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THE WHITE HOUSE  
WASHINGTON

May 4, 1983

MEMORANDUM FOR EDWIN L. HARPER

FROM: ERIC I. GARFINKELC\1,).<sup>1-</sup>"

SUBJECT: U.S.-Japan Industrial Policy Dialogue

Attached for your information is a draft of the discussion format for the D.3.-Japan Industrial Policy dialogue. As you know, the first meeting will take place in Tokyo on May 14 and 16.

cc: Wendell W. Gunn

THE WHITE HOUSE

WASHINGTON

May 4, 1983

ME:1ORANDUM FOR 1\TENDELL W. GUNN

FROM: ERIC I. GARFINKEL

SUBJECT: U.S.-Japan Industrial Policy Dialogue

Attached for your information is a draft of the U.S.-Japan Industrial Policy Dialogue prepared by USTR. There will be a U.S.-Japan Industrial Policy meeting to discuss this on Thursday, May 5, 3:00 p.m., in Room 323 at USTR.

cc: Edwin L. Harper

DRAFT AGENDA  
for  
**U.S.-JAPAN**  
Industrial Policy Meetings  
May 14-16, 1983

- I. Objectives of Japanese industrial policies.
  - A. What are the objectives of Japanese industrial policies for emerging industries?
  - B. What are the objectives for declining industries?
- II. Formulation and Implementation (Process) of Japanese industrial policies.
  - A. Formulation of Japanese industrial policies.
    - 1. How are the objectives of industrial policies developed?
      - a. What is the role of MITI visions?  
How are they formulated?  
With whose input?
      - b. What role in this regard do EPC forecasts and plans play?
    - 2. How are the specific policies, practices, processes and actions formulated?
    - 3. What are the respective roles of government, legislature and industry in this process?
      - a. Explain the role of relevant Diet Committees and the Industrial Structure Council.
    - 4. How are emerging industries selected for government assistance and guidance?
      - a. What input does the industry have in this decision (formal/informal)?
      - b. How, when, and why are industries deleted?

5. How are declining industries selected for government assistance and guidance?
  - a. What input does the industry have in this decision (formal/informal)?
  - b. How, when, and why are industries deleted?
6. How are specific firms chosen for participation in government-sponsored R&D projects, or other policy-related assistance?

B. Implementation of Japanese industrial policies.

1. Who is responsible for implementing industrial policies?
2. What are the respective roles of private and public sectors in implementing industrial policies?
3. What are the specific statutes/laws/regulations that enable implementation of industrial policies, practices?
  - a. What powers do the Extraordinary Measure Laws and other laws convey to MITI? To other agencies?
  - b. What powers do the Extraordinary Measure Law for the Stabilization of Designated Depressed Industrial/other laws convey to MITI and other agencies?
4. How do these laws relate to the Anti-Monopoly Law?
  - a. How is exemption from that law decided?
  - b. What is the role of JFTC in overseeing/ implementing the laws?

III. Specific components/elements of Japanese industrial policies.

- A. List past, present, and contemplated policies, practices, processes, and actions of Japanese industrial policies, including enabling statutes/laws/and regulations for specific components/elements.

For emerging industries listing should include, but not be limited to,

- . Subsidization of research and development.
- . Government-sponsored and funded cooperative research and development.
- . Elevation plans.
- . Financial assistance/fiscal incentives.
- . Rationalization of selected industries
  - . Specialization of technology and products
  - . Standardization of production
- . Sector exemption from competition laws (cartels).
- . Administrative guidance.
- . Other.

For declining industries listing should include, but not be limited to,

- . Subsidization of research and development expenditure.
- . Rationalization or anti-recession cartels.
- . Administrative guidance.
- . Import protection measures.
- . Financial assistance/fiscal incentives.
- . Other.

- B. List past, present, contemplated and industries selected or to be selected for government assistance and guidance. For emerging industries; for declining industries.

## **DRAFT** OUTLINE

### **U.5.-JAPAN** Industrial Policy Dialogue Discussion Format

- I. Objectives of Japanese industrial policies.
  - A. What are the objectives of Japanese industrial policies for emerging industries?
  - B. What are the objectives for declining industries?
- II. Formulation and Implementation (Process) of Japanese industrial policies.
  - A. Formulation of Japanese industrial policies.
    1. How are the objectives of industrial policies developed?
      - a. What is the role of MITI visions?  
How are they formulated?  
With whose input?
      - b. What role in this regard do EPC forecasts and plans play?
    2. How are the specific policies, practices, processes and actions formulated?
    3. What are the respective roles of government, legislature and industry in this process?
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- . Subsidization of research and development expenditure.
- . Rationalization or anti-recession cartels.
- . Administrative guidance.
- . Import protection measures.
- . Financial assistance/fiscal incentives.
- . Other.

- B. List past, present, contemplated and industries selected or to be selected for government assistance and guidance. For emerging industries; for declining industries.

## V. Effects of Japanese Industrial Policies.

- A. What are the intended results of Japanese industrial policies?
1. On domestic industry?
  2. On foreign companies?
  3. On competition (domestic and foreign)?
  4. On market access?
  5. On trade and investment flows?
- B. How do actual effects of Japanese industrial policies compare to intended results? (A. 1-5)
- C. What are the costs/benefits of industrial policies and practices?

U.S.-Japan Industrial Policy Meeting

Thursday, May 5, 1983

3:00 p.m.

Room 323, USTR

THE WHITE HOUSE

WASHINGTON

CCCT FLASH REPORT

May 4, 1983

MEMORANDUM FOR EDWIN MEESE III  
EDWIN L. HARPER

FROM: WENDELL W. GUNN

SUBJECT: U.S.-Japan Trade Relations



Ambassador Brock reported to the Cabinet Council on the progress to date in obtaining increased access in the Japanese economy for U.S. goods, services and investment. Brock noted that a greater reduction of formal barriers to the Japanese market had taken place over the past two years than in any previous period, and suggested that on this basis, by the end of this year, the Japanese market could be as open as the U.S. market. The discussion focused on three remaining problems:

- o Negotiations on Japan's beef and citrus quotas **will** continue in July and USTR is considering the filing of a GATT complaint against Japan **with** regard to other agricultural quotas.
- o USTR is considering not renewing a three year bilateral Agreement on trade in communications equipment, unless a substantial increase in sales of U.S. equipment to Japan's telephone monopoly is forthcoming.
- o A U.S.-Japan Committee has now been established to discuss industrial policies and their effects on trade. The U.S. objectives are: (1) to determine the elements of Japanese industrial policy; (2) determine if such policy is trade distorting and (3) to seek **ways** of eliminating such trade distortions, if any.

cc: Craig L. Fuller  
Roger B. Porter  
Becky Norton Dunlop

JRM/KAT

## ANALYSIS OF GOJ MEASURES TO INCREASE AGRICULTURAL QUOTAS

On January 13, 1982, the GOJ announced new minimum import levels for six agricultural quota categories. Their action on these six quotas was the same as they had proposed in October and December meetings with USG officials. In fact, many of the new quota levels are lower than levels in recent years. No action was taken on the beef and citrus quotas.

1. Beans and Peas: The quota for JFY' 83-85 is \$50 million. In JFY' 1980, the quota level was \$68.8 million; in JFY 81, \$120 million; and in JFY' 82 (April-September), \$58.8 million.
2. Peanuts: The quota level for JFY' 83-85 is 50,000 metric tons (Mt). The quota was 61,500 Mt in JFY' 80; 49,800 Mt in JFY 81; and 24,900 Mt (April-September) in JFY' 82.
3. Fruit Puree and Paste: The quota for JFY 83-85 is 3,000 Mt. In JFY' 80, the quota was 4,056 Mt. Actual trade in that year was 1,418 Mt. This quota level is one that we requested in the context of considering what would be acceptable for a 1-year moratorium. Liberalization would be preferred.
4. Orange Juice: The quota is for 3,000 KL. Quota levels have not been disclosed in the past, but the trade in CT 80 was 552 KL; in CT 81, 284 KL; and in CT 82, 183 KL (January-November).
5. Ketchup and Sauce: The quota level is 3,000 Mt. Again, quota levels have not been disclosed before this. Trade in CT 80 was 1,824 Mt; in CT 81, 2,336 Mt; and in CT 82, 1,590 Mt (January-November).
6. Non-citrus Fruit Juices: The quota for prune, cranberry, and tropical juices will be a total of 1,000 Mt for JFY' 83-85. Past quota levels have not been disclosed but trade, including pineapple juice, was about 1,380 Mt in JFY 72-80. According to the GOJ, actual trade of the three juices was 60 Mt in CT 81.

The quota on apple juice for JFY 83-85 will be 1,000 Mt. The quota level in JFY 80 was 4,000 Mt; and has been 0 in the past 2 years.

The quota on grape juice for JFY' 83-85 will be 2,500 Mt. The quota level in JFY' 80 was 1,800 Mt; in JFY' 81, 3,600 Mt; and in JFY' 82, it is estimated to be 3,600 Mt.

## ANALYSIS OF THE GOJ MEASURES TO REDUCE TARIFFS ON AGRICULTURAL IMPORTS

**The value of Japanese imports from the U.S. of the commodities which are proposed to have duties reduced (excluding brandy, chocolate**

**confectionery, and biscuits)** is \$132.8 million. The value of revenue lost to Japan on these items is \$4.1 million. The value of trade rises to \$147.8 million when chocolate confectionery and biscuits are included; the lost revenue to Japan rises to \$6.1 million. Finally, if brandy is included, the value of trade remains the same (imports of brandy are valued at \$18,000) but the revenue lost rises to \$8.3 million.

In general, MIN final duty levels were accelerated, which is appreciated but not of great value.

U.S. - JAPAN  
MAY 3, 1983

THE UNITED STATES TRADE REPRESENTATIVE  
WASHINGTON  
20506

May 3, 1983

MEMORANDUM

TO: Members of The Cabinet Council Commerce and Trade

FROM: Ambassador William E. Brock

SUBJECT: Current Status of U.S.-Japan Trade Relations

Objectives and Progress to Date

In its trade policy vis-a-vis Japan, the United States, currently and since the Administration took office, has pursued five objectives:

1. Obtaining overall access for U.S. participation in the Japanese economy in goods, services, and investment on a basis equivalent to that enjoyed by Japan in the U.S. market.
2. Ensuring trade composition and volume which reflect U.S. competitiveness.
3. Ensuring fair competition between United States and Japanese firms in the United States, 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.

over the past two years most of our efforts have concentrated on the first objective, that of securing equivalent U.S. market access in Japan. Progress toward meeting that objective has been partial but real; a greater reduction of formal barriers to the Japanese market has taken place over the past two years than in any previous period. (See "GOJ Trade Liberalization Measures Since President Reagan took Office" at Attachment A.)

The market openings described in the attachment have come about almost wholly in response to the Administration's intensive negotiating efforts vis-a-vis the Japanese over the past 18 months.

In September 1981, the United States and Japan agreed to create the U.S.-Japan Trade Subcommittee, a sub-Cabinet group, to meet frequently on pressing trade issues. Since then the group has met four times, most recently in early December of last year in Tokyo. These meetings have been devoted to defining the barriers to Japan's markets where U.S. products are competitive and to exploring ways to eliminate those barriers. In addition, a series of regular, nearly monthly visits to Japan by a working-level subgroup of the Subcommittee was instituted in August 1982 to follow up on trade initiatives taken by the Japanese Government.

### Agriculture

Formal, nontariff barriers do continue to constitute major impediments to our access in a number of specific instances. Two are particularly important. The first is agriculture, where quotas on beef, citrus, and a number of other less important products continue to hinder the market entry of highly competitive American foodstuffs. Negotiations on beef and citrus will continue in July. We are now determining the best time to pursue formally our GATT rights regarding the other quotas in the absence of any progress toward their elimination.

### NTT

A second important instance of the persistence of major formal barriers is that of Japan's public monopolies, particularly Nippon Telegraph and Telephone Public Corporation (NTT). Our three-year Agreement has failed to result in significant U.S. sales. In February I met with Dr. Shinto, President of NTT, and stressed that the Agreement would not be renewed unless a substantial increase in sales of sophisticated U.S. high technology equipment was forthcoming. USTR is now developing an options paper assessing the courses of action open to the Administration as we review whether to renew the Agreement, which expires at the end of this year.

### Industrial Policy

Further progress in opening the Japanese market is likely to be much more difficult and slow. As the formal barriers give way, we shall increasingly be confronting less obvious, but even more stubborn barriers to our exports and our investment,

barriers that arise from deeply rooted attitudes, beliefs, and practices in Japan's business world as well as those which are the by-products of government industrial policies.

At the same time, the focus of concern over U.S. trade relations with Japan among U.S. business, labor, and political communities--including key Congressional Committees--has shifted markedly in recent months. Calls for reciprocity have become fewer and fewer as concern has turned from the degree of access to the Japanese market to the terms of competition in the U.S. and world markets. Specifically, there is now a widely held and growing belief that our major trade problem is that Japanese Government industrial policies and industry targeting convey to Japanese firms a competitive advantage not available to American firms. The momentum toward this view is reflected in the effort presently underway in the House Ways and Means Committee Trade Subcommittee to draft legislation that would define targeting as a "subsidy in kind" and revise the countervailing duty statutes accordingly.

The confluence of these two trends on the same focal point, that of the trade and competition effects of Japanese industrial policies--suggests that we may have come to a stage in our trading relationship with Japan, strategically and politically, where a redirection of emphasis is both appropriate and essential.

Placing greater emphasis on the objective of eliminating the trade distortions and market disruptions emanating from Japanese industrial policies, maintains the Administration's initiative on what has become, on the Hill and in the boardroom, the key issue with Japan.

#### U.S.-Japan Dialogue on Industrial Policy

The increasingly key nature of this issue has led USTR to put major emphasis on it in discussions with the Japanese. When I met with MITI Minister Yamanaka in Tokyo in February, industrial policy was the major issue on our agenda, and he agreed that our two governments should begin a dialogue about it. Last week he and I exchanged letters formally instituting the dialogue with the creation of the U.S.-Japan Committee on Industry-Related Policies and Their Trade Effects. The Committee will be chaired on the U.S. side by Deputy USTR Michael B. Smith. Interagency preparation is now underway for the first meeting of the Committee, which is scheduled for May 14-16 in Tokyo.

A first objective of the dialogue will be informational: to educate ourselves about the constituent elements of Japan's industrial policy. A second will be analytic: to determine, in the light of our trade policy objectives and U.S. competitiveness, which of those elements should be of concern to us. And a third objective will be policy-oriented: on the basis of that analysis, to determine what an appropriate response to the Japanese policy might be.

The exercise will be especially important in light of the Congressional initiatives to deal legislatively with the problem that I mentioned earlier. Equally important, it will bear very directly on issues about which major divergences of view between executive agencies have arisen--the facts about Japan's industrial policies and the significance of those facts for trade.

Finally, and perhaps most importantly, few issues currently generate as much controversy in the U.S. business community. Petitions which focus on industry policy/targeting issues, such as the Houdaille petition, are likely to confront us from a number of sectors in the coming months. The dialogue will be an essential means of preparing for and dealing with such a development, a means for shedding light on the issue as we manage the heat it generates.

Attachment

GOJ Trade Liberalization Measures Since  
President Reagan Took Office

ISSUE

GOJ trade initiatives undertaken since November 1981 have resulted in slow but tangible progress toward market liberalization. Momentum appears to have increased since Prime Minister Nakasone took office. His government has taken a markedly more active approach to the market opening issue. In particular, implementation of pending legal changes could significantly reduce some important formal nontariff barriers. However, major problems of access remain in numerous sectors of importance to U.S. trade interests.

BACKGROUND

Since President Reagan took office, the Administration has engaged the Japanese in intensive bilateral negotiations, with the objective of removing obstacles to U.S. access to the Japanese economy, the world's second largest marketplace. Largely in response to these U.S. efforts, the Japanese Government has undertaken a series of market liberalizing initiatives over the past 18 months, as follows:

|               |                                                                                                                                                      |
|---------------|------------------------------------------------------------------------------------------------------------------------------------------------------|
| November 1981 | Acceleration of tariff reductions agreed to in the MTN. Cuts scheduled for 1983 and 1984 became effective in April 1982.                             |
| January 1982  | Elimination or reduction of nontariff barriers, largely related to customs procedures and/or standards, in 67 specific cases.                        |
|               | Establishment of Office of Trade Ombudsman to respond to foreign complaints of inadequate access.                                                    |
| May 1982      | Tariff eliminations or reductions on a wide range of products, including several of economic interest to the U.S. (cut diamonds, photo film, et al). |
|               | Simplification of some pre-customs clearance procedures.                                                                                             |
|               | Opening industry standards-setting bodies to foreign participation.                                                                                  |
|               | Improving foreign access to the distribution system.                                                                                                 |
|               | Phased liberalization of distribution of imported tobacco products.                                                                                  |

December 1982

Tariff eliminations or reductions including cuts on several items of major interest to the U.S. (tobacco, chocolate, paper products).

January 1983

**Review** of Japan's national system governing the certification of imported goods. (60% of U.S. manufactured exports to Japan under go discriminatory "on-the-dock" inspection). Review results in proposed legislation submitted to Diet in April 1983 to provide "substantially equal" treatment in inspection and certification of imports as that afforded to domestic products.

Strengthening of Office of Trade Ombudsman.

Furtlier liberalization of distribution of imported tobacco products.

February 1983

Adoption of recommendations of U.S.-Japan High Technology Work Group. Commits Japan (and U.S.) to non-discriminatory treatment of foreign high tech subsidiaries; rectification of trade distortions arising from government policies; concrete steps for immediate alleviation of problems; development by Japan of a plan to stimulate high technology imports, inter alia.

**As a** result of these GOJ initiatives there has been more progress toward market liberalization in the past two years than in any prior period. Moreover, market access may be significantly enhanced when and if the legal changes in standards and certifications procedures which currently impose discriminatory as well as costly and time-consuming burdens on most U.S. manufactured imports into Japan are approved by the Diet and implemented. But major problems remain to be addressed, including: GATT-illegal quotas on a number of agricultural products (beef and citrus, in particular) and on leather goods; high tariffs on many items of interest -to the U.S , including a wide variety of agriculture products, computers, computer parts and accessories, forest products, alcoholic beverages. farm machinery, auto parts, etc.; trade distortions related to government industrial policies and corporate practices; and others.

Government monopolies also continue to be a trade problem. Despite an agreement to open procurement by the telecommunications monopoly (NTT) to foreign firms, little in the way of U.S. sales has resulted even though U.S. products in this field are extremely competitive. The tobacco monopoly (JTS) continues to limit marketing, advertising and distribution of imported tobacco products. And the tariff reduction on imported cigarettes was accompanied by a tax surcharge that diminished by two-thirds the retail price reduction on those cigarettes that would otherwise have been possible.

In sum, progress has been made, but sustained effort is needed to secure elimination of major remaining impediments to market access.

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THE WHITE HOUSE

WASHINGTON

April 20, 1983

MEMORANDUM FOR EDWIN MEESE III  
EDWIN L. HARPER

FROM: ROGER B. PORTER */ti*

SUBJECT: Cabinet Council on Commerce and Trade  
April 20, 1983

Strengthening Japan's Enforcement of Export Controls

The Council reviewed an information paper on strengthening Japan's enforcement of export controls. The discussion produced agreement that:

- o There is strong evidence that the Soviets and to a lesser extent the Chinese view Japan as a fertile source for acquiring high technology.
- o Although a member of COCOM, the Japanese police and customs take a remarkably relaxed attitude toward attempting to stop shipments of goods to the Soviet Union that are inconsistent with the COCOM guidelines.
- o This problem has received little cabinet level attention and efforts to remedy it have not succeeded at lower levels.
- o We need a careful cost-benefit study of the impact of our export controls on U.S. firms.
- o The problem of the Soviets having relatively easy access to technological advances through Japan is increasingly important as Japan strengthens its own technological capabilities.
- o There is already at least one subcabinet level group (Senior Interagency Group on Technology Transfer chaired by Under Secretary of State William Schneider) looking at elements of this problem. There may be more.
- o We should have a high level (cabinet-level) approach to the Japanese on this issue.

Allen Wallis suggested and the Council agreed that we should have the SIG on Technology Transfer and any other groups working in this area report on their efforts soon to the CCCT.

There is no pressing need to involve the President at this point, although you may wish to alert him to the general problem.

Recommendations of the u.s.-Japan 'Work Group  
On High Technology Industries

/ '::

FOREWORD

In the area of high technology industries, industrial structures and trade patterns have been rapidly changing in the course of active technological innovations and development of new products both in the U.S. and Japan. These conditions may increase the potential for disruption in high technology markets and heighten frictions among trading partners. To resolve current problems, promote understanding and improve prospects for growth in high technology industries, the Work Group has begun by examining pressing issues in bilateral high technology trade, especially in the areas of semiconductors, supercomputers, and fiber optics.

Based on its discussions, and in accordance with its terms of reference, the Group submits the following recommendations to the appropriate authorities of both governments. Nothing in these recommendations shall be construed as limiting or derogating from the international legal rights and obligations of the two countries.

Activities of the Work Group naturally concern industrial and trade matters pertaining to the field of high technology, and nothing contained in the recommendations is intended to prevent either country from taking any action or not disclosing any information which it considers necessary for national defense purposes.

The Work Group recommends that the recommendations contained herein be implemented insofar as is consistent with domestic laws and international legal obligations.

**I. PRINCIPLES**

The Work Group recommends that each government:

A. Goals and Means

- Recognize that high technology industries have been growing rapidly and that further expansion of these industries has the potential to open up economic frontiers, assist in the revitalization of the world economy and contribute to the elevation of the quality of life:
- Recognize the important role of government in improving the climate for private sector investment and research and also recognize its-responsibility-to minimize trade distortions and impediments to free and open trade, investment, and technology flows that may result from government actions related to domestic high technology industries: and
- Reaffirm the importance of the role of governments in vigorously safeguarding the rules of the marketplace and preventing anti-competitive or predatory practices.

**B. Free Flow of Trade, Investment and Technology**

- Undertake to ensure full mutual access to trade and investment opportunities in high technology industries;
- **W9rk** for the reduction and elimination of such impediments and distortions as may exist in high technology trade;
- Seek to ensure that opportunities to participate in each other's markets will be substantially equivalent. (With positive action on the part of the private sector and government, increased opportunities can be expected to lead to increasing participation in each other's markets which should be possible to assess);
- Undertake to ensure that policies do not directly or indirectly discourage or impede government or private procurement of foreign high technology products or services, or bilateral transfers of technology;
- With a **view** to promoting free, fair, and open competition in high technology, undertake to provide that programs which provide particular advantages to enterprises in specific high technology industries will be open to enterprises constituted under the laws and regulations of the one country and owned or controlled, directly or indirectly, by nationals or companies of the other country, on the same basis as to enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country.

**C. International Cooperation**

- Affirm the significance of exploring appropriate ways in which cooperative efforts, including cooperative R&D and technology exchange consistent with anti-trust laws and policies, could promote high technology industries;
- Undertake to ensure that participation in government sponsored R&D projects will be open, in principle, to enterprises constituted under the laws and regulations of the one country and owned or controlled, directly or indirectly, by nationals or companies of the other country, on the same basis as to enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country.

## II. IMPLEMENTATION

### A. Market Access and Trade Promotion

#### 1. Joint Data Collection

The Work Group recommends that for a full assessment of the factors affecting bilateral high technology trade, the Work Group establish with the cooperation of private sector sources in both countries, a Joint High Technology Data Collection Task Force. The Task Force would begin with semiconductor data collection in the following manner:

- Decide on the coverage, classification and methods of data collection, taking into account the usefulness and availability of the data.
- Gather data on bookings and billings for the U.S. and Japanese markets.
- Gather additional useful production and trade data.
- Develop methods for eliminating statistical distortions such as those resulting from different treatment of value added in countries other than the United States and Japan.

These activities should be conducted in a manner consistent with each side's anti-trust or anti-monopoly laws and policies. The Task Force will begin collection of data, including bookings and billings, as of March 1, 1983 and make its first report to the Work Group on the data collected in early April, 1983. The Task Force will report on its progress at each meeting of the Work Group. Under the guidance of the Work Group, the Task Force will consider similar data collection in other high technology sectors.

#### 2. Solving Trade Problems

The Work Group recommends that:

- Problems of access, if any, especially as they relate to procurement and distribution, be discussed and solutions sought in the Work Group. If both sides agree, the Work Group will, as appropriate, take steps to have relevant agencies or independent organizations investigate and solve the problem. Note: Each side is, of course, free to take independent action.

- Each government include enterprises constituted under the laws and regulations of the one country and owned or controlled, directly or indirectly, by nationals or companies of the other country in its programs, and encourage inclusion of such enterprises in private programs, to promote sales or provide other economic benefits in the field of high technology industries.
- Each government take steps to eliminate the use of such specifications as may exist which arbitrarily discriminate against enterprises owned or controlled, directly or indirectly, by nationals of the other country in the procurement of high technology products by government entities and encourage the elimination of such specifications by private sector organizations. Any technical specifications prescribed by government procurement entities should, where appropriate, be in terms of performance rather than design. Taking into account the views and activities of the Work Group, among others, each government should explore issues related to the appropriateness of technical specifications prescribed by government entities.
- The Government of Japan develop possible concrete measures to promote imports of manufactured goods in high technology in light of the Prime Minister's May 28 statement, taking into account the views and activities of the Work Group.

B. Information Exchange, Technology Transfer and International Cooperation

The Work Group recommends that:

1. Channel for R&D Information

The governments create a government-to-government channel to facilitate the timely exchange of information on upcoming government sponsored R&D projects, and to provide information on ongoing projects including methods of access and technology rights.

2. Information Windows for Patents/Technology

Each government establish information windows to answer private sector inquiries concerning patent and technology exchange, including, where practicable, catalogue of patents, procedures for gaining access to patents, and procedures for licensing technology.

3. Data Exchange

Each government establish measures and institute proceedings to ensure a balanced mutual flow of technical information through appropriate public and private organizations, and make available technical reports on current government sponsored programs at least annually.

4. Access to Programs

Each government ensure that government sponsored R&D programs will be open, in principle, for participation by enterprises constituted under the laws and regulations of the one country and owned or controlled, directly or indirectly, by nationals or companies of the other country, on the same basis as for enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country.

5. International Cooperation in R&D

Each government make further efforts to promote cooperation in R&D in the technology fields which are suitable for international cooperation.

6. Access to Technology

Each government undertake to facilitate licensing of patents and technology held by the government in blocks and families rather than item by item, to enterprises owned or controlled, directly or indirectly, by nationals of the other country, on the same basis as to enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country. Each government also undertake to limit government intervention in the licensing of privately held technology.

## 7. Investment

Each government undertake to ensure that plans calling for the development or rationalization of a high technology industry are drawn so that all enterprises constituted under the laws and regulations of the one country, (whether owned or controlled, directly or indirectly, by nationals or companies of the one country or of the other country) participating in such an industry, are treated equally in terms of the opportunity for inclusion. Each government also undertake to ensure that enterprises constituted under the laws and regulations of the one country, and owned or controlled, directly or indirectly, by nationals or companies of the other country, are treated on the same basis as enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country in access to investment promotion programs, including depressed area funds, concessionary lending, etc.

## 8. Facilitating Cooperative R&D

The U.S. government review the impact of U.S. antitrust law on the ability of U.S. enterprises to participate in cooperative R&D programs, and make appropriate recommendations.

## C. Competitive Practices

### 1. Accounting Analysis

The Work Group recommends that by the end of March 1983, it bring together financial staff from high technology firms to examine U.S. and Japanese accounting methods in high technology industries.

## **III.** GENERAL

The Work Group will:

### 1. Report on Market Development and Trade

Using the joint data collection developed under Section **III** A.1. above, issue regular reports on market trends for high technology products in the U.S. and Japan and technology flows between the two countries.

2. Invite Private Sector Participation

Invite private sector advisors and industry representatives to participate in subcommittees of the Work Group, particularly in the consideration and development of individual sector reports, and in the review of trade distortions and conditions in specific high technology markets.

IV. LONG TERM WORK PROGRAM

The Work Group will undertake a long term work program, according to the attached outline.

V. ADOPTION

The Work Group recommends that the two governments act on these recommendations, after necessary internal procedures, not later than the end of January 1983.

## OUTLINE FOR LONG TERM WORK PROGRAM

### A. Sectoral Analysis

If agreed by both sides in the Work Group, the Work Group will conduct sectoral analyses with the objective of identifying and resolving sources of trade friction and of promoting industrial cooperation between the two countries.

The first sectoral analysis, a study of the semiconductor industry, will be initiated as of February 1, 1983.

Other sectors to be analyzed will be decided by agreement of both sides in the Work Group. Once a sectoral analysis has been agreed upon, the Work Group will agree on a timetable appropriate to the sector.

Upon completion of a sectoral analysis, it will be reviewed by the Work Group for not more than thirty days. The Work Group will then develop joint recommendations for resolving problems in the sector by its next meeting.

### B. Research Associations and Organizations

The Work Group will undertake a joint case study of the organization, management, and decision-making process (including the handling of patent/technology, the decision to launch new projects, etc.) in a specific research association or organization.

### C. Industrial Cooperation in High Technology

The Work Group will examine the nature of industrial cooperation agreements between the U.S. and Japan and between the U.S. and third countries and between Japan and third countries.

### D. Other Issues

Other issues, including patent rights and import promotion measures, will be addressed at the agreement of the two sides in the Work Group.

**TERMS OF REFERENCE FOR THE U.S.-JAPAN WORK GROUP  
ON HIGH TECHNOLOGY INDUSTRIES**

**I. OBJECTIVES**

Recognizing that high technology industries are making rapid progress and can be expected to contribute greatly to revitalizing the world economy, including the economies of both the U.S. and Japan; and recognizing the importance of maintaining and promoting open markets for high technology products and services, the Work Group will have the following objectives:

- o Examine the structure and functioning of high technology industries, including factors affecting competitiveness;
- o Recommend to respective appropriate authorities **ways** of facilitating innovation and research in high technology industries, enhancing the healthy development of international trade in high technology, including reducing or eliminating distortions to trade, if any, and other issues that might be appropriate;
- o Expand mutual understanding of the effect of technological developments on economic growth;
- o Identify areas in which cooperative efforts, including cooperative R&D and technology exchange, could promote high technology industries.

**II. DEFINITION**

"High Technology Industries" are defined as industries producing commodities or services based on the rapid application of innovations derived from research about which both countries share a common interest.

**III. WORK PROGRAM**

The Work Group will examine issues and make recommendations in the following areas:

- a. Prospects for high technology industries and their effects on trade and economic growth;
- b. The outlook for cooperative R&D;
- c. Ways and means to improve market access and the functioning of market forces in high technology trade;

- d. Mutual access to government-supported non-military R&D programs;
- e. Structure and functioning of high technology industries in each country;
- f. How quality, management and productivity affect competitiveness;
- g. Patent and related property rights and their effects on innovation and research in high technology industries;
- h. Actions which may promote or impair the health and viability of high technology industry and trade.

The work program will encompass but not necessarily be limited to the high technology sectors of semiconductors, computers, and telecommunications.

- IV. The Work Group will be composed of appropriate officials of the respective governments.
- V. Non-government technical experts by mutual agreement may be invited as appropriate.
- VI. Activities of the Work Group naturally concern industrial and trade matters pertaining to the field of high technology, and nothing contained in these Terms of Reference or in the recommendations made to the two governments is intended to prevent either country from taking any action or not disclosing any information which it considers necessary for national defense purposes.
- VII. The initial areas suggested for action:
  - o Examination of future prospects for high technology industries including sectors selected for special attention;
  - o U.S.-Japan cooperation in R&D;
  - o Ways to improve market access and the functioning of market forces in high technology trade;
  - o Development of a long-term work program.
- VIII. Immediate critical issues will be addressed in the first three meetings. Recommendations will be submitted to the respective appropriate authorities in January 1983.

February , 1983

Dear

1. High technology industries have been showing a rapid growth in recent years and are expected to play a primary role in revitalizing the world economy by stimulating other industries and fostering hope for better -quality of human life. We cannot have a real prospect in the future of the world economy unless we maintain close cooperations among industrialized countries in this area. It is particularly important for both Japan and the United States to maintain and even strengthen their cooperation in developing high technology industries and promoting trade and investment relations thereof. Such bilateral cooperations will certainly contribute a great deal to the further development of mutually beneficial economic relations between the two countries and they may well be expected to lead to broader cooperations among other countries.

2. From this point of view, I have been watching closely the work of the Japan-U.S. Work Group on High Technology Industries which was set up in July, 1982. The Work Group met three times since then and, based on its laborious studies, made "Recommendations" to the appropriate authorities of the two Governments. The Government of Japan thoroughly studied these Recommendations through intensive consultations among ministries concerned and reached the conclusion that the Recommendations provide a most appropriate guideline as to roles and actions of both Governments in the development of further cooperation between the two countries in the area of high technology industries.

3. I am pleased to hereby express, on behalf of the Government of Japan, the intention of the Government of Japan with respect to the Recommendations which consists of the "Principles," "Implementation" of concrete measures, and "Long-Term Work Program": The Government of Japan intends to respect their Principles and implement their concrete measures. The Government of Japan also expects the Work Group to elaborate the contents of the Long-Term Work Program as soon as possible. It is our understanding that endorsement by either of our Governments is of a unilateral nature and that nothing in this letter or these Recommendations is intended to constitute a legally binding obligation.

4. The closer cooperation between the two Governments based on the Recommendations indicates a new era of bilateral relations in high technology industries. My cabinet colleagues and I will continue to **work** together with you and other friends of the Government of the United States in this respect.

Sincerely,

Shintaro Abe  
Minister for  
Foreign Affairs

Dear ----- :

I was pleased to receive your letter of \_\_\_ informing me that the Japanese Government has endorsed the Recommendations of the U.S.-Japan High Technology Work Group and intends to respect their Principles and implement their concrete measures. I am pleased to inform you on behalf of the US Government that the United States Government also has endorsed these Recommendations and intends to respect their Principles and implement their concrete measures.

I believe that these Recommendations stand as clear evidence of the good progress that our two Governments can make through determined efforts to address promising as well as difficult areas in our trade relations. Furthermore, I believe that they will provide a framework for continued dialogue between our Governments through the Work Group.

It is our understanding that endorsement by either of our Governments is of a unilateral nature and that nothing in this letter or these Recommendations is intended to constitute a legally binding obligation.

I am convinced that by working together in a spirit of cooperation each nation can better adjust to the changing economic and trade climate caused by the emergence of the many new technologies.

Very truly yours,

SUMMARY OF u.s.-JAPAN HIGH TECHNOLOGY  
WORK GROUP FOR THE TPRG MEETING  
FEBRUARY 10, 1983

The U.S.-Japan High Technology Work Group was established in May 1982 in the wake of the controversy over Japanese trade practices and policies with regard to the 64K Ram. It then appeared that Japan and the United States were facing a potentially long series of trade problems in one high technology area after another. During a visit by MIT! Vice Minister Kurihara, these issues were discussed between Kurihara, Under Secretary Olmer and Ambassador Macdonald.

Vice Minister Kurihara proposed that a study group be established to review the issues. Under Secretary Olmer and Ambassador Macdonald agreed to the idea of a group but insisted that it would be a work group and that it should be aimed at making concrete recommendations. Further, it was agreed that these concrete recommendations would have to be made quickly if the group were to have any credibility. Hence, a target of October 31, 1982 was established for the development of such ecommendations.

The objectives of the U.S. side were three-fold:

1. We had a major concern about the difficulty of obtaining access to the Japanese market in high technology areas. We hoped, through the work group, to be able to substantially improve the opportunities for U.S. companies in the Japanese market.
2. Access to technology -- As Japan has devoted increasing resources to development of technology, it has increasingly begun to develop technologies of interest to U.S. companies. However, U.S. companies faced much greater difficulty in obtaining licenses and know-how from Japan than Japanese companies did from the U.S. It was, therefore, our objective to substantially improve U.S. access to Japanese technology.
3. Trade practices and industrial targeting -- We were very much concerned with the effects on trade that seemed to arise from Japanese industrial policies which

choose certain high tech industries as target industries. Such industries include semiconductors, computers, telecommunications, aerospace, etc. It was, therefore, our objective to commit the Japanese to jointly reviewing with us the trade effects of these policies and to taking steps to rectify any negative impact they may have.

The recommendations consist of three major parts:

- A. Principles - A number of principles are listed which affirm that markets and opportunities for investment should be kept fully open in high technology fields. The principles would commit the two sides to non-discriminatory treatment of foreign companies and to rectification of distortions to trade arising from government policies.
- B. Concrete Steps - A number of concrete steps are recommended for immediate alleviation of problems. These include:
  - 1. Joint collection of market data, beginning with semiconductors, to help anticipate trade problems.
  - 2. Development of a plan by Japan to stimulate imports of high technology products.
  - 3. Measures to enable U.S. companies to more easily license technology from Japan and to open Japanese government funded R&D projects to U.S. companies.
- C. Long-Term Work Program - If approved, the recommendations would commit the two sides to studying and making recommendations with regard to the trade impact of Japanese targeting policies in a series of high technology industry sectors.

#### LIMITATIONS

- 1. Anything dealing with national defense is excluded from the scope of the recommendations.
- 2. Nothing in the recommendations is meant to be inconsistent with domestic laws or international obligations.

RECOMMENDATIONS

The recommendations, if approved, would not constitute a legally binding international agreement. Rather, approval would be in the nature of a unilateral undertaking by each side to act in accord with and in carrying out the recommendations.

TUE ✓

Japanese Trade Issues

Set forth below is a status report on current U.S.-Japan trade issues.

1. Overall U.S.-Japanese Economic Relationship

One of the regular themes in our high-level discussions with Japan has been that of shared responsibility for the international economic **system**. As the two largest economies in the free world, each has a major role to play in international trade and finance. We have urged the Japanese -- during Prime Minister Nakasone's visit in January, at the Williamsburg Summit, and in contacts with the trade minister of the EC, Japan and Canada -- to look at the problem of access to their market in the context of the tremendous benefits Japan enjoys from market access elsewhere and their responsibility for maintaining a healthy international trading system. We have also urged that the Japanese internationalize their economy to a greater extent and allow a larger global role for the yen. Generally, the Japanese have been sympathetic to this line of reasoning, though they have not been able to discard completely the notion that they are a small, economically-vulnerable nation which cannot afford to take risks in the world economy.

Our dialogue on industrial policy, which arises from concern in the Congress and the U.S. business community that the U.S. develop an appropriate policy response to bilateral trade pressures from "targeted" Japanese industries, is also related to this concept of responsibility for the world economic system. Inevitably, Japanese efforts to encourage industrial development have more impact on world trade and finance than efforts by smaller economies would. Our approach to the Japanese on industrial policy should reiterate the theme of responsibility in a global economy.

2. Japanese Voluntary Automobile Export Restraints

In 1981, the Japanese set the current export restraint level of 1.68 million cars per year based on their analysis of the U.S. economic situation and auto sale prospects. The current restraint expires March 31, 1984. There are strong indications that Prime Minister Nakasone and his cabinet recognize the need to continue restraints on auto exports to the U.S., although they may desire higher levels reflecting the improved U.S. economic situation.

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### 3. NTT Agreement

The three-year NTT procurement agreement expires December 31. An interagency group is gathering data from private industry, from the GOJ, and other sources to determine whether or not it is in the interest of the USG to renew the agreement. Sales of U.S. equipment to NTT, although doubling every year of the agreement, are still less than two percent of the total NTT purchases. There are signs that the NTT bureaucracy **is making** a real effort to implement the agreement and the private sector does not appear in favor of allowing the agreement to expire. However, some believe there could not be sufficient purchases, or establishment of a commitment allowing fair and open competition on the part of NTT, to justify renewing the agreement. Current sales are inadequate. USTR has informed the GOJ that we have no "target" amount for sales, but renewal of the agreement will require major sales indicating genuine opening of the NTT market.

### 4. High Technology: Import Promotion

The U.S.-Japan Technology work group, at its last meeting, gave the Japanese a list of suggested actions the Government of Japan might take to promote imports of foreign semiconductors into the Japanese market. The next meeting of the work group is scheduled for September at which time the program will be discussed. U.S. reps have also suggested that we mutually reduce semiconductor tariffs to zero from the current level of 4.2 percent. This idea has arisen from time to time without any real discussion.

### 5. GATT Consultations on Agricultural Import Quotas

After numerous bilateral discussions over the last 18 months and a number of delays in proceeding to the GATT, the U.S. requested on July 1 GATT Article XXIII:1 consultations on 13 of Japan's 19 agricultural import quotas. The U.S. believes that Japan's quotas are inconsistent **with** GATT provisions. The first round of consultations was held on July 13 and another round probably will be held in mid-September. The Japanese have not provided adequate answers to the questions we posed on the quota's status during the initial consultations, despite recent high-level U.S. requests for the information.

## 6. Manufactured Tobacco Products

Recent GOJ tariff reductions on imported tobacco products have reduced the price differentials between foreign and domestic Japanese brands, but the effect on the retail price level of imported cigarettes, in particular, was largely offset by a **tax** surcharge imposed concomittantly on both foreign and domestic brands. The GOJ is also expanding the number of JTS retail outlets authorized to handle foreign brands to include all major cities by October 31, 1983. It is committed, on a "best efforts" basis, to permit all outlets which wish to sell foreign products to do so by March 31, 1985, **a year** earlier than announced in the May 28, 1982 trade package. However, the JTS monopoly severely restricts marketing and advertising activities for foreign brands as well as certain aspects of distribution and delivery. U.S. manufacturers have been pressing for the right to have the option to use other (or their own) distribution networks in order to alleviate these problems. The GOJ promised in a January 13 announcement to study the possibility of establishing an independent distribution network for foreign tobacco products. However, this will be done in tandem with the GOJ's analysis of the future of JTS as a part of the government's overall administrative reform efforts, and no target date has been established for the completion of the distribution network study. In a related development, JTS is establishing an export company, which raises subsidy, dumping and other issues.

## 7. Lowering Tariffs

The U.S. has been pressing the Japanese for some time to eliminate, or reduce, a wide variety of tariffs. In our July trade talks, we listed five key categories: certain high-value or value-added agricultural products, forest products, paper, alcoholic beverages and semiconductors.

On May 28, December 25, 1982, and January 13, 1983, Japan announced the reduction of tariffs on chocolate, biscuits, and a wide range of agricultural and industrial items. Almost all the reductions were accelerations of the MTN duty levels that were to be reached by April 1, 1987. For the most part, the reductions were either major cuts on items of minor export interest to the U.S. or minor cuts on items of significant interest. High tariffs remain on important competitive U.S. goods such as forest products (principally plywood, veneer and particleboard), alcoholic beverages, and a number of agricultural products.

In one tariff **area** (sem conductors) we are able to offer reciprocal benefits to Japanese industry, if Japan is willing to eliminate its tariff on the product. While the other tariff issues have all been raised formally on one or more occasions with Japanese officials, the mutual elimination of the 4.2 percent tariff on semiconductors has not yet been aggressively pursued by the USG, and could "sweeten the pot" for the rest of our list.

## 8. Citrus and Beef Quotas

The GOJ maintains import quotas and other trade barriers on beef, citrus and orange and grapefruit juices as part of 19 agricultural categories on which there are residual import restrictions. The USG believes that these import restrictions, particularly the quotas, are inconsistent with GATT provisions.

U.S. exports of beef and citrus items to Japan are now covered by a 1978 MTN agreement, which expires March 31, 1984. During negotiations in Honolulu in October, 1982, the USG requested the elimination of the quotas as of April 1, 1984, but the GOJ was not prepared to respond positively to the proposal. The GOJ has since suggested insignificant increases in the quotas during informal conversations and meetings. During an April 26 session, Deputy USTR Smith reiterated the USG objective of the elimination of the quotas, but suggested that a "toothless" quota might be acceptable for the interim. At the July 13 U.S.-Japan Trade Subcommittee meeting, the Japanese agreed to meet with us several **times** over the next few months to try to resolve the issue. Although it is unlikely the Japanese will completely eliminate the quotas in the next term, some reporting indicates that the Japanese may be able to offer a schedule of annual increases in the quota levels, possibly leading to complete liberalization over a lengthy **time** period. However, the quotas are probably the most contentious trade issue in Japan, and it remains to be seen whether Prime Minister Nakasone can build the consensus needed to **make** such a dramatic offer.

Wendell W. Gunn  
Eric I. Garfinkel  
August 30, 1983

MEMORANDUM

COUNCIL OF ECONOMIC ADVISERS

July 25, 1983

**MEMORANDUM FOR THE COUNCIL**

**FROM:** Geoffrey Carliner

**SUBJECT:** Japanese Industrial Policy and U. S. Trade Policy

u.s. and MITI officials have met to discuss industrial policy twice since the Houdaille decision, and will meet twice before the end of September. This memo summarizes what we have learned about Japanese industrial policies, discusses why they might be of concern to the u.s., and presents some of the policy responses that have been suggested.

**I. Japanese Industrial Policy**

The Japanese explain the goal of their industrial policies as overcoming market imperfections that inhibit factors of production from entering or leaving an industry. Industrial policies therefore concentrate on new, "emerging" industries to which market forces allocate too few resources and declining industries with too much capital and labor. Japanese industrial policies differ from the indicative planning of France and some other market economies in ignoring the majority of industries which are neither emerging nor declining. The industrial policies used by MITI and by other Japanese government agencies are designed to promote growth in specific emerging industries and to smooth the decline of other industries.

Information. The market imperfections preventing optimal growth in emerging industries include inadequate information and risks too large for private capital markets. To overcome these imperfections, MITI tries to gather the best information about future growth industries from all available sources. These include MITI men in major industrial centers around the world, as well as Japanese bankers, industrialists, traders and academics.

Councils. After deciding which industries offer the most promise, MITI plans the growth of emerging industries in councils which include representatives of producing and consuming firms, banks, trade unions, academe and the media. Representatives of foreign subsidiaries in Japan and of importers are not included. The council process not only

produces forecasts that may be better than private firms or investors could make for themselves. It also creates a consensus among the economic agents that MITI's plans make economic sense and should be followed.

Being excluded from MITI's councils may hurt foreign firms in several ways. First, they do not participate in deciding industry standards and certification procedures. The standards that are created will tend to be easier for their competitors to comply with. Second, foreign firms will miss an important opportunity to learn about the market strategies and development plans of their competitors. Although much of the information exchanged in the councils may be available elsewhere, the process of building a consensus within the councils undoubtedly helps participating firms in the marketplace.

Finally, it is possible that the councils sometimes reach an unstated consensus not to buy foreign products when Japanese alternatives are available. Even if there is no such agreement among Japanese firms, the existence of a consensus on industry growth may make it easier for MITI to persuade individual firms to buy domestic instead of imported products when price differences are not too large. However, the evidence that MITI acts in this fashion is at best circumstantial.

Subsidies. Once MITI has gathered and analyzed information and built a consensus on emerging industries, it uses several other tools to stimulate growth. First, it pays for research to develop new technology, for instance in computers, semiconductors, and commercial aircraft. MITI has also encouraged joint research among firms whose competitive spirit might have otherwise kept them from cooperating. In most industries, private research spending has far exceeded government spending. NC machine tools received special tax benefits until last March. Computer software is currently favored.

A second form of subsidy provided to emerging industries is special depreciation. MITI receives a budget each year for tax expenditures as well as for cash outlays. It uses the tax expenditures to pay for faster depreciation in targeted industries or for targeted capital goods than are generally available **for Japanese firms.**

Some emerging industries including computers also received subsidies in the form of low-interest loans from the government-owned Japan Development Bank. Most JDB loans go to energy conservation, urban development, and shipbuilding. However, the loans to emerging industries may have more effect than their size would suggest, since the JDB only lends as part of a larger consortium.

Cartels. Perhaps more important to emerging industries than these explicit subsidies is the understanding that MITI will protect the industry from temporary setbacks, especially excess capacity caused by recessions or overinvestment. During periods of excess capacity, MITI organizes formal or informal "recession cartels". MITI also imposes production quotas when foreign governments pressure Japan to restrain exports. These cartels restrict the output of each firm and prevent prices and profits from falling as far as short run competitive equilibrium levels.

Under these cartels, production quotas are generally allocated according to market shares. Therefore, prior to the recession each firm has an incentive to maximize market shares rather than to maximize short run profits. The incentives thus provided by MITI reinforce the existing inclination of Japanese firms, especially when entering new markets abroad or new industries at home, to concentrate on market shares and long run profits rather than on short run profits.

Administrative guidance. A final tool used by MITI is informal administrative guidance. This "guidance" consists of explicit suggestions concerning a firm's behavior, together with appeals to the national interest. Guidance may also include implicit promises of favors or penalties on subsidies or regulation that MITI controls.

During the postwar period when MITI controlled foreign exchange and capital allocations, a phone call from the ministry suggesting increased investment in a certain area was undoubtedly very effective. Today, MITI's power is greatly reduced, and it is not clear that a direction to buy Japanese instead of American semiconductors would always be obeyed, if indeed such instructions are given at all. Circumstantial evidence suggests that MITI does continue to give administrative guidance to restrict foreign access to Japanese markets, but the extent of effect of this industrial policy tool is probably unknowable.

Declining industries. In addition to directing economic activity into growth industries, Japanese industrial policy tries to smooth the flow of resources out of declining industries. (In some cases, for instance shipbuilding and petrochemicals, the growth industries of the recent past are the declining industries : the present.) MITI tries to encourage adjustment by providing help to declining industries only if the firms in an industry agree on explicit plans for reducing output and capacity. Only then will MITI approve subsidized loans and recession cartels to restrict production.

Although help to declining industries included import protection in the past, MITI claims that such protection is not

currently used. It is difficult to understand how a cartel could help domestic firms restrict output and raise prices without preventing foreign firms from replacing domestic suppliers and keeping prices low. Nevertheless, **MITI** does not admit to protecting declining industries even when it approves domestic cartels, and there is little evidence that it does so. Perhaps cartels that restrict domestic output and drive up domestic prices can work because of informal trade barriers, including administrative guidance from MITI or monopolistic distribution networks.

## II. Economic Effects

Encouraging favored industries. Industrial policy has several effects on the Japanese economy. First, it probably stimulates the growth of targeted industries by increasing tendencies that already exist in the Japanese economy. MITI helps to provide information that the private sector might find difficult or expensive to obtain on its own. MITI also helps to build a consensus among banks, producers, and industrial consumers. These actions may stimulate growth in areas that might have developed in any event. Granting subsidies also encourages somewhat higher investment in favored industries than would otherwise take place.

Export Surges. Second, MITI encourages rapid growth in emerging industries with its implicit promise to protect firms from some of the risk of building too much capacity. Allocating output during hard times on the basis of market share during the good years may make Japanese firms even fiercer competitors in domestic and foreign markets than might occur in the absence of an industrial policy. MITI's actions thus reenforce the existing inclination of Japanese firms to maximize market share and not to worry about overinvesting. By stimulating growth in favored industries, this policy may also create larger surges in exports than have taken place in industries not targeted by MITI.

Import Protection. Finally, MITI's consensus building, administrative guidance, and formal trade and investment barriers may protect Japanese markets from foreign competition. The process of building a consensus on emerging industries by having producers and consuming firms work together in developing plans may encourage them to buy from each other instead of from foreign producers. Administrative guidance may also be used to exclude imports. Although MITI's power has declined over the last 20 years, Japanese firms would probably follow a suggestion to buy Japanese goods, as long as the price difference wasn't too large.

In addition to these informal barriers to imports, formal barriers may also protect some emerging industries from foreign competition. These formal barriers have been substantially reduced since the 1960s. Japan's tariffs and quotas on manufactured goods are no more less restrictive today than those of other OECD countries, and even trade barriers such as certification procedures and restraints on foreign investment are being liberalized. Nevertheless, formal nontariff barriers continue to protect certain manufacturing sectors.

Many countries find that import protection results in inefficient domestic industries that charge high prices to downstream industries. Protection thus makes downstream industries uncompetitive internationally even when they are efficient. Japan seems largely to have avoided this dilemma by protecting emerging industries that are moving down a learning curve and by encouraging domestic competition via the promise of recession cartels. By increasing the sales and output of domestic industries, protection may even have increased the speed of learning and of productivity growth in some industries.

Reinforcing existing tendencies. In stimulating the growth of certain industries, erecting formal and informal trade barriers, and perhaps encouraging export surges, Japanese industrial policies have undoubtedly affected their trade with us. However, the most that can be said is that these policies reinforce tendencies in Japan that exist independent of the policies. Japan's rapid growth is due primarily to her high rate of investment in physical and human capital, not to any industry-specific policies.

The increased competition faced by U.S. firms, first in basic industries and consumer electronics and more recently in high tech, is the natural result of Japan's catching up after the devastation of World War II and the progressive opening of international markets. The U. S. cannot expect to continue to maintain its near monopoly position in knowledge intensive industries forever. As other countries increase spending on education and research, it is to be expected that they will take away some of our market share in this area. At most, Japanese and European industrial policies have only accelerated this tendency.

Japanese industrial policies also have no more than a marginal effect on overall trade. Japan's pattern of trade looks different from that of other developed countries for several reasons that have to do with formal or informal barriers erected by the government. First, because it must import oil and other raw materials, Japan will in any case run a large surplus in manufactured goods with the U.S. Second,

Japan's relatively large domestic market and distance from other developed countries result in less intra-industry trade than many other countries have. Third, Japan's oligopolistic distribution networks and lifetime employment practice make its markets more difficult to enter, by selling from abroad or by investing locally.

Finally, Japanese businessmen may still worry that Japan is a small island nation with few natural resources that must save its foreign exchange for essential raw materials. They may therefore be willing to pay a little more for domestic goods than for imports. They may also have a prejudice, sometimes based on experience, that Japanese products offer higher quality as well as more secure supply.

Japanese government policies reenforce these other factors. However, removing all the formal and informal trade barriers associated with industrial policy would not have a dramatic effect on Japanese trade. Moreover, to the extent that removing trade barriers increases imports, the yen will fall relative to the dollar and Japanese exports to the U. S. will rise. Such a development may be good for international efficiency and for consumers in both countries, but it will not ease our economic and political difficulties in industries such as autos and steel. The "fair traders" may not get the results they want if we succeed in convincing MITI to dismantle its trade barriers.

### III. Possible U. S. Responses.

Regardless of the "fairness" of Japanese industrial policies, our trade relations are far from smooth. We may want to change our approach even if we conclude that their practices are entirely legal and appropriate under international law. For instance, we may want to encourage the Japanese to open their markets beyond what is required by the GATT. In some cases we may want to close our own markets to allow our industries to adjust to increased foreign competition. We may even want to adopt more explicit industrial policies of our own. These specific policies would be in addition to general programs to encourage saving, research, and education.

The U.S. already pursues several policies that might be used to offset the trade effects of Japanese industrial policies. These include :--e--lotiationsto open Japanese markets to American investment and .mports, antidumping and countervailing duties desl•led to offset foreign dumping and government subsidies, and : port protection for U. S. industries hurt by imports. e also send occasional shots across bows to discourage ot er countries from subsidizing trade with third countries, and we have an industrial policy of sorts, run by DOD and NSF.

Opening Japanese Markets. For several years the U.S. has pressured the Japanese to lower their formal tariff and nontariff barriers, and we have made substantial progress in convincing them to do so. Tariffs on most manufactured goods are comparable to those in other developed countries. Foreign investment is no longer generally subject to government approval. Certification and standards procedures are in the process of being liberalized to facilitate trade. Most government procurement is open to foreigners.

Most of these nontariff barriers have only recently been lowered, so it is too early to see the effect of the lowering on imports to Japan. It is possible, but unlikely, that these recent changes may actually lead to a substantial opening of Japanese markets. In any event, few formal barriers to foreign investment and imports now exist in emerging industries. Most of our remaining disputes with Japan over formal trade barriers concern agricultural goods such as beef and citrus or light manufactured items such as cigarettes and leather. Short of asking the Japanese to abandon their industrial policies altogether, further negotiations may not have dramatic effects on the openness of Japan's markets in emerging industries. Most of the barriers that remain are the result of Japan's industrial structure and perhaps of very informal government intervention, not formal tariff or nontariff barriers.

Offsetting foreign subsidies. Existing U.S. antidumping and countervailing duty laws enable us to offset specific foreign government subsidies with tariffs. These measures do not include penalties, and may therefore encourage foreigners to take a chance that they will not be caught. Perhaps the laws should be changed to eliminate this incentive. However, doing so would have little effect on our trade with Japan, especially in high tech industries. Japanese subsidies to emerging industries are a small percentage of total research and production costs, and dumping is almost impossible to prove because forward pricing (below current costs but above expected long run average costs) is standard practice. The main effects of tightening our antidumping and cvd laws would be on developing countries like Brazil and on declining European industries.

Protecting U.S. Markets. We now offer protection to domestic industries hurt by Japanese imports regardless of whether they have been targeted. U. S. autos and motorcycles are protected even though those industries have not benefitted from Japanese industrial subsidies for 20 years. U. S. machine tools **were** denied protection in spite of recent Japanese targeting on that industry.

An alternative policy would give automatic protection to industries targeted by Japan regardless of whether imports cause serious harm. It is argued that such a policy would save American jobs in industries like machine tools and might also discourage the Japanese from future targeting by lowering the rewards of doing so. Adopting the Japanese technique of protecting emerging industries might even make them more efficient. Japanese high tech industries are said to move down learning curves faster because they have all of their domestic markets and part of our markets as well. Greater sales also allow them to spread the fixed costs of research and development over more units. The result may be both higher profits for Japanese producers and lower prices to consumers.

The Japanese can dominate their domestic markets and keep American firms out by informal trade barriers. With our open industrial structure, we would have to use formal barriers to keep Japanese firms out of our domestic markets. Doing this might benefit some U. S. industries, but if it failed it might have bad effects on downstream industries. Such a policy would also be a terrible precedent for the international trading system.

Subsidizing our exports. In order to persuade our competitors not to subsidize their trade with third countries, we occasionally subsidize our own exports temporarily. This has happened in the past with credit for civilian aircraft and more recently with agricultural products. This policy may or may not prove effective in discouraging the EC from subsidizing their exports. However, it is not useful as an offset to Japanese industrial policy, since export subsidies are small or nonexistent.

U.S. Industrial Policy. A final tool for countering Japanese industrial policy would be to adopt one of our own. The U. S. government already pays for a considerable amount of research and development through military, space, and NSF programs. Although the purpose of this spending may be defense or basic research, much of it has civilian applications. Some argue that these programs should be expanded, and focus more on civilian products. Others argue that the U. S. government should lend money to emerging and declining industries. Such **policies, it is felt, would enable U. S. industries** to grow faster and to compete more effectively with Japanese industries.

Providing research or capital subsidies will, of course, stimulate growth and reduce prices in the industries receiving benefits. The main danger of such policies is that the government will pick the wrong industries. For political reasons, we may pour public capital into just those industries

that private capital is leaving. Or we may choose to promote new technologies -that private investors have correctly decided offer little promise. There is little evidence to suggest that private capital markets work badly in the U.S., and substantial experience that indicates that choices influenced by politics are not as accurate at picking winners as choices dominated by economic considerations.

cc:PK, AW