TRADE POLICY COMMITTEE

OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON D C 20506

December 7, 1984

MEMORANDUM FOR MEMBERS OF TRADE POLICY COMMITTEE
MEMBERS OF CABINET COUNCIL ON COMMERCE AND TRADE

FROM: WILLIAM E. BROCK

SUBJECT: U.S. Trade Policy Toward Japan

As we approach the end of our first four years in office and begin a second term, we need to review our trade relations with Japan, our largest overseas trading partner. Such a review is necessitated by the increasingly contentious nature of our bilateral trade relations.

In light of the absence of substantial new U.S. sales, and the rapid escalation of our bilateral trade deficit, it is not unreasonable to ask if we have wasted four years. I believe not, for some progress has been made. Yet it is equally true that the situation is worsening daily, and will, in all likelihood, reach a flash point in 1985. Something has to change - soon.

This paper revisits U.S. trade policy objectives with respect to Japan. It covers methods by which we have sought to achieve those objectives, assesses the status of our efforts, presents the current trade situation and projections for the future, and offers an array of possible new approaches for your consideration.

Attachment

UNCLASSIFIED WITH CONFIDENTIAL ATTACHMENT

I. THE POLICY QUESTIONS

In setting the course of our trade policy toward Japan for the next four years, we must address two fundamental questions:

our objectives: what is it that we seek to have the Japanese do?

our tactics: what means can and should we employ to induce them to do it?

During the first term of the Administration, we have placed major emphasis in our trade policy toward Japan on the objective of attaining access in the Japanese market for U.S. goods, services, and investment equivalent to that enjoyed by Japan in the U.S. market. While our formal objectives have included other goals, including expanded Japanese imports of competitive U.S. manufactured goods, our negotiating efforts have focused heavily on market access. Those efforts, which have involved four years of intensive consultations and the repeated raising of the issues at every level, up to and including the President, have produced some improvement in our access in specific areas, but no notable increase in U.S. manufactured exports to Japan. During the same period, our bilateral trade deficit with Japan has mushroomed to staggering size, this year equalling our deficit with the entire world just two years ago.

Since our deficits with other countries have mushroomed also, and since we recognize that for structural reasons Japan will inevitably run a trade surplus with the world--and with us--it may be asked why we are focusing so much on Japan. There are two reasons. First, the President is meeting the Japanese Prime Minister at this time and not the others.

Secondly, the problem with Japan is somewhat different than that with the EC, Canada, or Latin America. In those cases, exchange rates or debt problems explain most of the deficit. But in Japan the problem is more complex. Even if we assume that macroeconomic forces (growth differentials, exchange rates) explain much of the growth in the U.S.-Japan bilateral deficit, that doesn't explain why Japan's imports from all countries, Europe, Korea, Taiwan, etc., are also very low. Indeed the United States takes 58 percent of all LDC exports, while Japan with an economy about half the size takes only 8 percent.

Thus, the problem is not just U.S.-Japan. Japan does not provide much participation in its market to any country regardless of exchange rates, comparative advantages, etc. In short, Japan's economy does not respond to international market forces as it should under free trade circumstances.

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This has given rise to unequal sharing of the burden of world adjustment and to increasing feelings of unfairness and even exploitation on the part of industries and countries all over the world.

This in turn is threatening to poison not only our bilateral relationship, but indeed the whole world trading system. It is this that compels us to review our basic objectives and tactics with regard to Japan.

With regard to our objectives, there are two basic questions. The first question is whether we should deal with the issue of the bilateral deficit and Japan's low manufactured imports by continuing to seek to expand our participation in the Japanese market or by moving to limit their expansion in the U.S. market. Assuming that our overall trade policy goal continues to be opening markets, the second question, simply put, is should we continue our virtually exclusive emphasis on equal access in Japan, or simultaneously push for a substantial actual increase in Japanese imports of U.S. goods, and particularly of manufactured goods?

With regard to our tactics, the question before us hinges on our objectives. If we continue to seek the removal of barriers to access, do we do so by continuing to use verbal persuasion only, or do we in addition make use of sanctions and/or incentives, such as denying access to the U.S. market, in order to achieve a change in Japanese behavior. If we seek substantial increases in imports of U.S. products, how do we pose to the Japanese both the desired result and the mechanism to accomplish it? Do we ask for specific import targets? What role do we ask the Japanese Government to play in reaching those targets?

II. REVIEW OF THE PAST FOUR YEARS

A. Objectives

During its first term, the Administration set five objectives for U.S. trade policy toward Japan, which were formally adopted by the Trade Policy Committee in February 1983:

1. Obtaining overall access for U.S. participation in the Japanese economy in goods, services, and investment similar to that which Japan enjoys in the U.S. economy.

2. Ensuring trade composition and volume which reflect U.S. competitiveness.

3. Ensuring fair competition between U.S. and Japanese firms in U.S., Japanese, and third country markets, and eliminating distortive or disruptive effects that may arise from Japanese Government industrial policies

or corporate practices.

4. Avoiding protectionist measures.

5. Inducing Japanese leadership in free trade commensurate with Japanese economic strength and Japan's stake in the system.

The complete TPC memorandum elaborating on each of these objectives is at Tab A.

In pursuing our objectives, we undertook a dialogue with the GOJ on industrial policy, opposed domestic content and other protectionist bills in the Congress, and encouraged Japan to take the initiative in getting a "New Round" of multilateral trade liberalization negotiations underway. By far our greatest emphasis, however, was on the first objective, increasing market access. In contrast, with the exception of the NTT Agreement and the High Tech Work Group's Recommendations, we devoted little effort directly toward the second objective, that of securing Japanese action to expand their imports of competitive U.S. manufactured products.

In our efforts to obtain equivalent market access, we engaged in intensive negotiations with the Japanese over the past four years. Those negotiating efforts focused on barriers to access: removal of either generic types of barriers common to a number of products (e.g., standards and certification procedures) or barriers to specific products, services, or investments (e.g., quotas on agricultural and leather goods, tariffs on a long list of products, "Buy Japanese" policies on satellites, restrictions on telecommunications services, trust banking, legal services, and numerous others).

B. Tactics

U.S. tactics during this period were characterized by an almost total reliance on verbal persuasion. We emphasized bilateral meetings as means for raising the market access issues, ranging from Presidential/Prime Ministerial visits, a Vice-Presidential "followup" effort, and frequent exchanges of visits by Cabinet Ministers, to a series of nearly continuous visits by sub-Cabinet and working-level USG officials to Tokyo.

With the exception of consultations on a few issues at the GATT, and a single dispute settlement there (on leather), our approach has been to seek to secure Japanese market opening by attempting verbal persuasion rather than by initiating action, either unilateral or multilateral, against Japan. One tactic that was frequently discussed but not employed by the United States was the application of U.S. trade law to restrict Japanese access to the U.S. market, either to induce Japan to open its market or to retaliate against Japanese policies restricting or distorting trade. In considering a petition filed by a U.S. machine tool maker, intense debate took place within the Administration over whether to take action under Section 103 of the Revenue Act of 1971 or Section 301 of the Trade Act of 1974. In the end, no consensus could be reached among the trade-related agencies, so no action was taken.

The principal tactic of the Administration then has been "negotiation by persuasion." To add weight to our attempts at persuasion we have used Presidential and Cabinet-level visits to set the tone by which both sides approached trade problems, and to engage senior political levels in specific issues which merited highest level attention.

C. Results

In addition to specific agreements covering standards, NTT procurement, beef and citrus, and the adoption by both governments of the High Tech Work Group's Recommendations, the major result of our efforts was the issuance by the Japanese Government of five "packages" of measures to diminish some barriers, including tariff reductions, legal changes in standards procedures, the opening up of tobacco and telecommunications monopolies to foreign competition, and others. But while these steps afforded some improvement in access, they produced no significant increase in U.S. participation in the Japanese economy. First, implementation of the steps announced has in many instances not been carried out, so that no actual market-opening benefit has ensued. Second, major barriers to highly competitive U.S. imports remain in place, without prospect of removal. And third, policies have been announced that are wholly (satellites) or partially (telecommunications) market-restrictive. (See Tab B for a detailed assessment of specific market access issues.)

Moreover, this more-or-less annual package approach, while responsible for some progress, has been essentially a sporadic and reactive response by Japan to U.S. pressures, rather than a sustained, self-initiated program of market liberalization. Once a package has been issued to stave off U.S. pressure, a period of inaction - with respect to both the implementation of commitments announced as well as to outstanding issues unaddressed in the package - has ensued, allowing frustrations to build. The packages may thus have contributed to the cycle of crisis and public acrimony - with the United States in the unwanted but unavoidable role of unsatisfied <u>demandeur</u> - that has plagued the U.S.-Japan trade relationship.

The "Ron-Yasu" relationship, while creating the umbrella under which officials pursued issues, also had the unfortunate result of leading Japanese officials to operate from the belief that it sheltered Japan from "excessive" U.S. actions.

To be helpful to Prime Minister Nakasone, who faced Lower House elections in December 1983, President Reagan did not push hard on trade issues during his November 1983 visit. It was agreed that followup mechanisms would be established by both governments to address outstanding trade issues. Unfortunately, much of our effort during the followup had to be devoted to fending off new, potentially very damaging legislative proposals by the Japanese--a proposal to remove copyright protection from software and a proposal to limit foreign ownership in firms providing value added telecommunications service networks (VANS).

III. JAPAN'S CURRENT AND PROJECTED TRADE PATTERN - SOARING EXPORTS AND LOW MANUFACTURED IMPORTS

A. Current Situation

The Japanese economy is currently experiencing an export-led recovery, with exports in the second quarter of 1984 up 16.3 percent over 1983, compared with a 6.7 percent increase in real GNP during the same period. Japan's exports are continuing to grow faster than its imports, resulting in a rapidly expanding current account and trade surplus. Exports to the United States have been growing especially rapidly: the rising surplus with the United States accounted for 72 percent of the increase of Japan's global trade surplus in 1983 and probably at least as much in 1984.

The bilateral surplus with the United States is projected at $34.7 billion in 1984, rising to perhaps $45 billion or more next year. Table 1 shows the U.S. trade balance with Japan, the EC, Canada, and the world from 1979 through 1984.

Table 1

U.S. Trade Balance
($ billion)

with:	1979	1980	1981	1982	1983	1984 (est.)
Japan	-9.1	-10.2	-16.1	-17.1	-19.7	-34.7
EC	8.2	16.7	9.2	3.4	-1.3	-13.1
Canada	-5.6	-6.9	-7.6	-13.9	-15.4	-20.9
World	-27.3	-23.4	-30.1	-35.2	-60.7	-115.5

As the table shows, our largest bilateral trade deficit is with Japan. But its share of the U.S. global deficit has remained relatively constant, and the other deficits are growing more rapidly. But the deficit with Japan is growing from a large base, and growing rapidly (by 76 percent this year). Even more important in this respect is the <u>character</u> of Japan's trade with us (and with the other industrialized and industrializing nations as well). <u>Indeed, the key and crucial issue is Japan's very low level of manufactured imports</u>.

Table 2

IMPORTS OF MANUFACTURED GOODS*
(Constant 1983 Dollars)

	Per Capita		% of GNP	
	1970	1983	1970	1983
Japan	$ 144	$ 267	0.8	2.8
United States	353	728	1.3	5.2
Canada	1,347	1,936	5.8	14.7
France**	634	1,135	3.0	12.1
FRG	768	1,428	3.3	13.3
Italy**	384	616	3.5	9.9
Netherlands	1,815	2,347	2.1	25.4
United Kingdom	541	1,218	2.7	15.2

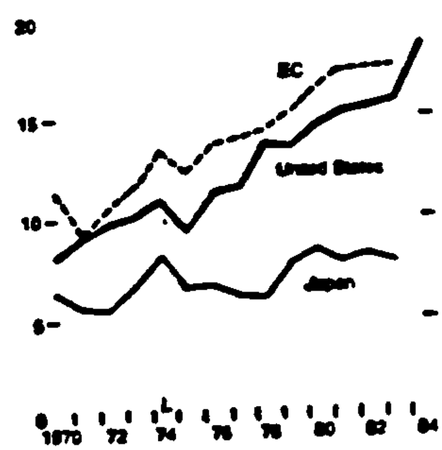
*Source: CIA; ITA, U.S. Department of Commerce; USTR.
**Based on GDP figures.

As Table 2 shows, Japan's imports of manufactured goods are very low, lower on a per capita basis and as a share of GNP than any of the other major industrialized nations. Japan's heavy dependence on imported raw materials does not account for the disparity between its small relative volume of manufactured imports and those of other resource-poor industrialized economies, as a comparison of the Japanese data in the table with those for West Germany demonstrates.

Moreover, import penetration in manufactured goods in Japan has remained low throughout the past 15 years, despite the various market-liberalizing measures that Tokyo has announced, especially when contrasted with the sharp growth of import penetration in this country and the EC, as Graph 1 documents.

Graph 1

IMPORT PENETRATION IN MANUFACTURES
(by value in percent)



Source: Morgan Guaranty Trust Company of New York. Value indicates imports as percent of domestic market measured by the sum of domestic value added and imports. EC data excludes imports from within the Community.

B. Japanese Projections

Earlier this year the Industrial Bank of Japan (IBJ) published an economic analysis for the period 1983-1990, which states that a straight line projection of present trends, with constant exchange rates, would lead to an insupportable current account surplus for Japan by the end of the period. The IBJ concludes that this can be avoided only by changes in Japan's economic structure.

The IBJ report estimates that international trade will increase at an average annual rate of 3.2 percent per year over the period, compared with an average of 5.5 percent in the 1970s. The report foresees a likely increase in protectionism and a less bright environment for trade than in the past decade. However, Japan's primary markets, the United States and the Pacific regional countries, are expected to enjoy better economic performance than the average, and when the market represented by China's development plans is added, Japan's trade performance should not deteriorate as much as might be expected. The report adds that trade frictions may be reduced by the fact that Japan's competitive strength in internationally traded products is shifting from a price advantage to a technological advantage.

The report says that Japan's exports might be expected to increase at an average annual rate of about 5-6 percent, compared with an average increase of about 10 percent in the 1970s. This is still high compared with overall international trade growth and compared with expected growth in domestic demand. In the absence of a change in the composition of Japan's imports, i.e., a continued high percentage of fuel and raw materials, imports would be expected to grow at only 4.5 percent average per year given lower expected GNP growth. If this were to occur, however, the current account surplus would swell to some $80 billion by 1990. Merely assuming stable oil prices and continued growth patterns without a change in import composition through the 1980s, leads to a surplus of that size. But the result would be a cumulative surplus of some $400 billion over the period 1983-1990, which would rival the OPEC surplus of 1974-1981. Because of the effect that would have on the international economy, the report concludes, the structure of the Japanese economy inevitably will have to change in order to restrain exports and greatly increase manufactured imports.

Japan's official rebuttal to criticism of the size of its current account surplus--contained in the 1984 International Trade White Paper--is to point out that Japan is a rich industrial country which has become a substantial net creditor. Domestic savings exceed domestic consumption by a substantial margin, and Japan is therefore a net lender abroad. It has long been accepted as "good" that rich nations run trade and current account surpluses in order to finance net flows of real resources to poorer countries. It should also be recognized that the composition of Japan's trade reflects its resource base; an island poor in raw materials, will not, logically, have the same export/import mix as a resource-rich country. Broadly speaking, the basic structure of Japan's trade is not inconsistent with the principle of comparative advantage, which forms the intellectual basis for the open, liberal trade and payments system.

While some portion of the Japanese trade surplus is structural and appropriate, part of the surplus is not structural and is due to a variety of factors, including market barriers in the capital and current account areas. A significant reduction in the Japanese surplus--and, in turn, a substantial reduction in pressures on the system--could result from actions which attack the non-structural component of the Japanese trade surplus.

IV. HIGH TECHNOLOGY TRADE AND U.S. NATIONAL SECURITY

An important, and disturbing, part of our trade problem with Japan is in the field of high technology. Japan is the only major nation with whom we run a trade deficit in high technology products.

That particular deficit is not due to any superior competitiveness of Japanese products. In nearly every sector of high technology - computers and computer software, telecommunications, satellites and other space-related products, as well as a host of others - the United States leads the world, including Japan. In the market segments for less sophisticated products in the high tech area, such as telephones, Japan does sometimes have an edge. Japanese firms use that advantage in more open markets such as the United States. However, the competitive edge that U.S. firms have in sophisticated high tech products all too often does not translate into commercial advantage in the Japanese market. Rather, their efforts to sell into that market are impeded by the intentions of Japan to develop "national autonomy" in these fields or to catch up with and surpass the United States in the commercial application of advanced technologies. Three of the major specific issues on our current bilateral trade agenda with Japan - satellites, telecommunications services and equipment, and computer software - relate to this problem. In satellites, Japan has adopted a space development policy calling for national autonomy, a policy that precludes, as a practical possibility, the purchase of U.S. or other foreign-made satellites by NTT and other government agencies, the largest market. In telecommunications, the liberalization of services appears likely to be accompanied by a procedure for interconnect equipment certification that will place a discriminatory burden upon foreign suppliers. And in software, the GOJ is considering changes in the legal protection of the rights of program developers that would spur the development of the domestic industry at the cost of serious harm to the interests of U.S. software developers.

Satellites, telecommunications, and software are high technology industries whose health and prosperity are vital to the economic and security interests of the United States. Denial of access to the Japanese market, the second largest in the world, means that U.S. firms must compete at a growing disadvantage against Japanese firms in their own market and elsewhere. It means they must compete with Japanese firms who can exploit the volume economies of unhindered participation in both the world's largest markets, and whose development of commercial products is spurred and supported by government. Faced with aggressive Japanese competitors, who compete fiercely with one another in their own market, from which strong foreign competitors are excluded, the U.S. firms find diminished not only their market share but the cash flow on which their investment in R&D and production capacity expansion depends. The prospect that, because of such one-sided restrictions on competition, these U.S. industries might diminish in relative productivity and technological innovation, is one that has serious implications for the security of this country. So too does the existence of Japanese restrictions on U.S. access to Japanese technology, deriving from the freezing out of foreign firms from government-sponsored programs to support commercial R&D.

The success of Japan's efforts in high technology will be determined by their success in the United States, because access to the largest market for high technology is critical to generate the cash necessary to fund future R&D. That provides us with multiple levers to use--if we will--in the pursuit of freer and fairer competition between our firms and the Japanese. A prime example is the space station project. The scope of Japan's participation in the project could--if we so decided--be made contingent upon an open Japanese market for satellites. Similarly, continued copyright protection in the United States for Japanese software could--and should--be made contingent upon continuation of copyright protection in Japan.

V. ALTERNATIVE STRATEGIES FOR THE NEXT FOUR YEARS

What Do We Want

The problem, simply stated, is that Japan does not buy enough manufactures from the rest of the world. We want Japan to buy more manufactured goods from us and from others.

A. Market-Oriented, Sector-Selective Option ("MOSS")

This option is intensive negotiations by sector to eliminate every specific barrier, policy, and practice that in any way limits import access. Such an intensive and comprehensive approach for particular sectors has been used in the past with Japan in only two areas: semiconductors and the yen-dollar talks. This approach would be as comprehensive as those were, but would add explicit willingness to use the leverage available to the United States to achieve a true opening of the sector (see Appendix on "Leverage").

Specific features of the MOSS approach:

1. Obtain Prime Minister's commitment to basic objective of a truly free market in key industrial sectors.

2. Focus on a coherent industry/product group. Point to how individual negotiating demands work jointly towards mutually agreed objective.

3. One negotiating team, headed by a trade negotiator at the sub-Cabinet level or above, for each key sector; team stays together throughout the talks. No delegation of detail to staff negotiations. Keep Vice-Minister at table, do not negotiate with Director-General of International Bureau; include domestic Director-General as well.

4. Detailed analysis of industry needed to isolate specifics of necessary Japanese actions and to draw on in actual conduct of negotiations.

5. Same team for followup and monitoring.

This approach is extremely time- and manpower-intensive. It requires large amounts of time for very senior officials; the detailed analysis takes considerable staff time and knowledge of specific industries.

Selection criteria for the key sectors to be negotiating targets might include the following:

-- market size in Japan (not in U.S.)

-- Japanese market growth potential

-- U.S. has world-class capability

-- sector has high visibility in Japan

These criteria would ensure that negotiations in a selected set of industries would have (a) maximum potential for direct dollar impact; (b) maximum demonstration or precedential effect; (c) maximum "spillover." Examples which would be immediate candidates would be telecommunications, forest products; non-examples would be autos, consumer electronics, walnuts.

This approach has several major advantages:

-- It establishes "beachheads" in the Japanese market for products with potential ripple effects.

-- It's philosophically consistent with our overall commitment to free markets, reduced government intervention, and an open liberal trade and payments system.

-- It offers the most direct attack on the Japanese "system," which we suspect is a major part of the problem we are trying to solve; therefore it offers better prospect for lasting gains.

-- It works in the direction of co-opting Japan into the worldwide trading system and adjustment process, rather than accepting its "outsider" stance and developing a separate set of rules for dealing with Japan.

B. Import Goal Option

The implicit logic of the MOSS approach, and of the market access/barrier removal approach emphasized to date, is that the attainment of an open Japanese market would lay the groundwork for the achievement of a substantial actual increase in Japanese imports of competitive U.S. goods.

Intensive analysis over the past several months, however, has led us to question whether our logic has been correct. We have assumed, for instance, that Japan's economy, like ours, is run for purposes of maximizing consumer welfare. For the past 100 years, however, Japan has focused upon developing economic and industrial strength for purposes of maintaining its national integrity and power vis-a-vis the West. There is strong evidence that this is still a wellspring of Japanese economic motivation.

Japan is a highly structured society and economy. Moreover, its concepts of market power, monopoly, due process, transparency, the role of government and business are such as to make an open market system like the United States very unlikely.

As a result, even successful removal of barriers doesn't usually lead to actual increase in imports. Even if a tariff is lowered, if a company can't get distribution, or dealers, or employees, or desirable office space, or unloading facilities, it is very difficult to do business. Hence, simple removal of barriers has not worked to increase Japanese imports of competitive U.S. goods, especially manufactures.

In view of this ineffectiveness of barrier removal to right the balance of real market access and to promote substantial U.S. participation in the Japanese economy, it is necessary for Japan to take steps that result in Japan's actually buying more.

This is not unprecedented in world history. After World War II the United States had an enormous trade surplus. We took positive steps to encourage others to export here, to encourage our industries to buy foreign goods, and to reduce our surplus in the interest of broader relationships. We want Japan to do the same.

This option would recommend, therefore, that President Reagan and Prime Minister Nakasone agree at this meeting on a goal of reducing the deficit by 50 percent over the next three years, and of doubling Japanese imports of manufactured goods.

can't do this
too many variables

C. Recommended Policy Approach

On the basis of intensive interagency consultations in which we have received the suggestions of all of the major trade-related agencies, USTR recommends that the Administration adopt a two-pronged approach in our trade strategy toward Japan over the next four years. That approach places equal weight on the objectives of market access and manufactured import increase.

1. The First Prong: Market Access, Emphasizing "Beachhead" Sectors

This element of our approach would continue our efforts to remove any Japanese barrier that prevents the free play of market forces. While we would continue to address the whole range of barriers, particular emphasis would be placed on the need for progress in specific sectors deemed especially important.

The first step in developing this approach is to establish a Reagan/Nakasone mandate reflecting a commitment to the basic objective of market-determined trade in key industrial sectors. Once this mandate is established, the key sectors would be identified on the basis of economic analysis that considers such factors as the sector market size and growth potential in Japan, its visibility in Japan, and U.S. capabilities as a world-class producer.

Once the sectors are picked, a team headed by a trade negotiator at the sub-Cabinet level would sit down to negotiate on all elements involved in selling in Japan: border treatment, standards setting and testing, regulatory environment, government "guidance" or interference, distribution and sales channels, and methods of product transportation.

This approach would require intensive negotiations characterized by:

a) high-level involvement at all stages;

b) intensive followup until desired results are achieved;

c) U.S. willingness to use pressure in response to any refusal by the Japanese to remove barriers or to implement targeted objectives.

An appendix on the subject of U.S. leverage provides a discussion of the means that could be employed to induce the Japanese to take the necessary steps.

2. The Second Prong: Japanese Manufactured Imports Action Program

This second and concurrent element of the two-pronged approach involves the securing of a concrete Japanese program to bring about a substantial actual increase over the next two-to-four years in Japan's imports of manufactured products. To implement this, Japan would agree to eliminate the barriers identified in its negotiations with us (prong one), and take the following additional steps:

a) The Prime Minister gives the President his commitment that Japan will adopt as a national goal, announced as a White Paper, a doubling of imports of manufactured goods and a halving of the bilateral trade deficit with the United States.

buying mission

b) The White Paper would set out with the usual specificity of Japanese White Papers, how imports are to grow, and establish that objective as a national goal necessary for Japan's security in the trading world. Specific goals would be set for the key sectors identified in prong one. The United States would be consulted fully in the drafting of the specifics of the program and would monitor performance.

c) The White Paper also would outline plans to be implemented to eliminate trade-restrictive or -distortive elements of Japan's industrial policies, including providing for: full transparency of policies, objectives, methods, and procedures; treatment for foreign firms equal to that given to the "most favored" domestic firms; and import goals for "sunrise" and "sunset" sectors.

VI. RECOMMENDATION FOR THE PRESIDENT'S MEETING WITH PRIME MINISTER NAKASONE, JANUARY 2, 1984

Whichever policy approach option we decide to adopt, this meeting will be crucial to setting the course - and the tone - of our trade relations with Japan for at least the next year.

All reports indicate that the Japanese expect trade, particularly the size of the bilateral defict, to be the major topic on the President's agenda for the meeting. It is vital that trade be the major subject of the meeting, and that the Prime Minister leaves the meeting convinced that the President is deeply concerned by the trade problem, and strongly believes that it must be resolved by bold, rapid steps by Japan before the damage it is inflicting on our overall relations becomes any greater. The most desirable outcome of the meeting with respect to trade is the announcement by both sides of Prime Minister Nakasone's commitment that Japan will implement a manufactured imports action program with a goal of doubling Japan's manufactured imports and halving the bilateral trade deficit with the United States over the next two years.

The opportunity to achieve such a major forward step in opening up Japan will never be better. Nakasone's situation now is unique in that he is, for the remaining two years of his tenure in office, more free of election-related limits to action than heretofore, and also less politically constrained than any successor will be again before around 1988. By that time, if the IBJ scenario unfolds, Japan's current account surplus will already have begun to rival the OPEC Dollar Drain. Only action now by this Prime Minister can commit Japan to a national effort to avoid such a crisis at the end of the decade.

We therefore recommend that the following points be made by the President in his January 2, 1984, meeting with Prime Minister Nakasone.

CONFIDENTIAL

SUGGESTED TALKING POINTS FOR YOUR MEETING WITH

PRIME MINISTER NAKASONE - BILATERAL ISSUES

-- We have made significant progress in strengthening the full spectrum of our relationship. I appreciate your personal role in this process. We must build on the momentum of the past two years to create a true "international partnership."

-- We both face a trade problem which is threatening to rend the fabric not only of our overall bilateral relationship, but of the whole free trade system.

-- I believe we are facing a crisis which we must resolve by working together. It is not in either of our country's interests to jettison the global trading system.

-- We both want to enhance our overall relationship by building increasingly close economic and trade relations. Your businessmen have been able to participate freely and widely in the U.S. economy, and that is good, and we want to keep it that way.

-- But, Yasu, I need your commitment and help to ensure that Americans and others participate widely in your economy.

-- I know you want to make Japan the most open market in the world in word and deed, and a leader in the international trade system. But we will both be judged by the concrete results we produce.

-- I suggest that we commit ourselves now to the goal of halving our bilateral deficit, and of doubling Japanese manufactured imports over the next two years. Let our negotiators meet this month to establish the means to carry this out.

Specific Issues

-- Also, adoption now by both of us of a central recommendation of the Advisory Commission--that market access should be made a national goal in Japan; that Japanese policies should be openly formulated and implemented, with ample opportunities provided for foreign entities to present their views; and that existing commitments should be fully and promptly implemented--should aid our efforts over the next two years.

-- The report of the U.S.-Japan Advisory Commission is an excellent starting point for strengthening our relationship in the future. We should endorse its thrust and have our two governments get together to discuss implementation of its many recommendations.

-- Among others, high technology and telecommunications products and services should receive the highest attention.

-- The yen-dollar agreement was one of the most significant developments in our economic relationship. Let us move aggressively to implement it.

-- We must accelerate progress on energy cooperation and increased trade in coal and LNG. I hope that we can lift the ban on exporting Alaskan oil.

-- I am pleased to see more two-way investment.

-- (If raised) I am committed to reducing our budget deficit and getting interest rates down even further.

-- (If raised) The decision about auto export restraints is Japan's to make. I agree that it is best to wait-and-see, and monitor the state of our auto industry and the trade environment.

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APPENDIX

LEVERAGE

The U.S. Government has considerable leverage to use in obtaining our trade objectives, provided that (a) we organize ourselves to use it effectively, and (b) we are prepared to implement specific measures as necessary. Before moving to specifics, some general points are in order.

1. The use of leverage should focus on changing Japanese behavior in clearly defined ways. It must not succumb to the obvious temptations to:

   -- react in anger or frustration; or

   -- use it as a justification for a protectionist action.

2. Real rules must govern.

   -- Exercise of muscle should always be accompanied by a clear explanation of what behavior we want changed.

   -- Consistency and determination are essential; it must be clear to Japan that we can and will act until Japan changes the policy we want changed.

   -- Reversibility rule: any barriers we impose will be removed when Japan responds appropriately.

3. Because our focus is on market access to Japan, we have an advantage. Japan presently has more access to U.S. markets than foreigners have to Japanese markets. Japan has more to lose from U.S. use of leverage. Moreover, it has fewer opportunities for counter-leverage, and a built-in incentive not to react in kind lest it lose even more.

4. Generally, leverage measures could be chosen in other areas of trade than that covered by the Japanese practice we want changed (e.g., close the borders to bicycles if we want wine duties lowered). This has two advantages:

   -- to create conflict among Japanese domestic interest lobbies; and

   -- to generate interagency conflict within the GOJ so that issues are elevated to poltical levels.

5. An extraordinary, higher degree of cooperation within the U.S. Government is essential. Agencies tend only reluctantly to put their particular areas of negotiation on the block for use as leverage in other areas. This must stop. Every agency's interests should be subordinated to the general effort.

Specifics on leverage and retaliation will tend to develop over time as we move into negotiation. However, we should not start out in Janauary without the most careful planning and development of retaliatory and leverage options that we can manage in the interim. Interagency staff work on this should begin immediately.

Some items are listed and described below. The list is not intended to be exhaustive but rather to demonstrate that opportunities for the U.S. Government to exercise leverage and/or retaliation do exist and do make sense.

1. We should exploit the interests of Japan's other trading partners in changing the Japanese system. In the Summit, East Asian, and other contexts, encourage like-minded countries to negotiate with Japanese on elimination of barriers.

2. Self-initiate Section 301 cases (President's retaliatory authority against unreasonable, unjustifiable, or discriminatory trade practices). Japanese standards policies might be a good place to start. Ultimate retaliatory action we are contemplating should be made known to the Japanese at the outset. It should take the form of trade barriers against goods which Japan considers important.

3. Given that Japan has yet to eliminate restrictions on leather imports, the United States should, in accord with GATT rules, take retaliatory action.

4. Play Japan's request for gateway landing rights for a new Japanese all-cargo airline (it's owned by Japanese freight forwarders and has a cozy, GOJ-sanctioned agreement not to "disrupt" JAL's cargo business) for all it's worth. This issue is perfect leverage not only in the civil air field, but also in related areas such as the hi-cube container dispute and the tobacco shipping question. If the Japanese want it badly enough, we can use it over and over again to get action on other trade issues as well.

5. Make Japan's scope of participation in the U.S. space station project contingent on Japan's being responsive on satellites. Participation in the station would provide major benefits to Japan, as partners who make significant investments in space station hardware will most likely retain ownership of those elements and will have a role in management of the station commensurate with their investment share. Exclusion would be costly to Japan for commercial and prestige reasons.

6. Use textile and similar sectoral market access negotiations not primarily to limit Japanese exports to the U.S. market, but to gain Japan's commitment, with numbers, to open its markets to third-country suppliers. That will help to take import pressures off U.S. markets, and at the same time gain support for U.S. objectives from third countries.

7. Mount a major USIS effort to tap the enormous latent consumer pressure in Japan for more cheap, high-quality imports of foods and consumer goods. The Japanese press is an ally here.

8. The issue of renewing the U.S.-Japan auto VER is usually seen as a problem. It may be an opportunity, if subtly played. Although it is clear that the Japanese want to increase the level of their auto exports to us, they seem ambivalent about whether they want the VER renewed. Different firms within the Japanese auto industry have different interests. In this context, we can create maximum leverage on other issues by creating maximum uncertainty on this one. The Japanese will abhor uncertainty, especially if we transmit signals that create dissension within the Japanese industry, erode the GOJ's control over the issue, and create the impression that anything we do will hurt them. We should put off resolving this question as long as possible, certainly beyond this Summit. Then, a decision on whether to seek an extension can be taken in light of the overall result of the 1985 effort on all fronts. In any event, the removal of the restraint should not be done in isolation from our general objectives. If it is removed, the condition should be that Japan should also, and simultaneously, act to open specific Japanese markets of even greater dollar value.

action in other sectors detailed

TAB "A"

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U.S. TRADE POLICY VIS-A-VIS JAPAN

I. U.S. OBJECTIVES

The overarching goals of U.S. trade policy are to further the development of the U.S. economy and the economic well-being of Americans, and to maintain and strengthen the international free trading system. To realize these goals in its trade relationships with Japan, U.S. trade policy has five general trade policy objectives:

A. Obtaining overall access for U.S. participation in the Japanese economy in goods, services, and investment similar to that which Japan enjoys in the U.S. economy.

B. Ensuring trade composition and volume which reflect U.S. competitiveness.

C. Ensuring fair competition between U.S. and Japanese firms in U.S., Japanese, and third country markets and eliminating distortive or disruptive effects that may arise from Japanese Government industrial policies or corporate practices.

D. Avoiding protectionist measures.

E. Inducing Japanese leadership in free trade commensurate with Japanese economic strength and Japan's stake in the system.

A. Obtaining access for U.S. participation in the Japanese economy in goods, services, and investment similar to that which Japan enjoys in the U.S. economy.

Our ultimate and fundamental trade policy goal has been to gain access to the Japanese economy for American goods, services, and investment on an equivalent basis to the access which the Japanese enjoy in the U.S. economy.

- Japanese firms have virtually complete access to the U.S. market.

- To the extent that the Japanese market (which is the second largest in the world for industrial and consumer products) is reserved for Japanese firms, while Japanese firms are free to compete in the U.S. market, our companies will be at a significant competitive disadvantage.

Our firms will be disadvantaged not only in terms of lost sales now, but also by being denied the continuing cost economies that result from participating in two high-volume markets.

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As a general rule we seek national treatment provided that such treatment gives U.S. firms access to the Japanese market. We must seek better than national treatment when such treatment would mean being denied access to the Japanese market.

B. Ensuring trade composition and volume which reflect U.S. competitiveness.

The U.S. seeks access to the Japanese market for all of its products.

o With some exceptions, however, our access has been more difficult to achieve for manufactured goods and value-added agricultural products.

Unlike in other industrialized countries, imports complement rather than compete with domestic products in the Japanese market. Imports sold in Japan tend disproportionately to be of products that are not produced there.

The proportion of manufactured goods among Japan's total import is low because of government policies and corporate practices.

o These policies/practices have the effect of excluding foreign competitors from, or imposing significant handicaps on, foreign participation in the Japanese market.

The removal of impediments to U.S. manufactured exports to Japan is a high priority because our international competitiveness in strategic sectors, such as high technology, depends on access to, and participation in, major world markets.

C. Ensuring fair competition between U.S. and Japanese firms in U.S., Japanese, and third country markets and eliminating distortive or disruptive effects that may arise from Japanese Government industrial policies or corporate practices.

Japanese industrial policies, trade policies, and corporate practices may give Japanese firms an advantage, not only in the Japanese home market, but also in the U.S. and third country markets.

o It is essential to ensure that Japanese competition is in accordance with international and national rules of fair play and is not disruptive in the U.S. marketplace.

- Practices of concern include import and export cartels (formal or informal), joint R&D, and industry targeting.

We need to learn more about these practices, which we consider unfair or unjustifiable, their competitive effects, and how to counter them when they injure U.S. firms.

D. Avoiding protectionist measures.

The U.S. must continue to maintain its commitment to free trade even though there are strong and ever-increasing domestic pressures for protectionism.

We must convince Japan that these protectionist pressures are real and building.

We must convince the Japanese of the necessity to take actions that will counteract these domestic pressures. Failure could undermine the world trading system. If the U.S. begins to adopt protectionist actions, it is very likely that other countries will rapidly follow.

- Japanese actions must translate into significantly increased market access to Japan for U.S. firms, especially in sectors where we are strongly competitive.

- Japanese actions must, however, represent a commitment to real trade liberalization and not simply a response to dampen American protectionist pressures.

E. Inducing Japanese leadership in free trade commensurate with Japanese economic strength and Japan's stake in the system.

As the second largest industrial power, Japan must shoulder a substantial leadership role in conducting and promoting free trade.

- No country benefits more from free trade than Japan.

- No country has depended more heavily on access to foreign markets for its growth and development.

Japan must become an active leader in maintaining and expanding the scope of free trade--at home and internationally.

II. RATIONALE FOR U.S. OBJECTIVES

While the virtue of reducing foreign trade barriers is universally applauded, the rationale for such reductions varies greatly. To guide us in developing a strategy to reach our objective, we need to sort out the valid reasons from the invalid ones for seeking an opening of the Japanese economy.

First let us put aside the fallacious reasons for seeking an opening up of Japan:

- We are not seeking a reduction in trade barriers because we are without sin, or to make them the same as we are. Exports to the United States run into barriers too (autos, steel, textiles and apparel, meat, dairy, and sugar). The international trade system accepts cultural and institutional diversity.

- We do not seek an opening of the Japanese capital market in the hope that it will promptly strengthen the yen. A particular yen rate is not a U.S. policy objective. In fact, we recognize that opening of the Japanese capital market is likely to weaken the yen at first.

- We are not trying to reduce Japanese trade barriers simply to improve the U.S. trade balance. Bilateral trade balances are not a U.S. policy objective. Moreover, an increase in Japanese imports following a reduction of trade barriers is bound to result in an increase in Japanese exports, some to the United States. The effect on our bilateral trade balance is indeterminate.

The fundamental reasons we want to open up Japan's goods, services, and financial markets include the following:

- Opening Japanese markets will produce the classic gains from trade. With the reduction of Japanese trade and service barriers, the United States can benefit from the operation of comparative advantage (through exporting and importing). With a reduction in Japanese trade barriers, Japanese and American economies will shift resources in line with comparative advantage to those products each can make relatively more efficiently.

- Opening the Japanese economy will permit a better allocation of resources. For example, opening of the Japanese capital markets will encourage the most efficient use of capital, which may be through greater outflows (the high Japanese savings rate may result in structural capital outflows) or through inflows (if foreigners want more yen assets).

- o Reducing certain Japanese trade barriers will improve the competitive position of some U.S. exporters. For certain U.S. industries, access to the Japanese market can be important (a) to allow them to capture economies of scale by expanding sales to Japan, (b) to prevent their Japanese competitors from having a protected base from which to export (i.e., a protected market can reduce risk, increase volume, and generate monopoly profits through higher pricing), and (c) to keep informed of competitors' activities.

- o Reducing Japanese trade barriers will address the equity concerns of U.S. businessmen, Congress, and the public. While it is difficult to measure precisely on an aggregate basis how protectionist Japan is, those who try to export to Japan generally agree it is harder to sell in Japan than in most developed countries, other than France or Italy. Anecdotal evidence abounds. The pervasive feeling of lack of equity undermines necessary domestic support in the United States for an open trading system.

- o Reducing Japanese trade barriers is necessary to maintain an open global trading system. Keeping an open domestic market is generally in a country's <u>own</u> overall economic interest (although a closed market <u>can</u> benefit particular groups or interests); but it is also in the interest of <u>other</u> countries that can reap the benefits from participating in a large, open trading system. In a sense, an open world market provides external economies, or free benefits, to trading countries. An open trading system requires that the major economies keep their own markets open, even though that may incur adjustment costs and political pain inflicted by special interest groups. Japan, as a major economy, should, therefore, open its own market to contribute to maintaining a worldwide open trading system.

III. CURRENT BACKGROUND ON ACHIEVING OUR OBJECTIVES

Over the past year we have pursued our trade policy objectives with Japan through an intensive dialogue in which we identified many barriers to the Japanese economy. (See the compilation of barriers previously circulated.) In response to our efforts, the GOJ undertook a series of unilateral trade liberalizing measures in November 1981 and January, May, and December 1982.

After the publication of the May package, USTR announced publicly that we were requesting that the GOJ work with the USG for the purpose of initiating a continuing program designed to resolve difficulties that may arise in implementing the package.

Beginning in August, a sub-group of the U.S.-Japan Trade Subcommittee inaugurated a regular series of visits to Tokyo, capped by a December meeting of the Subcommittee itself, with the following objectives:

- o To clarify the GOJ measures and plans for implementation.
- o To bring to the attention of the appropriate GOJ Ministries and/or the Office of Trade Ombudsman and seek resolution of specific access problems experienced by American businessmen
- o To sustain momentum toward a more open Japanese economy by addressing issues unresolved or omitted from the package.

Analysis of the various initiatives on the basis of clarifications received by the Subcommittee reveals substantial progress in such areas as customs procedures and easing of access to the insurance market. A number of standards issues appear to be on the track for early resolution. The promised system of business consultants has been set up and is in operation. And the Japan Fair Trade Commission has begun to take a more assertive role, both in beginning its promised monitoring of the distribution of foreign goods, and in proclaiming its opposition to legislation expanding exemptions to Japan's antimonopoly laws, specifically regarding cartels.

These are positive steps, representing tangible improvements. On the whole, however, the trade package was a disappointment. As yet, it has produced no major new opening of the Japanese market, nor completely resolved any major problem. While the Japanese are moving in the right direction, they are not moving far enough, fast enough. These thoughts have been clearly communicated to the GOJ. It is essential that the Japanese make significant new market openings.

From our perspective, a number of major issues are outstanding involving impediments to U.S. access in areas where there is very significant trade potential and where our firms are highly competitive. Some of these sectors have been noteworthy for the development of a coordinated industry-USG approach, tobacco products being the prime example. In other sectors, such as heavy electrical equipment and forest products, such a coordination of approach is still in the early phases of development. There are still others yet to be identified or stimulated to action.

IV. APPROACHES DESIGNED TO MEET U.S. OBJECTIVES

Despite the enormous expenditure of efforts, U.S. trade policy still has yet to achieve a fundamental change in the underlying Japanese attitude toward our relationship. The underlying tone of our dialogue has been at the core confrontational rather than cooperative. The chronic pattern of our trade relationship, with the U.S. in the unwanted aggressive role of having to demand, time and again, Japanese market openings, and the Japanese responding with reluctant and partial openings seen as "concessions," has caused an erosion of good will on both sides. In a period of economic stress, it has also helped fuel the fires of protectionism, a protectionism that the Japanese must be shown is a real and present danger to their economic interests.

Achievement of our general trade policy objectives with respect to Japan hinges on our ability to address two difficult and inter-related questions:

1. How to place our bilateral trading relationship on a more cooperative rather than confrontational basis (i.e., Japan increasingly taking the initiative in opening its market rather than reacting to protectionist pressures in the U.S.); and

2. How to rejuvenate and accelerate the Japanese movement toward a more open economy.

The following is a list of possible approaches we can use in addressing the above questions. Some of these are currently being pursued, while others need to be considered for possible use.

- <u>Emphasizing Trade in High Level Political Visits</u>

  -- High level political visits such as Prime Minister Nakasone's recent visit to Washington and upcoming visits to Tokyo by Secretary Shultz and Ambassador Brock offer invaluable opportunities for the U.S. to demonstrate the great importance we attach to the trade issues, and to exert maximum influence directed toward securing both official Japanese Government commitment at the highest political level to open Japan's markets and substanti measures by the GOJ to implement such commitment. Th key Japanese actions needed are:

    -- a clear political commitment by Nakasone to open Japanese markets;

    -- establishment of a strengthened process that wil do so; and

    -- real steps now that will make the commitment credible.

  -- Central emphasis should be placed on the vital import of Japan's taking immediate and ongoing action to ope its market in order to reduce the dangerously high le of current friction that threatens to damage the over bilateral relationship.

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- Existing Sector Committees - Bilateral USG-GOJ committees/ work groups, etc., on petrochemicals, high technology, forest products, manufactured tobacco products. and beef and citrus provide fora for addressing issues in those sectors. Maximum use should be made of these groups to open these sectors.

- Other Sectors - The bilateral groups discussed above cover a number of sectors, but not all. To be certain we are not ignoring critical sectors, the TPSC Subcommittee on Japan will identify those sectors in which the U.S. has significant trade potential and develop strategies for pursuing our interests. We have already begun to work with the soda ash industry and the trade associations in heavy electrical machinery, wood and wood products, and paper and paper products, to develop specific sectoral strategies. This effort should be intensified and guided by the Subcommittee's identification of sectors with major export potential.

- GATT Issues - The approaches outlined above envision as a first step an intensive dialogue with the Japanese with the objective of reaching a mutually satisfactory solution. In those cases where the dialogue fails to result in a solution within a reasonable time, we should avail ourselves of the dispute settlement procedures under the GATT or the appropriate code, as we have now done, for example, in the case of the leather quotas. We should pursue our rights vigorously.

- Non-GATT Issues - There are impediments to the Japanese economy which are not violations of Japan's GATT obligation These include such issues as business practices and attituc To get at these problems, the TPSC Subcommittee on Japan wi develop a coordinated program of U.S.-Japan bilateral discussions (both government-to=government and private sector-to private sector). In addition, through Congressional testimony, publications and articles, speeches, etc., we will attempt to bring public pressure to bear on Japanese business practices and attitudes we have identified as impediments to increased market access.

V. <u>HOW TO PROCEED</u>

The preceding list of approaches is illustrative. Other approaches need to be developed. The approaches need to be related to the objectives presented in Part I, which themselves need to be elaborated more thoroughly. Priorities need to be set. Existing tactical tools need to be examined and new ones need to be developed and explored. In sum, we need to develop a comprehensive strategy by which we will pursue our objectives.

To develop this strategy, a TPRG Japan Task Force will be formed. Chaired by USTR, the task force will have a steering committee comprised of Deputy Assistant Secretary-level representatives from State, Treasury, Commerce, and Agriculture. As appropriate the task force will include representatives from the Departments of Labor, Defense, Energy, Transportation, and Interior, the CEA, OMB, NSC, GAO, FDA, CIA, EXIM Bank, the President's Science Advisor, and others as needed.

The task force will be charged with developing a long-term strategy covering the next several years. As part of this plan, the task force will also develop a short-term strategy to address the immediate problems which confront the U.S.-Japan trade relationship.

The long time frame has two purposes. First, it avoids giving the false impression that there are simple, overnight solutions to U.S.-Japan trade problems. Second, it lends itself to the creation of a process for addressing the problems. A process rather than an episodic approach is more likely to be successful in the long run.

In developing a comprehensive strategy, the task force will address three other issues. First, in setting priorities, the task force will assure that in reacting to private sector initiatives the USG does not neglect our major trade interests. Petitions received pursuant to the various statutes must, of course, be handled appropriately. We must avoid, however, becoming purely reactive. In defining our major trade interests and developing a comprehensive strategy we should be able to integrate the handling of petitions received with the pursuit of our major interests.

Second, the task force must address the immediate threat posed by the rapidly shifting mood of the country and the Congress with respect to Japan. The rapid growth in anti-Japanese sentiment threatens the Administration with the loss of initiative. In developing the short-term strategy, the task force will keep in mind the need for the Administration to maintain leadership in trade policy in part to minimize protectionist pressures.

Third, as Japanese industrial policy, including industry targeting, is increasingly viewed as a fundamental cause of trade friction between our two countries, the task force will examine this issue in detail and develop appropriate recommendations.

As the task force completes discrete portions of the comprehensive strategy, they will be submitted to the TPRG and the TPC for consideration and approval.

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TAB "B"

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TAB B

II. Assessing Progress

Agriculture - Intensive negotiations led to the signing earlier this year of agreements concerning expanded access for U.S. beef, citrus, and other agricultural exports in the Japanese market. Although these agreements did produce expansions of the quotas, the original U.S. goal of eliminating these GATT-illegal Japanese quotas was not achieved. The issue will likely emerge once more as a politically prominent controversy in U.S.-Japan trade relations during the last two years of the second term of the Administration, when talks are scheduled to take place again.

High Technology - We have negotiated two sets of "recommendations" (general principles and semiconductors). Japanese commitments include: foreign company access to government-sponsored R&D programs; use of performance (versus design) specifications; establishment of a concrete program to promote imports of U.S. semiconductors; improved access to GOJ-held patents; mutual elimination of semiconductor tariffs; and participation in a semiconductor data collection program to provide "early warning" on political trade problems.

To date, no U.S. company has been able to participate in a GOJ-sponsored program; the U.S. share of the Japanese semiconductor market is declining (the Japanese share of the U.S. market is increasing) and there are few indications that long-term relationships are in the making. MITI has declined to expand its guidance beyond major semiconductor manufacturers, or to other industries, e.g., the Japanese auto industry, which is a major user of semiconductors.

A semiconductor data collection system is in place, and the Diet has approved the elimination of the semiconductor tariff (pending parallel U.S. action). A new policy, which would improve access to GOJ-held patents, is reportedly in preparation.

No concrete program for the promotion of U.S. high technology products has been announced.

The single most significant high tech issue is the MITI proposal which would eliminate copyright protection for computer software. Although the U.S. objection was in part responsible for MITI's inability to put the bill before the Diet, the effort is continuing.

Industrial Policy - Our dialogue on this subject has produced no recognition by the Japanese that industrial policies can and do have trade effects. The policy for the promotion of an indigenous space industry still entails a prohibition on procurement of foreign satellites by NTT and other GOJ entitites. MITI is preparing new legislation which would enhance its ability to fund and manage high technology industries. The Ministry of Posts and Telecommunications is working on a "Telecommunications Industry Promotion Law." A new Depressed Industries Promotion

Law went into effect in January 1984. Some industries (including fertilizers, plastic, paper) are already "designated" to receive benefits. A new program providing for specific subsidies for "venture" businesses in specific new technologies has been established, and a comprehensive new law is reportedly in preparation.

Services - Strong U.S. objections succeeded in eliminating restrictions on foreign ownership of VANS originally written into the telecommunications reform legislation. However, it is not yet clear whether implementing regulations will provide for:

--- a registration system which is transparent, non-burdensome, and protective of confidential data;

--- distinctions among VAN classes which permit U.S. participation in the most attractive service segments;

--- effective safeguards against cross-subsidization by the new NTT.

Decisions in these areas could have the same or greater restrictive effects as the originally proposed limits on foreign equity.

The Japan Federation of Bar Associations has failed to agree on measures to end the current restriction on U.S. lawyers in Japan. A program of "Countermeasures Against Foreign Lawyers" is being prepared.

Standards - Legislation amending 17 laws governing standards and certification procedures passed the Diet in May 1983, but key reforms have not been implemented:

-- the commitment to permit foreign participation in standards setting activities has not been implemented by ministries other than MITI.

-- Provisions of the new law granting "direct access" to the two-step Japanese approval process have not made it easier for U.S. companies to obtain approval because U.S. firms are understandably reluctant to open their factories and labs to Japanese inspectors. To solve this problem, MITI has approved two U.S. testing firms; MHW has approved one, and MAFF has approved one.

-- U.S.-generated test data is still not accepted by MHW.

A new standards/certification procedure being established by the Ministry of Posts and Telecommunications under the new Telecommunications Enterprise Bill appears to be more restrictive than the NTT system. It also appears to violate several bilateral agreements:

-- there is no provision for U.S. company participation in standards drafting;

-- certification testing will be accomplished by an organization owned by the major Japanese telecommunications equipment producers;

-- there is no commitment to accept U.S. test data;

-- NTT-supplied equipment may not be subject to the same procedures.

Investment - The designated company test has been eliminated. The prior notification requirement remains in effect, although the Foreign Investment Council is scheduled to consider shortening the period to less than two weeks. Implementing regulations permitting foreign participation in trust banking are expected to be in place by the spring of 1985.

Energy - U.S.-Japan coal trade has stagnated, and the United States remains the swing coal supplier to Japan. The Japanese have made it clear that there is no prospect for new purchases of U.S. coal in the short term (before 1990). Japanese and U.S. companies have agreed on feasibility studies on development of Alaskan coal and North Slope natural gas for export to Japan.

Fisheries - Tariffs have been reduced on some specific fisheries imports. Quotas remain on nine items. Japanese purchases from U.S.-Japan joint ventures have failed to meet the 50,000 metric ton target. The GOJ continues to bar the sale of surimi processing vessels (and associated technology transfer) to the United States.

Government Procurement - The Agreement has failed to provide access to GOJ procurement. In some ministries, up to 95 percent of purchases are accomplished under single tendering exceptions, with no foreign competition. The NTT Agreement has been renewed and improved to provide access to the R&D phase of NTT programs, but the GOJ has failed to provide a definitive statement on the future of the Agreement after NTT becomes a "private" entity in April 1985. Actual purchases by NTT have been disappointing:

-- the dollar value is low: $140 million, or only 4.5 percent of NTT's total procurement in 1983; indications are that 1984 procurement will be lower.

-- there have been no sales of sophisticated telecommunications equipment which is central to the network and which would lead to long-term relationships with U.S. suppliers.

Tariffs - Japan has granted U.S. requests for tariff reductions on several specific items including computers and related items, photographic film, medical equipment, and machine tools. However:

-- in many instances, as in paper, the depth of cuts was insufficient to provide any significant improvement in market access;

-- in others, such as chocolate confectionery and tobacco, significant tariff cuts have yielded virtually no change in U.S. market share; or, as in one, may not improve the U.S. position relative to other suppliers;

-- important U.S. requests, such as forest products, walnuts and citrus, wrought and unwrought aluminimum, aluminum aircraft skins, and aramid fiber, remain outstanding.

Tobacco - Japan has reduced its tariff on imported cigarettes from 35 percent to an *ad valorem* equivalent of 20 percent. Nearly all retail outlets in the country will be permitted to handle imported brands as of next year. Moreover, legislation passed earlier this year will, when implemented in April 1984, end the monopoly by the government-owned Japan Tobacco and Salt Public Monopoly Corporation over the importation and distribution of tobacco products. Depending on how the new legislation is implemented, a significant increase in market access for highly competitive U.S. cigarettes could ensue. But the earlier liberalizing steps have not made much of a difference in the U.S. products' share of the Japanese market.