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STATEMENT OF
ELMER B. STAATS
COMPTROLLER GENERAL OF THE UNITED STATES
BEFORE THE
JOINT ECONOMIC COMMITTEE *TNT00700*
ON

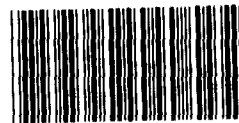
[ISSUES AND PROBLEMS RELATING TO UNITED STATES-JAPAN TRADE]

Mr. Chairman and Members of the Committee:

We are pleased to be with you today to discuss our recent report, "United States-Japan Trade: Issues and Problems." Our work was performed at your request for GAO to undertake (1) a comparative analysis of U.S. and Japanese trade policy and (2) a study of the experience of firms that have been successful in penetrating Japanese markets and other firms that have encountered only frustration.

The steadily increasing deficit in U.S. trade with Japan between 1976 and 1978 resulted in widespread concerns in the United States. In 1978, the deficit reached \$11.6 billion, amounting to two and half times that of 1976. Currently, it is estimated that the U.S.-Japan bilateral deficit in 1979 may be about \$9 billion.

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Trade policies contrasted

In comparing U.S. and Japanese export policies, GAO finds the sharpest contrast in the different approach toward the identification of what is a suitable export industry. Japan's commercial policy rests on identifying industries with strong export potential and providing them with support. In the United States, there is no analysis of export potential among industries. Before targeting an "export industry," Japan asks "Do the products of this industry have a high value-added content? Will the demand for this product rise with rising income?" These questions are not asked in the United States. Japan encourages its strong industries; the United States protects its weak ones.

GAO found significant differences in "export consciousness" between the two countries. Japanese "think" foreign trade, as early as the fifth grade, school children are introduced to its importance for their country. Americans come from a quite different background--a richly endowed economy, continental in breadth, for which in the past, foreign trade has been a minor element.

This study confirmed that the United States must heighten its "export consciousness" which, among other things, means studying other nations' preferences and designing products accordingly.

Japan's foreign trade administration is more focused than that of the United States, because, lacking raw materials and land sufficient to feed itself, virtually the only goods Japan has to sell to the world are manufactured goods. The United States, by contrast, sells manufactured goods, agricultural products, and crude materials, each with its own trade administration.

Japan's primary technique for encouraging industries with strong trade potential has been accelerated depreciation, with great emphasis on modern plant and equipment. The United States has no statistics on the average age of plant and equipment by industry and how these statistics compare with other countries. The United States extends investment credit to all manufacturers alike; Japan favors certain industries over others, with a view to supporting industries important to the performance of the economy. At the present time, for example, the computer industry is receiving the greatest government benefits.

There is an important time frame difference between Japan and the United States in trade policy. Japan anticipates. Its conception of "early warning" rests on economic projections 5 to 10 years or more in the future. Because Japan perceives increasing pressure from newly industrializing countries in textiles, consumer electronic products and the like, the government feels compelled to encourage industry

to move into more sophisticated types of manufacture.

The United States reacts. Its conception of "early warning" is based on import statistics of the goods which arrive.

We selected seven case studies to illustrate the wide range of problems in different industries and to identify factors that are favorable to marketing in Japan. The firms and trade selected for study were drawn from the following industries:

computers	machine tools
automotive	logs and lumber
telecommunications	soybeans
color television	

Our study of the seven U.S. industries reveals that problems encountered in penetrating the Japanese market are both U.S. and Japanese in origin. On the Japanese side, our study reveals that past Japanese Government policies, tariff and non-tariff barriers, government assistance presently given to certain key industries, and the structure of the Japanese market affect the ability of U.S. producers to enter the market. On the U.S. side, we believe that U.S. corporate strategy and the domestic market orientation of U.S. industry have inhibited the success of U.S. producers in the Japanese market.

PAST JAPANESE GOVERNMENT
POLICIES AND THEIR IMPACT

Some of the difficulties which U.S. firms face today in their attempts to penetrate the Japanese market are the

result of past Japanese policies. Although, in the recent past, the Japanese have been willing to remove many tariff and non-tariff barriers, this has often occurred only after "targeted" industries have become firmly entrenched in the domestic market and highly competitive in international markets. For example, after 1971, Japan's auto industry was no longer closed to foreigners as it had been since the early postwar years. Until 1971, the Japanese Government, in an attempt to aid the development of the auto industry, did so by excluding imports and foreign investment (with the exception of licensing foreign technology), by granting the industry preferred status for receipt of foreign exchange allocations, and by granting special tax concessions to the industry. As a result of these favorable policies, Japan's domestic auto production expanded eighteen-fold between 1959 and 1969 with exports growing gradually from 7.3 to 18.4 percent of production. By the time Japan began reducing import and investment barriers, exports had taken on increasing significance in the continued growth and health of the industry accounting for over 50 percent of production by 1977.

Another case in point is that of the color television industry. Again, as we have discussed at length in our report, the Japanese industry was protected by tariff and

non-tariff barriers which effectively prevented the entrance of foreign competition. As noted in the case of the auto industry, Japan has been willing in the recent past to lower or do away with barriers such as foreign exchange allocations, investment restrictions, import quota systems and high tariffs. However, these reductions for the most part did not occur until the beginning of the 1970's when the Japanese industry was well established domestically and enjoying growth in international sales.

JAPANESE GOVERNMENT ASSISTANCE

Japan, with its systematic and coordinated industrial growth and trade policies, has in several instances been over-zealous in its protection of its "growth" or "target" sectors. Not only has the Japanese Government afforded these sectors protection from foreign competition, but it has also provided targeted sectors with special tax incentives, R&D subsidies, development loan programs, market guarantee programs, overseas market development programs, promotion of cooperative Japanese industry relationships, etc. Excellent examples of targeted industries receiving such aid are the Japanese computer, machine tool, and telecommunications industries. The Japanese computer industry has been the recipient of a number of direct subsidies such as the very-large integration program (VLSI) whereby the

government subsidized 50 percent of selected private companies' R&D for fourth generation computers. Additionally, for research purposes, the Japanese industry has been divided into three groups--Fujitsu-Hitachi, Nippon Electric (NEC)-Toshiba, and Mitsubishi-Oki.

In addition to industry research groups, close business government relations have also enhanced development of Japanese industry. This is true in the machine tool and telecommunications industries. Japanese machine tool builders have been encouraged to develop, as a 6-year national project, a flexible computer controlled machining system. Similarly, Nippon Telephone and Telegraph (NTT), the government regulator/operator of Japan's telecommunications network, encourages a variety of telecommunications, technology and service-related R&D through direct and indirect subsidies and joint R&D efforts with its four family members.

The Japanese Government, in an effort to encourage and direct the development of key industrial sectors, has enacted a number of tax incentives and concessions for research and development, marketing, etc. Perhaps the most significant of these are accelerated depreciation allowances which allow targeted industries to write off as much as 50 percent of the costs of plant and equipment in the first year.

Furthermore, the Japanese Government either itself or through specially-created agencies has provided guaranteed markets or strong incentives for Japanese purchases of targeted industry products. For example, the Information-Technology Promotion Agency created in October 1979, was established to, among other things, purchase any software package having a high degree of public interest. In some instance, special depreciation allowances have been enacted for end-users to encourage the purchase of sophisticated equipment.

NTT: AN EXCEPTION TO LIBERALIZATION

We believe, that at this point, it would be useful to discuss the Japanese telecommunications industry. This industry obviously benefits from many of the tax incentives and R&D subsidies enjoyed by the computer industry given the increasing computerization of telecommunications systems. In fact, the primary firms involved in the development of computer hardware, software and peripheral technology are also members of NTTs family. However, unlike any of the other examples presented in our case studies, the telecommunications market is virtually closed to foreign and, in fact, domestic manufacturers not members of the NTT family. Primary among the barriers impeding U.S. entrance in the market is the lack of clear definition between central office and interconnect markets and NTT's policies

regarding equipment and installation approval. Additionally, although most nations prefer domestic suppliers in granting contracts for telecommunications equipment, NTT's use of sole-source procurement--in other words, procuring from its family members--rather than competitive sealed bids or negotiated contracts has further circumscribed foreign entrance to the market. Despite the negotiation of the government procurement code and a bilateral mutual reciprocity agreement, we do not anticipate a substantial decline in the bilateral telecommunications trade deficit.

Even if access to government procurement were to be denied to the Japanese suppliers, the Japanese would still have an immense opportunity in the private U.S. market. However, the U.S. suppliers do not have similar access to the Japanese market because of the procedural and structural problems discussed above and in greater detail in our report.

THE JAPANESE DISTRIBUTION SYSTEM

While the telecommunications market remains a conspicuous exception to Japan's recent liberalization of trade barriers, some other U.S. industries face markets which for structural reasons are difficult to penetrate. For example, U.S. manufacturers of color television receivers (CTRs) note many problems in entering the Japanese distribution system. Japanese retail and

servicing facilities are generally owned or controlled by the major manufacturers. Exclusive distributorships are heavily, if not totally, financed and supported by CTR manufacturers. As a result, these distributors normally do not carry foreign brands because they fear losing their franchises with their normal suppliers. U.S. electrical and electronic product manufacturers, therefore, must rely on a Japanese firm with an established distributor chain for the sale of their products. Similarly, U.S. auto manufacturers state that they are unable, under Japan's exclusive dealerships, to market through the dealer networks of the major Japanese auto manufacturers. This system is currently under investigation by Japan's Fair Trade Commission.

As suggested by our case studies, in addition to causing these marketing problems, the Japanese distribution system is responsible for adding costs to U.S. products in the Japanese market. For example, in our automobile case study, the manufacturer (case participant) pointed out that these distributorships are the single most significant element in increasing the cost of an American car in Japan. It should be noted that the distribution system similarly applies to Japanese manufactured automobiles. Car dealer incentives and profit margins account for an increase of \$950, \$1,925 and \$2,600, for subcompact, small sporty and compact cars, respectively. Similarly, our soybean

case participant stated that the distribution system contributed to increased costs of soybeans, although not to the extent that U.S. exports become noncompetitive with substitutes.

STANDARDS AND APPROVAL SYSTEMS

As indicated earlier, many Japanese tariffs have been reduced; however, a number of non-tariff barriers exist which impede access to the Japanese market. Perhaps the most significant of these are the approval systems required to meet safety, electrical, and engineering standards in order to sell in Japan. For example, in our auto case study, we note that the approval process for foreign automobiles is more complicated and time-consuming than that for Japanese automobiles. While Japanese auto manufacturers are able to "self-certify" that an automobile meets standards once the type of vehicle has been approved; U.S. auto manufacturers, even after obtaining approval for a type of vehicle, must submit each auto to be sold for further inspection in order to obtain approval. Our case participant described no less than 19 changes--some relatively minor, others significant in terms of work required and costs incurred--made to U.S. vehicles to meet Japanese standards. Similarly, our consumer electronic case participant noted that stringent design specifications, quality control and safety standards have created problems for them in the Japanese market.

In the case of telecommunications, U.S. producers also face similar problems. A significant factor inhibiting U.S. entrance into the market is NTT's type and case or installation approval. Although general specifications are publicly announced by NTT, detailed specifications are generally not publicly disclosed on the grounds that they are proprietary to NTT or to the company which developed the product. Given the close relationship between NTT and its "family" which presumably is aware of unannounced specifications, foreign firms are seriously disadvantaged in this market. Not only do these approvals require a significant amount of time to obtain, but they require an extensive amount of documentation from the manufacturer as well. Moreover, NTT requires that equipment and manufacturing facilities be inspected for quality control. However, NTT has reportedly never made such overseas inspections.

It should be recognized that, in some instances, regulations have been relaxed. Japan deferred for 3 years until 1980, its stringent 1978 automobile exhaust standards and has simplified its emission testing procedures for U.S. items considered equivalent to those of Japan. In addition to suspending its emission standards on foreign cars temporarily, the government, in 1977, began sending examiners to the United States. These examiners perform safety and emission testing on-site which will reduce the cost and time required for

meeting approval. Similarly, recent changes in Japanese import regulations have had a positive effect on U.S. lumber exports. While the Japanese do not recognize lumber grading marks stamped outside Japan, reinspection regulations have recently been relaxed. Additionally, in June 1978, Japan revised its grading standards to match more closely those of the United States in order to alleviate lumber quality classification problems.

U.S. CORPORATE STRATEGY AND
DOMESTIC MARKET ORIENTATION

While Japanese market structure and government policies have made it difficult for a number of U.S. firms to successfully compete in the Japanese market, U.S. corporate strategy and the domestic market orientation of U.S. industry have also contributed to this lack of competitiveness. For instance, the strength of the American auto industry is in large cars which were in high demand in the domestic market. Exporting large cars, the U.S. industry was able to capture only a portion of the small luxury car market in Japan. Because U.S. producers were not able to achieve volume sales, they were reluctant to make changes in their vehicles which required expensive retooling--for example, a shift from left-hand to right-hand drive vehicles. Although the Japanese make such modifications to their export vehicles, they are able to do so because of the high volume of sales

in the United States and the fact that only a few other countries such as the United Kingdom use right-hand drive vehicles. Thus, since left-hand drive is used overwhelmingly worldwide, Japan was converting to compete in the world market whereas the U.S. producers would be converting essentially for the Japanese and U.K. markets.

In the case of lumber, U.S. mills have been reluctant to convert to produce Japanese sizes as they want to be ready to meet the demands of the vast U.S. housing market. Rather than produce lumber suitable for the traditional Japanese housing market, U.S. mills prefer to export U.S.-sized lumber. Thus, they have been able to capture only a small portion of the Japanese lumber market. U.S. producers would rather that the Japanese change their housing construction methods in order to use U.S.-sized lumber, than change U.S. lumber sizes to meet Japanese requirements.

Similarly, our TV case participant, noted in a 1970 letter to a potential Japanese distributor that making required modifications for safety and design standards would not be economically feasible. The U.S. firm, after weighing the expense of gearing production for these changes against potential sales volume, determined that such costly modifications would not be cost effective.

Apart from not adapting their products to meet the needs of the Japanese market, some U.S. industries have been criticized for not providing adequate after-sales servicing and technical assistance. Japanese machine tool importers claim that U.S. machine tool firms have a poor record in follow-up servicing, particularly in the area of numerically controlled machine tools. They also cite the long delivery time of U.S. machine tools as compared with Japanese machine tools as problematic.

Japanese distributors of U.S. electrical and electronic products stated that there was a lack of enthusiasm on the U.S. side for export. They stated that often there was very little effort to conform products to meet Japanese design and safety specifications, and a lack of coordination between domestic and export model changes in design and feature. Japanese firms complained that model changes are often made in accordance with U.S. market trends without any concern or focus on the needs and demands of the Japanese market. Furthermore, Japanese companies pointed out that U.S. firms make little follow-up effort in their sales, for example, meeting with distributors, providing technical and sales assistance, and so on.

U.S.-JAPAN AGRICULTURAL TRADE

While we found that U.S. manufacturers in our selected case studies face a variety of difficulties in their attempts

to penetrate the Japanese market, the U.S. agricultural and raw materials sectors have been extremely successful. In 1978, 35 percent of our exports to Japan were agricultural products, compared to 21 percent of our exports to the world. Because Japan must import many agricultural goods and raw materials, there are few, major trade barriers hindering U.S. exports of such products as soybeans and logs.

Logs, not lumber, dominate Japan's wood products imports from the United States. However, this has been the result of both the desire of the Japanese to protect their sawmill industry, as well as the reluctance on the part of U.S. mills to cut lumber suitable for the present Japanese housing market. We found disagreement among members of the U.S. wood products industry as to whether the United States should attempt to export more lumber (and other value-added products such as plywood) rather than logs, or if the United States should be exporting logs at all. During upturns in

the U.S. housing market, Japanese demand for U.S. forest products is viewed as competition which forces up the price and restricts the supply of U.S. lumber. This attitude has led to both formal and informal log export controls. Thus, in this instance, balance-of-trade considerations are in conflict with domestic concerns.

There is an additional feature of U.S.-Japan trade revealed in our case studies which we believe is noteworthy. Even as U.S. producers pay more attention to the needs and demands of the Japanese market and consumer, some U.S. producers see their best opportunity in competing with Japanese products in the American market. The U.S. auto industry, for example, is now working hard to produce smaller cars, and sees the trade challenge more in terms of reducing Japan's share of the U.S. market than in U.S. gains in the Japanese market.

SUMMARY

GAO believes that the trade imbalance between the United States and Japan has been caused by a mix of several elements:

- a weakening in U.S. manufacturing productivity and competitiveness;
- a trade policy that is import rather than export oriented; and
- Japanese tariff and non-tariff barriers.

Productivity and Competitiveness. Our study has revealed a number of factors such a low savings and investment rates, a decline in R&D expenditures relative to GNP, a disparity in the quality of manufacture for certain products compared with the Japanese and problems in labor-management relations which contribute to a weakening in U.S. productivity and competitiveness in international markets. As we point out in Chapter 9 of our report, it is alarming to note that in the past several years the United States has had the lowest rate of savings and capital formation of any major industrialized country. By contrast, Japan has had the highest rate. Savings in the U.S. economy are proportionally one-third those in Japan, and proportional to its GNP, Japan has been putting up new plant and equipment and infrastructure at double the rate of the United States. In 1978, although the American economy was close to double the Japanese economy, investment level equipment were almost equal--\$148 billion in the United States compared to \$144 billion in Japan.

Similarly, in recent years the United States has been spending a smaller proportion of GNP on R&D than was true earlier. As our relative expenditures on R&D have been falling, Japan's relative expenditures have been rising. Moreover, the record of quality manufacture between the two countries is disparate. In product after product, Japan's defect ratio is lower than that in the United States.

GAO believes the United States must pay greater attention to new plant and equipment. For most of the years, 1970-78, Japan's ratio of gross fixed investment (exclusive of residential construction) to gross domestic product has been double that of the United States. Not only has Japan's ratio of personal savings to disposal personal income in this period been roughly three times that of the United States, but the United States has proportionately been investing far higher amounts outside its borders.

Another important element in Japan's international competitiveness is its employment system which grants job security to the elite of the labor movement, with the result that relatively, Japan experiences far less time lost to strikes than the United States.

The foregoing factors combine to produce quite different levels of productivity in the American and Japanese economies. Japan's average annual increase in productivity was 3.4 times that of the United States between 1960-77, and between 1970-77, Japan's annual gains were 1.8 those of the United States. In fact, between 1970-77, with the exception of the United Kingdom, the U.S. average annual change in productivity was the lowest of any other major industrialized country.

Although U.S. exports have had a sharp price advantage in the last 2 years vis-a-vis Japanese goods due to currency realignment, American goods have been handicapped by the

greater inflation in the American economy as compared to the Japanese economy. That the U.S. price advantage has not been translated into increased exports to the extent that might be anticipated is no doubt a reflection that, although price is an important determinant of international competitiveness, other factors such as product quality, after-sales servicing, financing, government decisions, other non-monetary factors, artificial trade restrictions, and so on, also affect U.S. industries ability to compete in foreign markets.

Trade Policy. U.S. industry has traditionally focused its attention on the domestic market because of the size and wealth of this market. Japan, on the other hand, because of its need for raw materials and many agricultural products, has had a keen awareness of the importance of exports. It is not surprising, then, that Japan's trade policy focuses on identifying and providing support to industries with strong export potential, whereas, U.S. policy has focused on protecting industries from injurious imports. Thus, Japan's trade policy is anticipatory, while U.S. policy is reactive.

Tariff and Non-Tariff Barriers. Finally, the U.S.-Japan trade balance has been affected by tariff and non-tariff restrictions. Previously, Japanese tariffs, investment restrictions, and import quotas afforded Japanese industries protection from import competition until these industries were well entrenched in the domestic market and successfully competing in foreign

markets. Since the early 1970's, these barriers have largely come down; however, attitudes and perceptions on both sides have not changed as rapidly. Moreover, our case studies reveal that the Japanese distribution system and design and safety standards present recurring problems for American producers selling in Japan. Although there are various factors affecting U.S. sales to Japan including the domestic market orientation of U.S. industry, efforts should be made to overcome the ~~above-mentioned~~ inequities in the bilateral trade. Additionally, U.S. industry must be encouraged to address the underlying economic factors discussed above which also affect its international competitiveness.

Mr. Chairman, this completes my prepared statement. I would be pleased to answer any questions at this time.