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Observations on U.S.-Japan Trade and Financial Relations

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House Committee on Foreign Affairs

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Mr. Chairmen and Members of the Subcommittees:

We are pleased to be here today to discuss our recent work on U.S.-Japan trade and financial relations.[1] The state of the relationship between the United States and Japan reflects a growing economic interdependence as well as heightened tension exacerbated, to a large extent, by record U.S. trade deficits and Japanese trade surpluses in recent years. The sheer size of the $50 billion plus bilateral trade imbalance alone has stirred protectionist sentiment and intensified concerns about restricted access to Japanese markets for U.S. exports.

One key principle of the international trading system is that governments should interfere in trade flows only when necessary (such as requiring product safety standards) or when economic conditions clearly warrant action. Whenever regulations that would restrict trade are justifiable and imposed, international trading rules call for them to be transparent, that is, well-publicized and clearly understandable. A common complaint of U.S. companies has been that many Japanese barriers stem from policies and practices which are not transparent or are otherwise questionable under international trading system principles.

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[1]U.S.-Japan Trade: Evaluation of the Market-Oriented Sector-Selective Talks (GAO/NSIAD-88-205) and Market Access Concerns of U.S. Financial Institutions in Japan (GAO/NSIAD-88-108BR).

In response to internal changes, as well as to the concerns raised and pressure exerted by the United States, the Japanese government has taken measures to restructure its economy, instituted specific tariff reductions, and participated in other market-opening initiatives--such as the Market-Oriented Sector-Selective (MOSS) talks and the U.S.-Japan Yen/Dollar agreement.

THE U.S.-JAPAN MOSS TALKS

The United States and Japan initiated the MOSS talks in 1985 as a unique attempt to address a broad range of U.S. trade concerns about Japanese trading practices. The impetus for these talks originated in a meeting between then-Prime Minister Nakasone and President Reagan in January 1985, and culminated in a joint decision to institute MOSS negotiations to begin to resolve the difficult issues surrounding the U.S.-Japan trade imbalance.

The MOSS talks were designed to provide a bilateral negotiating forum with the objective of reducing or removing all government-imposed Japanese trade barriers within selected sectors rather than negotiating specific problems on a case-by-case basis. The initial round of MOSS negotiations involved four sectors--telecommunications, electronics, medical equipment/pharmaceuticals, and forestry products--with transportation machinery/automotive parts being added as a fifth sector in 1986.

These sectors were generally selected on the basis of the following criteria.

- -- The sector had a history of wide-ranging trade complaints about either formal or informal trade barriers.
- -- The U.S. industry was internationally competitive.
- -- The products under discussion constituted a sector.
- -- U.S. market share in Japan was small.
- -- There was potential for increased U.S. sales.
- -- The U.S. industry was interested in the talks and willing to provide backup information.
- -- There were good prospects for near-term, observable results (i.e., within 3 to 5 years).

Industry representatives we contacted stated that the MOSS talks achieved varying levels of success in reducing or eliminating Japanese tariff and nontariff barriers. The agreements reached in the individual sectors are briefly summarized below.

Telecommunications

As Japan moved to privatize its government owned telecommunications monopoly, Nippon Telegraph and Telephone (NTT), the early legislative proposals provided for continued strict control of Japan's domestic telecommunications market and limited foreign access. U.S. negotiators used the opportunity presented by the privatization of NTT to push for increased foreign access. Agreements were reached that eliminated a number of restrictive standards; the number of standards in Japan were reduced from 53 to 21. And most importantly, the key performance standard of "no harm to network" was implemented, making Japan and the United States the only countries to have such a liberal standard, which allows any component or part to be used in a telecommunications system as long as it will not damage the system. In addition, the Japanese Telecommunications Business Law set up a legal framework to greatly liberalize the Japanese telecommunications market by permitting foreign and domestic companies to compete for the first time with NTT.

Medical Equipment/Pharmaceuticals

U.S. medical equipment and pharmaceutical companies faced significant barriers due to the complex regulations governing Japan's universal health care system. As a result of the MOSS talks, Japan eased requirements for testing and test data, approval and licensing of products, and the introduction of new products into its National Health Insurance reimbursement system. Japan's regulatory system was also made more transparent, allowing foreign firms additional opportunities to communicate with Japanese regulators.

Forestry Products

Forest products and paper products faced significant tariff and nontariff barriers. The major result of the Forestry MOSS talks was the reduction of tariffs for several categories of wood and paper, which was phased in between January 1986 and April 1988. Japan also altered one building standard but made no significant changes to other nontariff barriers.

Electronics

The Electronics MOSS talks lacked the definition and momentum of the other MOSS negotiations. Two of the most important issues--semiconductors and supercomputers--were negotiated outside of the MOSS framework. Although the talks were never formally concluded they did lead to a reduction in tariffs on computer parts and telecommunications equipment and establish intellectual property protection for original semiconductor chip design and computer software.

Transportation Machinery

Transportation Machinery MOSS talks (referred to informally as the Auto Parts MOSS) addressed private business practices, such as the keiretsu supplier networks, issues which are generally considered outside the realm of governmental trade negotiations. Because the focus was on private sector practices, some government officials did not feel that auto parts trade was an appropriate topic for the MOSS talks. Agreements reached involved providing information on purchasing department contacts in Japanese auto companies and collecting data for a 5-year period on Japanese auto makers' procurements from U.S. parts suppliers. Since the negotiations were completed in August 1987, it is too soon to fully judge the impact of the agreements reached. However, U.S. auto parts exports to Japan did not grow during 1987 and overall imports still account for only a small share of the multi-billion dollar Japanese auto parts market.

EVALUATION OF THE MOSS PROCESS

Our evaluation of the MOSS talks largely focused on obtaining the views of U.S. industry representatives with experience in the Japanese marketplace. Most of those interviewed were generally positive about the outcome of the negotiations, even when they did not have specific examples of direct benefits generated by the MOSS agreements. The structure of the MOSS talks was considered very important by many of the U.S. firms we contacted. In particular, the use of high-level government negotiators and the on-going interaction between government and industry were considered essential to the success of these negotiations. As one U.S. official told us, "MOSS became the code word for high level attention."

Most firms that responded to our questions felt that the MOSS agreements led to fairer treatment for their products in the Japanese market, although relatively few respondents believed that the MOSS talks alone would greatly increase their exports to the Japanese market. Many firms acknowledged that much of the responsibility for improving U.S. export sales to Japan rests on increased efforts by U.S. industry.

The value of the agreements reached varied among the five sectors and largely depended on the situation surrounding each specific sector. Timing, the type of barriers present in the market, and the degree of compatibility between U.S. and Japanese interests were each important influences.

Timing

The MOSS talks began in January 1985, just prior to the April 1985 privatization of NTT. This gave the U.S. negotiators a key "window of opportunity." A draft Japanese Telecommunications Business Law contained language that, while privatizing NTT, would have strictly controlled Japan's domestic market and continued to limit foreign access. The privatization initiative gave the U.S. negotiators a specific negotiating focus, and the legislation privatizing NTT became the vehicle for liberalizing the Japanese telecommunications market. Most importantly, Japan agreed to alter its attachment rules for terminal equipment connected to the telecommunications network, thus accepting the "no harm to network" standard proposed by the United States. This standard has been used successfully in the United States for 10 years.

Types of Barriers

The telecommunications sector and the medical equipment/pharmaceutical sectors involved the negotiation of nontariff barriers related primarily to restrictive government standards. Restrictive standards are relatively more susceptible to a successful outcome in negotiations than are private business practices, which served as the focus of the less successful transportation machinery negotiations.

Coincidence of Interests

The medical equipment/pharmaceutical negotiations were affected by the severe cost containment problems that Japan's Ministry of Health and Welfare had with the national health care system.

These cost pressures could be alleviated partly by streamlining its regulatory requirements, changes that coincided with the U.S. objective of having Japan ease its health care regulations so that the highly competitive U.S. industry would have greater access to Japan's health care market.

This coincidence of interests was similar to the circumstances surrounding the 1984 Yen/Dollar Agreement. Japan's financial markets had been tightly regulated for much of the postwar era. The U.S. government believed that deregulation of Japan's financial markets and internationalization of the yen would lead to a substantial strengthening of the then-undervalued Japanese currency. Officials of Japan's Ministry of Finance were split into two groups. Some were comfortable with the status quo, under which they had considerable influence over domestic and international flows of capital. Others felt that in order for Japan to be a major economic power into the 21st century, it had to have deep and efficient capital markets, an objective at odds with continued tight regulation. The coincidence of interests between the U.S. objectives and those of one faction in the Japanese Ministry contributed to a commitment by Japan to deregulate its tightly controlled financial markets--changes that might not have been possible at the time without both U.S. pressure and support within Japan's Ministry of Finance.

FUTURE U.S. GOVERNMENT INVOLVEMENT IN MOSS TALKS

U.S. firms strongly stressed the need for continued monitoring and on-going involvement of high-level government officials to ensure that the MOSS agreements reached are fully implemented and that Japan's markets are further liberalized. Concern remains that the United States should not "simply walk away and let Japan think that they have done enough," especially since things could "easily revert back to the way they were" prior to the MOSS negotiations.

From the perspective of many U.S. business officials, there are still significant barriers to Japan's expanding domestic markets. However, a new round of MOSS talks on a different series of sectors does not seem to be supported by either U.S. government officials or industry representatives. Some trade experts believe that these sector-selective negotiations are too expensive, both financially and in terms of the time and energy of senior government officials and business participants, to warrant a new round of talks unless clearly defined issues are identified which are susceptible to change as a result of government-to-government negotiations.

MARKET ACCESS CONCERNS OF U.S. FINANCIAL INSTITUTIONS IN JAPAN

Japan has become a crucial focus for international finance--indeed, The Tokyo Stock Exchange is now the largest in the world. Japan has gradually liberalized its financial system in recent years, a process accelerated by the benchmark Yen/Dollar Agreement in 1984. In negotiating this agreement, the U.S. Treasury sought to increase the use of the yen as an international currency, promote the development of the Euroyen market, and liberalize the Japanese capital markets by deregulating interest rates, expanding market instruments, and improving foreign access. By taking these steps, the Treasury believed the Japanese financial markets and the value of the yen would more fully reflect Japan's status as a major economic power.

We have found that, in general, progress in liberalizing Japan's financial markets has been more rapid in the international than in the domestic market. The rigidities of the regulated Japanese domestic markets affect U.S. firms' abilities to compete. For example, approximately 60 percent of bank deposits in Japan remain subject to interest rate controls and Japan has not announced a timetable for full interest rate deregulation. As late entrants to Japan's financial markets, U.S. and other foreign banks do not have large established retail networks, and therefore they do not have direct access to regulated low-cost domestic Japanese deposits. As a result, U.S. and other foreign banks rely on relatively high-cost money brokers for their funding in Japan, because Japan does not have a true interbank yen market where banking institutions borrow and lend funds among themselves.

U.S. financial institutions in Japan reported that in some areas they generally receive national treatment, i.e. the same treatment as Japanese firms. However, they still find Japan a difficult market in which to compete and have been frustrated by their lack of access to certain financial sectors. In particular, one national treatment issue remained, which also affected other foreign financial firms--limited access to the Japanese government bond market. In recent weeks, the Japanese government has announced a significant liberalization in how it will sell government bonds in the future, which should substantially improve opportunities for U.S. firms to increase their share of that market. U.S. financial firms also find it difficult to introduce new financial products that they expect to be able to market successfully. Although this is not a national treatment issue *per se*, it is a source of concern regarding outside firms' access to Japanese financial markets.

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Mr. Chairmen this concludes my prepared statement and I will be happy to respond to any questions you may have.