tokyo.

This was the case when Japan proposed a step-by-step process for ending tests of nuclear weapons. It was also the case when Japan presented the so-called "Miyazawa plan" for dealing with the Third-World debt crisis. It is this kind of American dismissive attitude that provokes the greatest resentment among Japanese. But if we are willing to take seriously Japanese ini-

tiatives in the security arena while moving decisively to revitalize the U.S. economy, then firm American policies towards Japan on trade matters or foreign direct investments will not damage the bilateral relationship.

Representative HAMILTON. Thank you very much.

We will turn to questions now, and I would like to begin by getting a general impression from each one of you about the future of U.S.-Japanese relations.

Are you optimistic or pessimistic about the future? What is your general sense of it, without getting into a lot of detail? We will get into detail in a minute.

How do you feel about it?

Dr. MOCHIZUKI. I am basically optimistic about the U.S.-Japan relationship because of the mutuality of interest.

Despite the writings of Mrs. Ishihara and Shintaro, the Japanese see the United States as the most important country for Japan.

Representative HAMILTON. You think the future relationship is going to be positive, even beneficial?

Dr. MOCHIZUKI. It will be positive and beneficial. I am very pessimistic about the United States's ability to compete with the Japanese economically.

Mr. OLMER. I am reminded of an old Navy saying, "Keep the crew sullen but not mutinous."

I believe our relationship will be fractious but manageable, and there will be a mutual benefit experienced by both sides selectively.

Representative HAMILTON. You think it is going to get better in the years ahead, or worse? It has been fairly fractious in some respects.

Mr. OLMER. I think the fractiousness is going to get worse. I hope that our ability to manage it will get better.

Representative HAMILTON. Dr. Saxonhouse?

Dr. SAXONHOUSE. Given the volume of economic interactions between the two countries, given the role that the Japanese economy plays in our country, given the role that our economy plays in their country, there is no question but that there are going to be many, many frictions, particularly as the relationship is interdependent.

In the future, we will certainly not be able to dictate to Japan as we once did in the past. Because of the interdependent relationship, however, I expect that cooperation will have to be the norm.

The stake that we have in each other's economy and in a stable world order will ultimately force cooperation, even as we argue with each other more than, I think, many of us would find attractive.

Representative HAMILTON. You are on the optimistic side.

Dr. SAXONHOUSE. I am certainly optimistic.

Representative HAMILTON. Dr. Harris?

Dr. HARRIS. I would like to be guardedly optimistic.

Representative HAMILTON. That is a good diplomatic approach.

Dr. HARRIS. I also agree with my colleague, Mike Mochizuki, that the Japanese have developed effective ways of managing interdependence, and I am not sure we have yet done that.

I see a lot of uncertainty in the picture ahead. If we don't adopt those approaches, then I am quite worried.

Representative HAMILTON. Now, when you talk with the politicians and their constituents, the thing that impresses them on this relationship is how worried the American people are about the Japanese relationship.

They are worried about all the things that you have talked about this morning: the technology transfer, the foreign investment, the trade deficits and everything else.

And in all of the polls—and I think most politicians would say those polls confirm their own experience—the American people see the Japanese as a bigger threat than any other country in the world today.

In public meetings that I have been in in the last week, I am impressed with how much time we spend talking about Japan. What strikes me in your quick responses to a very general question, is how much more positive and optimistic you are about that relationship than my constituents might be about that relationship. There is an element of anger in their reaction to it.

Next, let me ask about U.S. policy.

The President is going to go to Japan in a few weeks. He is going to meet with the Prime Minister. How do you see U.S. policy today? How would you describe U.S. policy today towards Japan, and what changes would you make in that policy towards Japan? Or are you very comfortable with it?

Everybody is being very polite. Just speak up. Fire away. Dr. Saxonhouse, you go first.

Dr. SAXONHOUSE. I do want to discuss the question that you asked. I want to make one slight addendum to your remarks about your experiences with your constituents.

At the same time that there is concern about the future of U.S.-Japanese relations, I think your constituents are very, very happy to buy Japanese products, and I am quite certain that the State of Indiana has a local office in Japan and is very eager to attract Japanese investment to the various counties in Indiana.

I suspect that when it is known that a distinguished Congressman like yourself is going to Japan, perhaps some of your constituents ring up your office and say, "Couldn't you put in a good word for us with X Company or Y Company? We are trying to land that factory for our new industrial park."

There is a general concern about the rise of Japan. It reflects the more complicated world we live in today, where the United States is no longer the dominant power.

At the concrete level of individual interest, however, consumers, producers and government officials in the State of Indiana, in the State of Michigan and elsewhere, are all very eager to deal with Japan. Each have their own Japanese strategy for adjusting to the new global situation.

Now, having said that, let me turn to U.S. policy towards Japan.

President Bush, as you point out, is making a very important trip to Japan. I think it is going to get a lot of publicity. I think it is going to shape the U.S.-Japanese relationship certainly for the coming year, perhaps for a longer period of time.

And I think that it is important that President Bush in this visit address some of the most important problems facing the United States and Japan.

In particular, we face a global economy in recession. We face an American economy in recession. We face an economic disaster in the Soviet Union and in Eastern Europe. Much of the rest of Europe is also facing a recession.

Something needs to be done, and I think President Bush should call on Prime Minister Miyazawa to undertake a new large expansionary fiscal program in Japan. We need Japan to be the locomotive of the world economy.

Now, 15 years ago, we tried out the locomotive theory on Japan, and I don't think it made much sense then. Japan was a much smaller economy; it didn't import as much from the rest of the world; it was too small to pull the global economy out of a recession.

Today, Japan is a larger economy. It imports much more than it used to. A very high proportion of those imports—more than 50 percent—are manufactured products.

There is an enormous amount that an expanding Japanese economy could do to help the global economy out of a recession, indeed to help the United States out of a recession.

Exports to Japan, as my colleague on the left has pointed out, have grown rapidly from this country, particularly manufactured exports, particularly from the region of the country where you and I both reside.

These have been very important for the Midwest, and an expanding Japanese economy could do a great deal to keep factories humming in our states.

I should point out that, whereas the Japanese economy was growing very rapidly earlier in the year, this quarter the Japanese economy may actually experience negative growth, or if it doesn't experience negative growth, it will experience a very low rate of increase in its GNP.

A large fiscal package could do an enormous amount. I would suspect that we should target Japan to have a deficit in its government accounts of perhaps something as high as 1 percent of GNP.

Now, we have already agreed in principle to a program of this kind in the Structural Impediments Initiative. The Japanese government agreed to undertake \$3 trillion worth of public investment over the course of the 1990s.

At the time that this agreement was made, there was an addendum which said: where cyclical conditions demand it, the timing of these expenditures should be adjusted.

I think we ought to frontload some of that \$3 trillion in Japanese public investment. We need a rapidly growing Japanese economy.

Representative HAMILTON. So the number one item on the President's talking points when he sits down with the Prime Minister would be to say, "Mr. Prime Minister, you have to be the locomotive."

Dr. SAXONHOUSE. That is number one. Number two, we have to worry about the Uruguay Round. In particular, President Bush should call upon Prime Minister Miyazawa to stand with the other major trading countries of the world and convert all of its agricultural quotas to tariffs. In particular, it should remove the ban on imported rice.

Representative HAMILTON. We have been disappointed in the Japanese performance on GATT?

Dr. SAXONHOUSE. We have. Certainly, the Japanese should have at the very outset of the negotiations suggested that they were going to make major changes in their agricultural policy. Everything should have been on the table.

In fact, what happened was that rice, in particular, was always excluded, and I think that has been very unfortunate.

Many Japanese, of course, will come around and whisper to you that, "Don't worry, when the United States and Europe finally agree on European agricultural subsidies, of course, we will come along." But that is not a leadership role.

Representative HAMILTON. They have to lead.

Mr. Olmer, you want to answer this question too? I am going to ask each one of you to respond to it, if you would.

Mr. OLMER. If this unique opportunity devolves into a question of whether Japan should buy a few bags of rice from the United States, I think it will be a loss of monumental proportions.

Not that Japan should be permitted to maintain a ban on imports of rice, not at all. But that should not rise to the level of Prime Minister to Presidential significance.

First of all, our President must realize—and I am confident that he does—that the Prime Minister of Japan is not the counterpart of the President of the United States. Mr. Miyazawa has very severe limits on what he is able to do. He is not a powerful domestic political leader, much as we might want him to be and, I am sure, much as he would like to be.

President Bush is taking with him a number of American business leaders. I would hope that Mr. Miyazawa would have somewhere in the wings a group of counterpart Japanese businessmen who might be willing to sit down and talk about how they are going to buy more American products during the course of spending the \$3 trillion in domestic infrastructure improvements that the Japanese seem intent on embarking on in the next couple of years.

I would think that there would be an opportunity to talk about a principle that was developed in the course of U.S. trade negotiations in the last couple of years, that of getting Japanese companies to “design-in” American components.

This is a critical time for that to occur if Japan truly is going to be spending that much money.

Representative HAMILTON. Why is the President taking these business leaders? Are we going to have negotiations here? Is that one of the major purposes of the trip, to sell American products abroad?

Mr. OLMER. I am sure it is hard for you to believe, but I don't really know. [Laughter.]

I think it is nice to have a representative sampling of American blue-chip companies and large industrial conglomerates such as exist in the United States, many of whom have had successful joint ventures with Japan, many of whom are seeking additional opportunities.

I just had a couple of additional items.

I think the President has to recognize not only the limits on prime ministerial power and authority and the concomitant importance of not only the Japanese bureaucracy but the Japanese community to take action that would benefit us, but also the limitations on the Japanese economy itself.

Real estate values have started to come down. The Japanese stock market has lost, at least in paper terms, \$2 trillion in the last couple of years.

Their banks have experienced a major financial crisis. They are not going to be able to be as submissive, even if they wanted to be, to our demands.

In the end, it will fall on us to do for ourselves what is in our best interests.

I am intrigued by Professor Mochizuki's notion of establishing standards for foreign direct investment, and as I pointed out in my testimony, the State of Illinois has urged Congress to develop a policy of coordination. I think that has—

Representative HAMILTON. You think that has merit?

Mr. OLMER. I think the idea has a lot of merit.

I know it is almost heretical to suggest that we should have pronouncements on performance requirements, that the government of the United States should do that. But I certainly think it is worth exploring.

We do it when our feet are held to the fire. We have done it time and again, and usually with an end result that we are not happy with.

We have done it with semiconductors; we have done it with machine tools; we have done it in other kinds of industries. And in the end, we are not happy with it.

I think we ought to start at the beginning.

Representative HAMILTON. Dr. Mochizuki, Dr. Harris, and then Dr. Saxonhouse wanted to say something more.

Dr. MOCHIZUKI. The first thing I would like to emphasize is that although we talked a lot about Japan, there really is, when it comes down to concrete policy, a lack of attention by the U.S. government on Japanese policy.

One indication of this is that Secretary of State James Baker has spent only two nights in Tokyo since the beginning of the Bush Administration.

I also think our policies toward Japan have been unbalanced. We have always talked about what Japan needs to do without really providing a strategy of our own to revitalize our own economy.

So I agree wholeheartedly with Professor Saxonhouse, that we should ask the Japanese to become the locomotive of the world economy, but at the same time, I think President Bush would get a lot of support from the Japanese if he would unveil an American national strategy to revitalize itself and to ask for Japanese support in that plan.

Now, I agree with Mr. Olmer that Prime Minister Miyazawa is not an American president. He is a leader of just one faction. But this is not to say that there is no center of political power in Japan, although some analysts have talked about that.

There is a center of political power and it is the collective leadership of the Democratic Party. I find it strange that President Bush is taking an entourage of business leaders but not an entourage of the political leadership of this country.

I think it would make a major impression on the Japanese if the leadership of the U.S. Congress met with the entire leadership of the Japanese Liberal Democratic Party, and then he would get all of the major political figures on board, rather than trying to use the U.S.-Japanese issue to weaken the Miyazawa prime ministership.

In terms of security policy, I believe it is time for a fundamental reassessment of our security policy vis-a-vis Japan.

Up until now, because of the Soviet military threat, we insisted that Japan shoulder more of the burden for defense spending. I think President Bush should be very clear in thanking the Japanese people for their financial support in the Persian Gulf crisis. There is still a lot of resentment that the American people were not appreciative enough.

But at the same time, we should acknowledge a greater Japanese role in United Nations peacekeeping activities. With the collapse of the Soviet Union, the United Nations peacekeeping activities will be entering a crisis at time when there is greater need.

Representative HAMILTON. Should we support a permanent seat on the Security Council for Japan?

Dr. MOCHIZUKI. In the long term, I think we should move in that direction. There are a number of difficulties in revising the United Nations charter, but I think we should accept, in principle, that Japan should have a permanent seat on the United Nations Security—

Representative HAMILTON. And a larger role in the international financial institutions?

Dr. MOCHIZUKI. Certainly. Also, we should work with the Japanese to decrease the security threat in Northeast Asia.

Representative HAMILTON. Should we withdraw American troops?

Dr. MOCHIZUKI. We should not withdraw all of our American troops, but we should begin to think about what is the minimal necessary troop presence to maintain security in that region.

Representative HAMILTON. So what is your answer?

Dr. MOCHIZUKI. I think we can decrease our troop presence to half, and probably eliminate—

Representative HAMILTON. Over a period of a few years?

Dr. MOCHIZUKI. Over the period of this decade. And we should do this in conjunction with efforts to drastically reduce Soviet naval and air presence in Northeast Asia.

It should be part of a bargain in exchange for Japanese and American support for stabilizing the Russian economy.

Representative HAMILTON. Dr. Harris?

Dr. HARRIS. I think I would like to begin by, perhaps, emphasizing that we shouldn't have elevated expectations of what will come out of a visit like this.

I think a President, the Prime Minister, can set the tone and symbolic things can happen, but I am not sure that we should be too ambitious in the sense of some striking result.

Perhaps, we need to deepen the dialogue and the discussion.

I would focus on the next century. I would focus on what kind of a relationship we are looking for, and what the United States and Japan can be doing together to get ready for the century ahead in the midst of a very uncertain environment.

What people have mentioned is, improve the international rules of the game for trade, beginning with GATT. And working way beyond that into new areas like intellectual property rights, R&D subsidies, competition policy.

Unless we are able to work together in these areas, technological competition is going to intensify to the detriment of both sides and beyond.

I think, as a part of this emphasis, we have to continue to look at the differences that have been initiated under the structural impediments initiative in the two market economies, and to get a better sense of how those differences can be transcended.

There are areas like competition policy that I think will deserve a lot of attention in the future, and signaling that will be important to continue the momentum.

In addition, I would agree with others who have emphasized the security context and the new role that Japan can play in peacekeeping, perhaps in confidence building, perhaps in areas of arms transfer policy, although I think that that is less certain at this point.

But I would also extend the argument to say that we need to engage in a very deep set of discussions with the Japanese about how we define security.

They have had a much broader definition in some ways, emphasizing the economic dimensions, and I think that we need to have that discussion with them. We need to share what they have to say, not only about the role that they would like to play, but perhaps even asking what role they would like us to play.

Beyond that, I think, in the area of technology, emphasizing some global problems, the environment and so on, where we can work together over the long term, would be well-received in Japan. A lot of interest is being placed there now, anyway.

Representative HAMILTON. At the end of the discussion with the Prime Minister and his visit to Japan, what do you think, in your view, without having exaggerated expectations, where do we come out? What should be targeted as our achievement point from this visit?

Dr. HARRIS. I think we should target, as an achievement point, adding meat and bones to the phrase, "New Global Partnership."

It is a good concept. It has been raised by both American and Japanese leaders. But we have to become more precise about what we mean.

I am emphasizing the technological dimension, but I think that you could do this in other areas as well.

Representative HAMILTON. You are thinking in terms of organizational structures that are necessary?

Dr. HARRIS. Some concrete examples, yes.

Representative HAMILTON. Dr. Saxonhouse, you wanted to say something additional?

Dr. SAXONHOUSE. Just on this last point.

One thing that President Bush ought to be asking Prime Minister Miyazawa about is his Soviet Aid program. I guess we will soon need a new word instead of Soviet.

The Japanese currently have a restriction in their ODA programs. They can't provide money to areas of the world that have a per capita income of more than \$2,300.

The Soviet Union, by that regulation, is excluded.

I think President Bush should ask the Japanese to immediately revise that regulation and to contribute in a massive way to stabilizing economically that part of the world. It is a very important role for Japan to play.

They have the resources to do it. In many respects, we don't have comparable resources. And they should come forward and play the role that their economic conditions really permit.

I ask also for another chance to say something in connection with your question about why the business leaders are being brought along. It was suggested, in particular, that this was a representative grouping.

I think it is very clear it is not a representative grouping at all. There are a disproportionate number of the members of the delegation who are representatives of the automobile industry.

I only hope that what comes out of the Bush visit to Japan is not new restraints on Japanese exports of automobiles to the United States. I hope that there are no new restraints on Japanese competition in the American automobile market.

Representative HAMILTON. You were very critical in your statement of these restraints on trade. I just want to get a quick reaction from the other members of the panel, to see if they agree with you on that point.

Do all of you agree with Dr. Saxonhouse with regard to his criticism of the restraints on trade that currently exist in U.S.-Japanese relationships?

Dr. HARRIS. No.

Representative HAMILTON. You don't agree?

Dr. HARRIS. No. Although I think the problems are much deeper than just the trade issue, and I think we need to address them through articulating clearly what kinds of foreign investment we want and through building technology policy here.

Representative HAMILTON. The restraints on automobiles, whatever else we have, you think those are valid restraints?

Dr. HARRIS. At this point.

Mr. OLMER. I am the one who used the term "representative." I guess I would like to clarify it. It depends on how you define representative.

The automobile sector accounts for approximately three quarters of America's trade deficit with Japan, so taking to Japan American manufacturers of motor vehicles is indeed representative of the problems we face in terms of the trade deficit.

As to the efficacy of the trade restraints, clearly most of them have not worked, but the fact of the matter is that absent some effort at pressuring the Japanese, they wouldn't have accommodated us.

Many openings in the Japanese marketplace have come about solely, if not exclusively, because of the American trade pressures.

Representative HAMILTON. So you support these trade restraints?

Mr. OLMER. I have already said that I don't believe most of them have worked, in terms of improving the competitiveness of Detroit. But I do believe that we wouldn't have gotten as far as we have gotten with Japanese intentions regarding opening their own markets, or Japanese investment in the United States in higher value-added manufacturing.

Representative HAMILTON. On balance, you think they have been worthwhile? Meritorious?

Mr. OLMER. If I had to say yea or nay, I would say no, they are not.

Representative HAMILTON. Okay.

Dr. MOCHIZUKI. I am not against these restraints in principle. I am against the way they have been implemented in the past.

I agree with Professor Saxonhouse that in the end what it has done is that it has improved the competitiveness of Japanese industry vis-a-vis the United States.

I would be in favor of such restraints if, after negotiating with the Japanese for these restraints, we could impose upon American industries a commitment to restructure itself to improve performance, and to allocate the rising prices that will naturally come from these restraints to easing the pain of adjustment for workers.

I think it is absolutely appalling that after these restraints have been negotiated, the U.S. automobile manufacturers have increased their prices, and essentially allocated increased profits to increase their salaries, as well as to make investments in other things besides improving the performance of the industry.

Representative HAMILTON. Before I go to Senator Sarbanes, I want to have Mr. Olmer comment on your criticism of the trade negotiators. He is pretty tough on you trade negotiators with Japan, as you remember in his statement, where he talks about how we have to do a better job and that we are not as well prepared. They are more experienced and tougher negotiators, apparently.

What do you think of that? You have been involved in these negotiations. Is that true? Are we patsies for the Japanese on trade?

Mr. OLMER. No. We are not patsies.

I suppose the proof of the pudding is in the eating, and the fact of the matter is that our deficit has gotten worse. If you want to attribute that to the competence of trade negotiators, clearly they haven't functioned properly.

However, I would point out that in the last three years, the principal negotiators with respect to Japan have been fluent in Japanese—people who have gone to school there, lived and worked for a considerable period of time.

Representative HAMILTON. You think we are getting better on that point?

Mr. OLMER. We are getting better in several respects.

Increasing numbers of Americans at secondary school levels are studying Japanese. When I first went to Japan in 1958, it was a great rarity to come across a Caucasian that spoke Japanese. It is not the case any longer.

I won't say there is a profusion of Japanese-speaking trade negotiators or businessmen, but they are not rarities any longer, so we are getting better at it.

Dr. MOCHIZUKI. I agree with Mr. Olmer that there has been an increase in people who speak Japanese, but that essentially is about two or three to manage a bilateral trade relationship which involves close to \$150 billion.

In this country, we have a number of Americans who do speak Japanese. They are lawyers working for Japanese companies, or they work for Japanese banks. They are not hired by the United States Trade Representative's Office because they do not have the budget to hire these people.

And second, it is appalling that the United States Trade Representative's Office has to rely upon interns. Many of my undergraduates have worked as interns to provide needed information in negotiations.

I am sure that these students have been very effective, but the trade matter is so important that we should not have to rely on college undergraduate interns to come up with the position papers for negotiations.

Representative HAMILTON. Senator Sarbanes?

Senator SARBANES. Thank you.

I would like to ask each panel member whether you believe Japan is assuming international responsibilities in, for instance, the security area or in the economic area, commensurate with its relative worldwide economic strength.

Dr. HARRIS. I think we are beginning to see this happen, but it is a slow process, and it is going to take some time before we reach a level where either the Japanese or Americans will be satisfied, based on what we see now.

I think the biggest changes have been in the area of international financial institutes and in aid—development assistance. We see small tentative steps in the area of security.

I think probably much more could be done, as I said earlier, in the area of trade and international rules of the game.

Senator SARBANES. I take it that the answer is that you do not believe that Japan is not assuming international responsibilities commensurate with its economic trading. Is that correct?

Dr. HARRIS. I believe Japan is beginning to do this, but it will be some time before we see the full development.

Senator SARBANES. At the moment, is there a gap between the responsibilities they are assuming and their economic strength?

Dr. HARRIS. There is a gap in expectations.

Senator SARBANES. Do you think there is a gap in reality?

Dr. HARRIS. I think there is a gap. If there is a gap in expectations, then certainly—

Senator SARBANES. Expectations may be unreasonable or irrational. Let us assume reasonable and rational expectations on the basis of the strength of the Japanese economy, internationally.

Should they be assuming a heavier international responsibility?

Dr. HARRIS. Yes. They should.

Senator SARBANES. Dr. Saxonhouse?

Dr. SAXONHOUSE. I think you are quite correct when you say, as of the moment, Japan is not assuming responsibilities commensurate with its economic power.

I think the rate of change in this area is very, very rapid.

Seven years ago, Japan had only a very limited international aid program. It had very, very little in the way of expertise on how to run such international aid programs.

Today, Japan is the largest aid-giver in the world, surpassing the United States. I think the Japanese government officials have developed an enormous amount of expertise in this area.

They know how to give aid. They have opinions about how to make it work, and many of their opinions are very interesting.

Still, Japan ought to be doing more, even in aid. As I pointed out in a response to Vice Chairman Hamilton's question, Japan has been slow to help the Soviet Union.

We are facing an enormous crisis there, and there is a dramatic need for more Japanese aid. Japan is the one country today that has the available resources to make a very big contribution there.

The United States can't do it. Germany can't do it. But Japan can and should do it.

I agree with Dr. Harris that Japan should be doing more in the security area than it is currently doing. Japan ought to be doing much, much more in the area of basic research.

Japan is a great beneficiary of America's investments in basic research and development. The United States has been, over the last 100 years, continually moving the technological frontier out, and doing it in a way that the rest of the global economy can benefit from its efforts.

Japan has done very little in this area. Most of their research and development is of a proprietary character. It is beneficial for the Japanese firms that undertake it. It is very beneficial for the consumers who buy the products of these firms, and many of those are in the United States, of course.

But the kind of research and development they do is not beneficial for American firms, except in so far as they purchase Japanese products. America's knowledge base is not being expanded in a substantial way by Japanese R&D.

They ought to be making a much larger commitment to basic R&D.

I expect that one of the things that will happen on President Bush's visit to Japan is that Prime Minister Miyazawa will make a commitment for the Japanese to help fund the super-collider that is being built in Texas.

I think this will be a very substantial contribution and one in which I think the United States should welcome.

Senator SARBANES. Mr. Olmer?

Mr. OLMER. The short answer to your question, Senator Sarbanes, is I do not believe that Japan has assumed those responsibilities that we should reasonably expect. And I do not believe that the pace of change is adequate.

Senator SARBANES. Dr. Mochizuki?

Dr. MOCHIZUKI. I also agree that Japan has not contributed to international security commensurate with its economic capabilities, but I believe that the pace of change is rapid.

In relation to Japan becoming the number one foreign-aid donor, in terms of official development assistance, there is now a great deal of support among Japanese business circles to increase the percentage of official development assistance from 0.3 percent of GNP to 0.7 percent, which will make Japan more than twice that of the United States, in terms of foreign economic assistance.

Senator SARBANES. What is Japan's contribution in GNP towards defense?

Dr. MOCHIZUKI. I would like to stress that Japan's—

Senator SARBANES. What is the answer to that?

Dr. MOCHIZUKI. To its own defense, it is 1 percent of GNP.

But what must be underscored is that Japan's conception of international security is not always the same as that of the United States. Over 70 percent of the Japanese population is against the use of military force, even to promote international peace and justice; whereas, in the United States, 70 percent of the Americans feel that the use of force is appropriate.

But the Japanese are beginning to contribute greatly through nonmilitary means to promote international security.

It is the number two contributor to the United Nations. It has been the number three contributor to peacekeeping operations by the United Nations. And with the imminent collapse of the Soviet contribution to peacekeeping activities, it will move into the number two position.

Senator SARBANES. How much does that amount to as a percentage?

Dr. MOCHIZUKI. That amounts to very little. But I think Japan—

Senator SARBANES. What is the percentage of GNP for defense?

Dr. MOCHIZUKI. It is close to 5 percent.

Senator SARBANES. We have 5 percent for defense, and Japan has 1 percent for defense, right?

Dr. MOCHIZUKI. Right.

Senator SARBANES. That makes the point that they are contributing double what we are on foreign aid, but that is a small figure.

They are doing 0.7 percent of GNP and we are doing, I assume on that calculation, 0.35 percent.

Dr. MOCHIZUKI. I disagree fundamentally with the comparison that you are making, because after the end of the Cold War, I think the 5-percent GNP defense spending by the United States is too much.

So what we should not be getting from the Japanese is not 5 percent of GNP defense expenditure.

Senator SARBANES. I am not necessarily pushing for that. I thought one of the things that was interesting in your statement, as I understood it, was to suggest that instead of recognizing this gap, that the answer is not necessarily that they should rearm, but that they should assume other responsibilities in the international arena.

Dr. MOCHIZUKI. Yes.

Senator SARBANES. We should assume less on the defense side and therefore free up some resources.

But the point I want to try to get across is, if you take all international responsibilities—security and economic—a very large gap exists between the burden the United States has been carrying and the burden Japan has been carrying.

On the order of a magnitude of three to one, we have been carrying about three times the burden that Japan has been carrying, based on the figures you have given me.

If we had been spending only 1 percent of GNP on defense, we would have had a lot of money to do a lot of other things, would we not?

Dr. MOCHIZUKI. Certainly.

Senator SARBANES. This gap, in assuming responsibilities under this international framework, Japan has been able to compete in a very intense way with not only the United States, but with others as well. Is not that the case?

Dr. MOCHIZUKI. I think the Japanese, if they had been spending 4 or 5 percent of its GNP on defense, would still have been able to compete with the United States economically.

I don't think that it is the lack of a large defense budget that has been the foundation of Japan's—

Senator SARBANES. You do not think it has been a factor?

Dr. MOCHIZUKI. It has been some. It has made some contribution. But I think it is highly limited.

The way to improve our competitiveness is not to get the Japanese to go and spend more on security.

Senator SARBANES. Why should we not argue that if you have a strong economy, you should assume international responsibilities commensurate with your economic strength?

Why should the international responsibilities be carried by those whose economy is in a less strong position?

Dr. MOCHIZUKI. I agree with you wholeheartedly. I think we should ask the Japanese to contribute to international security. But it does not have to be in terms of building up its military capability.

Senator SARBANES. I am not defining it that way.

Dr. MOCHIZUKI. I think Japan is beginning to contribute much more to international security activities.

The one barrier to this, of course, is that some Japanese feel that this is unfair because it is like taxation without representation, and therefore the Japanese would like a greater voice in the United Nations Security Council.

They resent the fact that they contributed \$13 billion to the Persian Gulf crisis and that they were rarely consulted. Secretary of State Baker did not make one visit to Japan during the Persian Gulf crisis to get Japanese support.

I think the Japanese are also willing to provide an incredible amount of aid to the Soviet Union to stabilize the economy. Earlier this year, there were rumors afoot in Japan that there was a program—a \$20 billion aid program—being drafted that could have been presented to President Gorbachev if he had been willing to return the Northern Territories to Japan.

So I think the Japanese are quite ready if the right bargain can be struck between Russia and Japan to help deal with the foremost security problem today, which is how to manage the collapse of the Soviet Union.

Senator SARBANES. Let me ask the panel this question.

Some of you talked about being optimistic about the future relationship. How stable can a relationship be that has such a large trade imbalance almost at the center of it?

I worked for Walter Heller when he was the Chairman of the Council of Economic Advisors to President Kennedy in the early 1960s, and the U.S.'s economic strength was quite large, internationally, relatively speaking.

The United States ran trade surpluses, but there was a conscious effort to try to keep them within a reasonable range as a contribution toward the growth of international economy.

Now, I have to say to you, I find it difficult to see how you can have a stable relationship when the trade imbalance is as large as it has been running between the United States and Japan.

Do you find that an unstable factor in the relationship? Is not it important to get this trade balance down into a much narrower range if you want to have a more stabilized and positive and constructive relationship between the two countries?

Mr. OLMER. Senator Sarbanes, I think the word "stability" is not one I would choose to characterize the future prospects of the United States and Japanese relations.

I think there will be very serious, continuing disagreements over precisely that issue, even when, in my view, it is not entirely merited.

It is not entirely merited because so much of that trade deficit comes from the purchasing decisions of American multinational corporations, buying from their own overseas subsidiaries, and by Japanese companies in the United States from their affiliates abroad.

The thing that has to be dealt with first and foremost, in my opinion, is the continuing perception of unfairness. Sometimes it is justified that there is an unfairness, as between American and Japanese exporters to the United States.

I believe that the Japanese government—the bureaucracy and industry—must come to an accommodation in terms of their purchasing decisions on a long-term basis, to buy American products which meet their specifications as to quality and price, and so on.

And to do such, on a long-term basis, has been one of the targets of the Structural Impediments Initiative; and despite the misgivings of a number of officials that they haven't had a lot of success, I think that there has been some significant breakthrough.

Representative HAMILTON. If the gentleman would yield—

Do you believe that the Japanese market of all the major industrialized nations is the most closed market in the world?

Mr. OLMER. I would rather answer that on an industry-sector by industry-sector.

And if you allowed me to at least cover one area, telecommunications, I have a conflict. I represent both American and other Western producers. The French and the German telecommunications markets are a lot more closed than Japan's.

Representative HAMILTON. I understand you can pick sectors. But overall, is the Japanese market the most closed market in the world?

Mr. OLMER. No, sir.

Representative HAMILTON. You don't think so?

Mr. OLMER. No, sir.

Representative HAMILTON. Dr. Saxonhouse, who would be more closed?

Mr. OLMER. France. That would be my first choice.

Dr. SAXONHOUSE. The Japanese spend more on a per capita basis on U.S. imports than Americans spend on a per capita basis on Japanese imports.

Representative HAMILTON. What is that conclusion—

Dr. SAXONHOUSE. Excuse me?

Senator SARBANES. We have twice as many people as they do.

Dr. SAXONHOUSE. These are decisions made by individuals, and decisions made by individuals with comparable incomes. I think it is a little difficult to suggest that the Japanese market is the most closed market on earth when you look at those kinds of numbers.

Representative HAMILTON. Does your number suggest that the American market is more closed than the Japanese market?

Dr. SAXONHOUSE. I think it is very clear that a large proportion of Japanese trade with the United States is restrained.

I put in my testimony that over 40 percent of the Japanese exports to the United States is restrained by one or another agreement.

Representative HAMILTON. Is it your view that the American market is more closed than the Japanese market?

Dr. SAXONHOUSE. I think both markets have many restrictions. I think, in the case of Japan, there are many restrictions that should be removed. The

agricultural quotas should be removed. The tariffs on processed food should be removed.

Representative HAMILTON. You see both markets about equally closed?

Dr. SAXONHOUSE. I think it is difficult to make an overall assessment, as Mr. Olmer suggested. I think that the perception of the American public is wildly out of line with the reality. And I think that is the most important point.

On the basis of what you would read in the American news magazines and in the newspapers, you would get the impression that it is impossible for Americans to sell in Japan, and that is absolute nonsense.

This is a very important market for many, many American firms. And many, many American firms do very, very well in the Japanese market.

At the same time, there are many, many Japanese firms who could sell a great deal more in the United States, were it not for the actions of American trade policy.

The share of American products in the Japanese market is about 1.9 percent of Japanese GNP. The share of Japanese exports in the American market is about 1.8 percent of American GNP.

There is a lot that can be done in the Japanese market, and there is a lot that is being done. When the Japanese yen appreciated, this triggered an enormous increase in American manufactured exports to Japan. That is not an example of a closed market.

We export steel to Japan now. That is just an example.

Senator SARBANES. Does anyone think that you can run trade imbalances of the size that the United States has been running with Japan over a sustained period of time, and expect that there is not going to be a very sharp friction in the relationship of the countries?

Dr. HARRIS. Mr. Chairman, I don't believe that that is possible.

Senator SARBANES. What is possible?

Dr. HARRIS. That you can continue to run very large trade imbalances.

Senator SARBANES. So, if you are concerned about the U.S.-Japanese relationship and getting some of the friction out of the relationship and having them interrelate on a more positive and constructive basis, one of the first objectives would be to get this trade imbalance into a better range, would it not?

Dr. HARRIS. My personal opinion is that, yes, trade is a very important issue.

I would add to what others have said, that the composition of Japanese imports is somewhat unique. The low level of manufactured imports has been widely noted by analysts, and I think this is an area where more can be done.

Senator SARBANES. Do you think the responsibility for getting the trade balance into a better range is solely or primarily the responsibility of the country running the trade deficit? Or is there, if not an equal responsibility, certainly a significant responsibility on the country running the trade surplus?

What is your view on that question?

Mr. OLMER. I tried negotiating that very point a number of years ago. In response, a very experienced Japanese negotiator on the other side of the table said this was an extraordinary and historically unprecedented suggestion, to say that it was the responsibility of the surplus nation to reduce the character and the size of its surplus.

I believe then, and I believe now, —

Senator SARBANES. I hope you pointed out to him the responsibility that the U.S. assumed earlier in the subsequent post-World War II period when we undertook to do exactly that.

Mr. OLMER. I believed it then, I believe it today, that it is a responsibility that Japan must accept, and to a degree is accepting. Although I would argue that the pace could be improved significantly.

Dr. SAXONHOUSE. May I have a moment?

Senator SARBANES. I assume everyone will have a moment.

Dr. SAXONHOUSE. When you worked for Walter Heller, it was irresponsible of the United States to run too large of a surplus. And in the early postwar period when the United States sought to cut down its very large surplus, we were talking about the overall surplus that the United States ran with the rest of the world.

I am sure Walter Heller did not discuss the U.S. balance of payments or the U.S. balance of trade with a particular country. He talked about our overall payments relation with the rest of the world.

Senator SARBANES. Actually, Walter Heller, who was in my judgment a very wise and perceptive public policy economist, was concerned about the overall figure, and was also concerned within the overall figure about the particular figures.

That is not to suggest that each particular figure had to be in balance or at balance, but it is to suggest that he recognized that it would exacerbate the bilateral relationship with a particular country if the specific figure was allowed to run too large, even if it was offset elsewhere, so that the overall figure would be in somewhat better balance.

Now, if the overall figure is in better balance, it eases some of that pressure, but you still have a problem on the individual figure.

If the United States were running a trade surplus, even with a large imbalance with Japan, it would ease some of this problem. But I still submit to you, you still have a bilateral problem with this very large trade deficit.

Dr. SAXONHOUSE. But we have to keep in mind what are the available policy instruments.

In the mid-1980s, Japan ran a surplus in its current account that was about 5 percent of GNP. Now, that is about the same that the United States ran in the late 1940s. We had a Marshall Plan that brought down our overall surplus to a much more manageable level.

Between 1986 and 1990, Japan's 5-percent surplus went down to a little bit more than 1 percent, so I would say that in the last four years, or the four years between late 1986 and early 1991, Japan made an historic adjustment in its trade surplus.

The great tragedy was that——

Senator SARBANES. Who did they make it with?

Dr. SAXONHOUSE. The great tragedy was that the surplus did not come down with the United States to the same degree.

It did come down somewhat. It came down from about \$58 billion in 1986 to about \$40 or \$41 billion in 1990.

Senator SARBANES. It is expected now to go back up.

Dr. SAXONHOUSE. It is expected to go up.

Senator SARBANES. Who did they correct it with, Europe?

Dr. SAXONHOUSE. Almost everybody else.

Senator SARBANES. How come the Europeans do not have this trade balance problem with Japan and the United States does?

Dr. SAXONHOUSE. Senator Sarbanes, you have to remember that in 1986 the United States had experienced six years of a heavily overvalued dollar.

We were heavily overvalued with respect to the yen, and heavily overvalued with respect to every other major currency.

Senator SARBANES. That was the Donald Regan policy when he was at Treasury.

Dr. SAXONHOUSE. I think that is correct.

Senator SARBANES. Then Baker went to the Treasury, Regan went to the White House. It was a great deal for the Treasury, a bad deal for the White House. Then Baker did the Plaza Accord, and we began to get the currency in a somewhat better shape.

Dr. SAXONHOUSE. Exactly. But at the time, in 1986, we had an extraordinary deficit with Japan. Our exports to Japan were perhaps 30 percent of our imports from Japan.

So we started out from a very, very large imbalance.

Now, if your exports are only 30 percent of your imports, your exports have to grow three times as fast as your imports in order to make any dent in the bilateral imbalance.

Our exports to Japan did grow more than three times as fast as our imports from Japan. The bilateral balance did come down, but starting from such a large imbalance, which was not true of Japan's bilateral relations with any other country, this just took a long time.

And were it not for the current recession in the United States or in Japan, I would suspect that this imbalance would not be opening up again.

Senator SARBANES. How about the current recession in the United States?

Dr. SAXONHOUSE. That is hurting as well.

Senator SARBANES. The other way.

Dr. SAXONHOUSE. That's right.

Senator SARBANES. So, if neither had a recession, would we be worse off or better off?

Dr. SAXONHOUSE. I think, if neither had a recession, we would probably be better off.

Senator SARBANES. I see a lot of hands now.

Dr. HARRIS. I would like to come back to one point very briefly, and that is the nature of trade, the composition of the trade imbalance.

I think that we need to be looking at the patterns of international competition in high-technology trade, and the analyses that have been done, which compare the United States, Europe and Japan over ten years or so, that show a weakening of American capabilities in these science-based knowledge intensive areas.

I think that this is a point that deserves a great deal of attention. It means looking beyond the trade balance per se to the strengths of American industry in manufacturing.

I think that is where a lot of emphasis needs to be put in the long run if we are really going to deal with the trade balance over the next 10 or 15 years.

Senator SARBANES. My perception, and I just have to lay it out here, is that it is not a reciprocal two-way street. I do not agree with the assertion that access to the Japanese market is as open as access to the U.S. market.

I think the Europeans have played Japan's game fairly effectively, so they keep the trade relationship in much more balance. The United States has not.

We have been operating off of one set of rules, and the others operate off a different set of rules, and it is reflected in this trade imbalance.

The same thing is now happening to us with respect to the People's Republic of China, which is obviously manipulating the trade relationship.

I think important steps have been made, but the PRC's trade surplus is the result of its trade position with the United States. It runs a very positive figure with the United States and negative figures with everybody else.

What I think is happening is, the Europeans are getting export possibilities in Japan because it is put very much on those terms. You are going to take our products if we are going to take your products. When, in effect, our people are underwriting European exports into China.

I think some of that has happened with Japan, and it is my own view that they have as much a responsibility as we do to try to straighten out this trade imbalance.

Mr. OLMER. Senator Sarbanes, if I might come back to your question about explaining why the Europeans don't experience similar problems with Japan.

The Europeans have had nearly identical grief as the United States has had with respect to exporting to Japan, and I would say that a lot of our companies have had a lot happier experiences in recent years than counterpart European companies.

But on the question of Japanese exports to Europe compared with Japanese exports to the United States, I don't believe that—despite the influence of macroeconomic factors—the EC would permit as great a trade deficit with Japan on a bilateral basis as the United States has tolerated.

They would have taken steps, and have taken steps, to simply stop them, particularly in sensitive areas that are heavily protected in the EC. I have no doubt that they will continue to do that in automobiles, certainly in steel.

Negotiators have uncovered quiet agreements that don't see the newspapers, but do represent restraint of trade, perhaps not to the overall and long-term benefit of European industry, which I think lags behind ours in some of the areas that Dr. Harris has talked about. But, nonetheless, they exist.

Representative HAMILTON. The Japanese export of automobiles to Europe—at least some European countries—is very severely restricted?

Mr. OLMER. In some European countries, it is zero. In some, it is a mere token. And it was most instructive to see how the British government attempted to deal with Japanese direct investment in an automobile factory in Europe where they demanded initially 80 percent local content.

Representative HAMILTON. I think it is probably time to wrap up the hearing. We have had you here for a long time.

May I just ask a couple of quick questions, and hopefully get a very quick response.

Dr. Saxonhouse, I would be interested in knowing how you would characterize the Japanese economy. How do you describe the economy in terms of the market and so forth?

Dr. SAXONHOUSE. I would characterize Japan as a market economy. I think, in years past, it was heavily regulated, but much of this regulation has been swept away over the postwar period and most particularly within the last ten years.

Representative HAMILTON. How does it differ from the other major industrial market economies?

Dr. SAXONHOUSE. The most important difference in the Japanese economy from the other market economies is the practice of permanent employment. That there is no market for experienced workers and managers in Japan shapes a lot of the rest of the economy.

For example, with that situation, Japanese firms are loathe to be taken over by other firms with which they have had no previous relationship.

Representative HAMILTON. Mr. Olmer, you are shaking your head.

Senator SARBANES. What about this elaborate interrelationship system amongst the Japanese companies? The keiretsu system where they establish purchasing arrangements which apparently pose a real obstacle to our people trying to gain access to their markets.

In other words, all of the kinds of restraints that appear on paper—tariffs and other things—have come down, but this network of business relationship prevails.

Dr. SAXONHOUSE. We have to be very careful on the question of keiretsu. There are two different kinds of relationships that are sometimes discussed in connection with keiretsu.

One is a vertical relationship—the relationships between large Japanese companies and their suppliers. This has gotten a lot of attention recently. I think this is overdone.

Japanese firms are not vertically integrated in the same way that American firms are. For example, Toyota Motor Company is primarily just an assembler of automobiles. And then there are lots of suppliers in which Toyota would have equity interests that are separately incorporated companies, and in many cases the Toyota interest may only be a minority interest.

The important thing is to realize that Toyota's U.S. counterparts will also have suppliers with which they have long-term relationships. Those are called the Ford Auto Parts Division and the Fisher Body Company for GM, among other examples.

American automobile manufacturers have long-term relationships with companies that are vertically integrated into the main company. For example, IBM uses relatively little in the way of outside suppliers.

So, in these cases, it is very difficult for a foreign firm to sell to GM what is being produced by its in-house division. It is very difficult for a foreign firm or for another American firm to sell to IBM what is being produced by an in-house IBM division.

To the extent that Japanese companies want to have long-term relationships with particular suppliers, I don't think we should complain about that at all.

What we should ensure, however, is that if the Japanese firms want to saddle themselves with high-cost suppliers—suppliers who aren't giving them components that are as high quality and low cost as they could get from an American supplier or some other foreign suppliers—we should ensure that we can compete with them in the final goods market.

As long as we can compete with Japanese manufacturers head-to-head in the final goods market, then we shouldn't worry so much about this vertical keiretsu relationship.

That is why the Structural Impediments Initiative was so important when it took up the question of the Japanese distribution system.

To the extent that we can crack open the Japanese distribution system and allow the free entry of more Japanese firms and American distributors as well, so we can put American goods on the shelves of Japanese shops, as long as that is the case, as long as we can compete at that level, we shouldn't worry a great deal about keiretsu relationships.

Mr. OLMER. I would like to make three quick points.

One, lifetime employment is diminishing in Japan, and I am advised that less than half of the work force now benefits from it. Two, without making a value judgment on whether "keiretsu" is good or bad, in direct response to Congressman Hamilton's question, I believe that that probably is the single most important characteristic factor in addressing the Japanese economy,

and we could spend days arguing whether one kind or another is bad or indifferent, or more like us or not. But it is a major distinguishing characteristic of the Japanese economy that we have to learn more about and learn how to deal with, insofar as our interests are affected.

And the third point—Dr. Harris touched upon it, and I think it deserves a lot of attention—is the question of competition or antitrust policy.

In a truly global environment, there should be a convergence of antitrust policy, and I believe that here is an opportunity for the United States to take a leadership role. And I believe that in the last couple of years we have seen the absence of a fractious relationship between us and the European Community.

They have solicited our views, and we are closer than we have ever been before. There are some signs that the Japanese antimonopoly commission is improving its efforts at rooting anticompetitive behavior, and I believe that that should further be encouraged by the United States.

Representative HAMILTON. Two questions left.

Dr. Harris, give me a very succinct description, if you can, of the Japanese technology policy.

Dr. HARRIS. Japanese technology policy, I think, is a product of government and industry working together. It is a full-blown policy that encompasses everything from human resource development to technology diffusion, and it is also linked to a very coherent international trade and investment strategy.

Representative HAMILTON. Is there a lot of government money that flows into that?

Dr. HARRIS. The government money, in my view, is not the key point. There is a certain amount of R&D subsidy in critical areas; sometimes that can make a difference in leading the way, showing the direction. That can be important. But it is not the sheer number of yen that are being invested that makes the difference.

Representative HAMILTON. What does make the difference? The unusually close relationship?

Dr. HARRIS. I think it is the ability to mobilize resources within the private sector and the government, focusing on new areas that are based on an analysis of what kind of economic structure is desired in the future.

We have seen, over time, adjustments in the Japanese economy that have been made possible through this kind of joint action, and I don't mean to suggest that it is Japan, Inc. But I do think that there is a coherent policy.

Representative HAMILTON. Dr. Mochizuki, what is Japan's economic strategy in East Asia? Is it a strategy of economic dominance.

Dr. MOCHIZUKI. It is a strategy of increasing ties with Asia as a major export market as well as a major producer of the lower value-added products.

It is not seen as an alternative to North America, but it is seen as a hedge in case the United States moves into a neo-isolationist policy.

Representative HAMILTON. Thank you very much for your testimony this morning.

It has been a productive and very good morning, and we thank you for your testimony.

We stand adjourned.

[Whereupon, at 12:38 p.m., the Committee adjourned, subject to the call of the Chair.]