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Economic Strategy Institute

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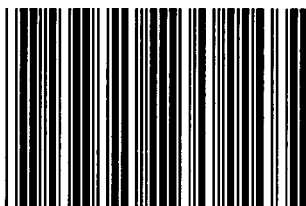
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BAUCUS

United States Senate

WASHINGTON, DC 20510-2602

Remarks of Senator Max Baucus Economic Strategy Institute March 17, 1993

Thank you all very much. I'm honored to be here, and I thank you for inviting me to speak today.

I'd like to give special greetings and thanks to the Economic Strategy Institute's Director, Clyde Prestowitz. One of America's foremost experts on Japan and on trade policy, Clyde has shown throughout his career the integrity, the commitment and the intellect we need so badly in policy debates and public service. As you know, he's appeared before my Subcommittee many times, and today I'm delighted to return the favor.

I'll begin with a saying that hasn't yet become a cliché, although it should. The US-Japanese relationship is the most important in the world today, bar none.

You all know that those are Mike Mansfield's words. As he has on so many issues, he saw it long before the rest of us. And before I begin my formal remarks, I'd like to note that Mike turned ninety yesterday, and to tell you how proud every Montanan is of him and his many years of service to our country. I'm sure you all join me in wishing this good and wise man a very happy birthday, and many more to come.

THE US-JAPANESE POLITICAL PARTNERSHIP

The US-Japanese partnership Mike Mansfield did so much to build, first as U.S. Senator and then as our Ambassador to Japan, is approaching a critical time.

For nearly fifty years, the United States and Japan both confronted the threat of the Soviet Union -- an empire of more than 300 million people, armed with nuclear weapons, a vast conventional army and a hostile ideology, facing west to Europe and east to the Pacific.

Today that empire is gone, and the Cold War has gone with it. And these events removed a principal reason for the postwar alliance between the United States and Japan. In the coming years, we're likely to see a reassessment of that alliance in both countries.

Many Americans are deeply frustrated by the trade deficits we've run with Japan for a whole generation; by the years of negotiations that have failed to eliminate it; and by Japan's perceived unwillingness to help pay the cost of world leadership. They wonder whether the alliance has cost us too much.

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In turn, many Japanese are frustrated by the same failure to make progress on trade; by the recrimination which comes a year or two after every supposed agreement; and by American indifference to Japanese views on such critical issues as China policy. They wonder whether the time has come to seek a new and more independent course in the world.

I believe neither country can afford to give up the alliance. Clyde put it well in his book Trading Places -- for better or worse, the fates of Japan and the United States will always be linked. The question is whether that creates prosperity and contributes to a more stable and peaceful world; or whether it leads to disputes, conflicts, instability and danger.

CHANGES IN JAPAN

The result of these reassessments are particularly important, since they come at a time when Japan is beginning to play the global political part its economic leadership makes inevitable.

In Cambodia, Japanese peacekeepers help make the UN more effective through their role in the Cambodian peace and elections process.

Japanese development aid has grown to equal our own at approximately \$11 billion per year, and is larger than ours as a proportion of GNP.

The \$13 billion in Japanese financial support for the Gulf War coalition, though it got off to a slow start, was a remarkable and heartening contrast to Japan's token \$10 million contribution to the protection of tankers in the Persian Gulf just three years earlier.

And we find Japanese citizens like Sadako Ogata at the UNHCR, and Yozo Yokata at the UN's Human Rights Commission, taking a lead in refugee relief and promoting human rights. This, of course, is not a government policy. But it shows that talented, well-educated Japanese now view accomplishment in these fields as worth their time and their effort, and that Japanese people believe that the world's problems are their problem too.

This is an evolutionary process, and still has a ways to go. To mention two areas where I would like to see more: aid for democracy in Russia and other former Soviet republics will not succeed without a Japanese commitment; and the world environmental crisis requires leadership as strong from Japan as from America and Europe.

All this is to say that trade is not the only aspect of the US-Japan relationship. Our political ties remain crucial to the whole world. But it is long past time to recognize that no issue is as important as trade in our relations with Japan.

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PRIORITY OF TRADE

During the Cold War we tended to view fair trade, and America's economic needs in general, as separate from and less important than our political and national security agenda. We made an implicit bargain with Japan: you follow our lead on politics and the military; in exchange we'll sacrifice our economic interest.

President Clinton says that our security depends more on a strong economy, excellence in critical technologies and open markets abroad than raw military power. I agree with him, and I welcome this vision. But to fulfill it, we must make some big changes -- perhaps nowhere more than in policy toward Japan.

RECORD OF PAST NEGOTIATIONS

Our past neglect of economic security has done us terrible harm. At the level of individual industries, it allowed Japanese businesses to not only compete, but to nearly cripple such critical American industries as autos, consumer electronics, machine tools and semiconductors. On a larger scale, it let Japan run trade surpluses with us for the past twenty years, reaching a high of \$56 billion in 1987.

Throughout this period, Presidents came and went, saying they were at last going to take trade with Japan seriously. They held talks in every conceivable forum.

They worked through the GATT. They talked the currency exchange rates up and down. They tried to stimulate Japanese consumer demand. They argued over individual industrial sectors. They even tried to change Japan's entire economic and political culture through the Strategic Impediments Initiative.

Their efforts were not entirely fruitless. Japan's tariffs and other visible barriers to trade are mostly gone. Some closed sectors opened up. Japan became the largest overseas market for American agricultural products, and our second largest market for manufactured goods.

But with the exception of Super 301, none of these talks had the results we hoped for. And the public is not foolish. They know we're not getting very far. And they're angrier and more frustrated about it every year.

JAPAN'S TRADE WITH THIRD COUNTRIES

Many, both in America and Japan, point to American failings to explain why the trade deficit doesn't go away. They argue that American goods aren't the highest quality; that American businesses don't plan and invest for the long term; that American government runs

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high budget deficits and fails to educate American children as the modern economy requires; that American citizens consume too much and spend too little.

Some of this is true. Like Ambassador Mansfield says, there are usually two sides to every issue -- and sometimes the other side is right. We have a great deal to learn from Japan, in areas like education, promotion of critical technologies and investment. And we've obviously got to fix our problems, the budget deficit first among them.

Much of it, however, is wrong. The arguments about quality are particularly troubling, especially since they are so often used as an excuse for closed markets in which competitive American products like semiconductors and auto parts have no fair chance to compete. But even if all of it was true, to say that it alone explained the trade deficit would be to ignore basic facts about Japanese trade.

Our deficit with Japan peaked at \$56 billion in 1987. In that year, we ran a global trade deficit of \$152 billion, which included a \$20.6 billion deficit with the EC, an \$11.3 billion deficit with Canada and a \$34.1 billion deficit with the East Asian NICs.

After 1987, our deficit with Japan marginally declined, then began to rise again. Yet during the same time, we cut our deficit with Canada by nearly half, cut the deficit with the NICs by 73%, and begun running a surplus with the EC. Worldwide, our deficit is now \$65 billion, two thirds of it with Japan.

Furthermore, much of the fall in our deficit with Japan stems from a shift in Japanese exports to other markets rather than growing openness to imports.

Today, nearly all developed economies have trade deficit problems with Japan as serious as ours. The EC runs a consistent \$20 billion deficit with Japan, and must run an array of VRA programs to prevent it from getting even worse. The deficits run by East Asian NICs have more than doubled from \$20 to \$52 billion since 1987.

I am happy to concede that some Japanese products are the world's best. But not all. It is simply impossible to argue that Thai rice, Korean consumer electronics, British banks and American semiconductor chips and other goods and services from all over the world could not compete in a fair Japanese market.

THE JAPANESE ECONOMY AND IMPORTS

Studies of the Japanese economy's comparative openness to imports bear this out. According to the President's Advisory Committee for Trade Policy and Negotiations, Japan imports about 5.9% of the manufactured goods its economy consumes. The US, by contrast, imports 15.3%. Excluding trade within the European Community, imported manufactures

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make up 15.4% of German consumption; 17.7% of British; 13.7% of French; and 12.6% of Italian consumption.

The experience of American firms in individual Japanese market sectors confirms in detail what this kind of study finds in general. Highly competitive US goods -- supercomputers, semiconductors, satellites, farm products, even skis and baseball bats -- simply do not find buyers in Japan without intense political pressure from the United States.

The Advisory Committee report thus recommends a big change. It says the time has come to negotiate on results rather than process. In sectors where invisible barriers block imports, they advise us to worry about rule and processes later, and to negotiate percentages of market share for imports now. We should look very seriously at these recommendations; they are made by leaders of some of America's most successful companies, and they are not made lightly.

The American Chamber of Commerce in Japan has a similar view of the Japanese market. Their recent 1993 White Paper cites a barriers to trade in thirty-four specific areas. These include markets ranging from soda ash to insurance to software, and wider problems from government procurement policy to distribution systems to patent law. The White Paper's highly diplomatic evaluation of our progress is this: "The existence of negotiations and the conclusion of agreements does not mean that problems no longer exist."

These reports are particularly compelling because they include the views of businesspeople who buy and sell things on the ground, not only economists trying to apply a theory. It's cattlemen, computer companies, insurance sellers and chemical manufacturers who see first-hand how it works in the real world -- not simply academics with a model of how it ought to work.

Japan has eliminated most visible barriers to trade. But informal barriers are still there. As four generations of American trade negotiators have discovered, they are easy to name and difficult to change.

- Preferences for long-term suppliers as opposed to competitive bidding for lowest-price, best quality products;
- Economic structures like keiretsu which further complicate the task of foreign suppliers;
- A national propensity to save and invest rather than to consume;
- A widespread view of foreign goods as a threat -- as sinister modern versions of the four black ships Commander Perry moored in Tokyo Bay so long ago.

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These are facts of life in the Japanese economy. They have endured through wild currency rate swings, stock market booms and busts, economic transformation and technological revolution.

We may dislike these facts. We may protest against them in one round of negotiation after another. At times we may well learn from them. But however we react to them, they are facts of Japanese life.

If we don't approach our trade relations with this in mind, we will continue to fail. And frustration in both America and Japan will rise, endangering a political partnership that is essential to the peace and well-being of the whole world.

SII AND SUPER 301

That brings us to the question of what approach we should use to make progress. The Structural Impediments Initiative expires this July. Although it focuses on some of the right cultural problems, I am not especially optimistic about its chances for solving them. Changing an entire nation's way of life is a pretty ambitious goal -- one which can easily lead to disappointment.

However, I do not rule out SII as part of a larger, more holistic approach to Japan policy. That can include a number of approaches. Mickey Kantor said at the Finance Committee last week that we shouldn't "slavishly adhere to one approach" when it comes to Japan, and I think he's right.

Regardless of the Administration's decision on SII, however, we need negotiations that work at the level of individual industries trying to sell their products. And if we review the past twenty years, we'll find that what works is Super 301.

In 1989, using Super 301, we cited Japan's wood product, satellite and supercomputer markets as unfairly closed to American imports. We made them a priority, and we got results.

By 1987, eleven years after the marketing of the first supercomputer, Cray and Control Data had made only one sale to the Japanese government. In 1990 and 1991, with Super 301 in force, American firms won three of nine procurement contracts. American satellite makers succeed as well. Japan is now the world's largest importer of US wood products. Both countries prosper, just as free trade theory would predict.

The lesson is if the US government makes trade a priority and backs up its negotiators with the threat of retaliation, we can make progress. If it stalls, as the American Chamber of Commerce in Japan reports we may have happened last year in supercomputers, we turn up

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the heat. So I've reintroduced Super 301. I expect Congress to pass it this year, and I expect the Administration to sign it.

LISTENING TO JAPAN

At the beginning of my remarks today, I noted the implicit bargain we made during the Cold War. You follow our political lead; in exchange we'll make economic concessions.

That bargain has never been good for us. And after the Cold War, I cannot imagine that it will survive. I've outlined the trade policy I think should replace it. But I do not want to close today without giving the other side of the new bargain.

We say we want Japan to be a world political leader. I sure do. But as Japan becomes a world political leader, we must listen much more closely to Japan's views on political issues. We too rarely understand that Japan lies in a complicated region, and that Japanese leaders have very difficult questions to answer. Some examples:

-- The Chinese economy is growing at 9% a year. Chinese military spending is growing at more than 10% a year. And China's political leadership will soon give way to a new generation with unpredictable views. How should Japan respond?

-- As we've seen this week, radical and isolated North Korea can cause a crisis at any time. If it does not, we will soon witness the end of the Kim Il Sung era, perhaps followed by Korean national reunification. What will such events mean for already difficult Korean-Japanese relations?

-- Further north, with growing concern about reform in Moscow, what will be the future of Russia and its Pacific fleet?

None of these issues are simple. All, and many others, will have a tremendous influence on Japan's future. American indifference to Japanese views on them can cripple our alliance.

If this relationship is to work, we have to remember a few things. Japan has national interests just as we do. They are important and we should respect them. As a friend and an influential East Asian democracy, Japan has worthwhile advice to give us. We should solicit that advice and we should respect it.

When the Japanese Foreign Minister, in his first meeting with our new President, says isolating China will destabilize Asia, we should take him seriously. When Japanese officials - leaders of a democracy, an ally and the second largest economy in the world -- say their country should have a permanent seat on the UN Security Council, they're absolutely right.

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CONCLUSION

Once again, the United States and Japan have the most important bilateral relationship in the world, bar none. Mike Mansfield says it all the time -- and he's right every time. We will continue to have the most important bilateral relationship in the world, whether our alliance continues or whether frustrations over trade break it up.

The end of the Cold War removes one of the old pillars of our alliance. The risks of failing to secure that alliance in the post-Cold War era are obvious and grave.

Without the threat the Soviet Union posed to both of us, failure to make progress on trade will alienate the American public. Failure to listen to Japan's views on questions of national importance will alienate the Japanese public. Disputes and conflicts will increase, and over time the US and Japan could become rivals rather than allies. It would be a long, slow, disastrous process, with terrible consequences for world trade, for the global environment, for the stability of Asia and for world peace.

It does not have to happen. If we are willing to be both tough and fair about our economic interests -- if we are open and willing to listen to Japan's political views -- we can set our partnership on a stronger base than ever before. That will be one of the most difficult tasks either of our countries faces in the years ahead; and it may well be the most important.

Thank you.