2 Reducing the Trade and Investment Imbalance

The Bush administration was dedicated to a strong political and security relationship with Japan. But it also wanted more balanced economic ties. Meetings before my departure for Tokyo with the president and his senior advisers—Jim Baker, Nick Brady, Brent Scowcroft, Bob Mosbacher, and Carla Hills—left no question in my mind about that. Consequently, I considered a sizable reduction in our bilateral trade deficit and the achievement of more equitable access to Japan's market as high-priority tasks for my mission. To be sure, the United States neither could nor should have expected to balance its current accounts on a bilateral basis. Moreover, the sources of its current global deficit were to be found in the savings/investment imbalance at home. Yet the size and persistence of the bilateral trade deficit and the perception that this reflected a lack of reciprocal access to the Japanese market undermined support for the U.S.-Japan alliance, jeopardized future bilateral political cooperation, and invited micromanagement of trade policy by Congress.

Congressional agitation over the trade issue was apparent at my confirmation hearings. Within the executive branch no clear strategy for handling trade policy had yet crystallized. Nor did I anticipate dramatic policy initiatives, although I did expect the administration to approach bilateral negotiations with a growing sense of urgency. The 1988 Trade Bill had established firm deadlines for measuring progress.

And the political climate in Washington spurred the administration to act with dispatch. The ongoing FSX negotiations, moreover, demonstrated that within the executive branch, the trade agencies had become more assertive on U.S.-Japan issues and the readiness of the White House and State Department to play down economic interests in favor of strategic concerns had diminished.

When I was pointedly asked by Senator Helms whether I intended to raise the rank of my commercial counselor to the level of minister counselor—the rank of his State Department counterpart at the embassy—in order to highlight the new priority accorded trade issues, I replied that I expected personally to serve as the embassy's "First Commercial Officer." Of course, I did not plan to supplant Keith Bovetti, a capable career commercial officer whom I subsequently promoted. But I wanted it known that I would make trade matters my personal business.

In fact, I took up my duties in Tokyo with strong convictions about several needed adjustments in the embassy's modus operandi. One priority was reestablishing the mission's reputation for credible and objective economic reporting. Preserving a balance between empathy for the host country and analytic detachment about it is one of the most demanding challenges for a professional diplomat. Among intelligence and policy agencies in Washington much of the embassy's analytic work on economic issues was widely discounted as reflecting an advanced case of "clientitis." Needless to say, there were many exceptions to this generalization: for example, the embassy conducted the analytic work that underlay the successful negotiation of a beef and citrus agreement in 1988, as well as providing input to future Bush administration proposals on distribution, land use, and tax policy in the Structural Impediments Initiative (SII) talks. Nevertheless, in the late 1980s, the Tokyo Embassy was reputed to have tilted too far in favor of its host. I was determined to effect a rapid change in this balance, for the embassy could not expect to exert influence on trade issues if Washington agencies thought it was tailoring its reports to a preconceived policy agenda.

A second requirement was a closer relationship with the U.S. business community. Many Japanese companies were beating ours badly in global competition. They could count on extensive and enthusiastic government support of their commercial activities. Given the size of the trade imbalance and the extraordinary difficulties foreign companies faced in penetrating the Japanese market, it seemed to me the least the embassy could offer was competent, energetic, proactive help to our own companies. That meant augmenting the talented group of commercial officers at our posts in Japan and displaying a receptive attitude toward any reasonable request American firms might direct our way. I wanted the U.S. business community to know that our doors were open and we were ready to lend them a hand.

A third priority was greater assertiveness in explaining U.S. market-opening requests and macroeconomic policy proposals to Japanese constituencies. The Japanese press tended to approach trade negotiations in a defensive and nationalistic spirit. I was not inclined to leave public interpretations of our proposals to them—or for that matter to Japanese authorities. So I resolved to speak straightforwardly and often to a wide variety of Japanese audiences, in hopes of broadening public understanding of the need for basic changes in the trade relationship. Blunt talk on such matters was not necessarily standard practice for ambassadors. There is an observable tendency among many diplomats speaking publicly to skate around problems and avoid controversies by relying on bland clichés. I believed, however, that if the U.S.-Japan relationship rested on the broad convergence of interests we regularly proclaimed, it could survive an acknowledgment of differences, provided they were approached in a friendly spirit. Leaving problems to fester, on the other hand, was likely to fuel resentments in United States while inviting miscalculations by Japan.

Dimensions of the Trade and Investment Problem

On substance, I had a nodding acquaintance with economics but had never borne responsibility for managing trade or investment issues. By instinct and intellectual conviction I was a free trader; more importantly, I represented an administration of that persuasion. But I also believed greater reciprocity in our economic ties with Japan would improve the competitiveness of U.S. companies, facilitate closer political relations with Tokyo, and head off additional protectionism in the United States. Ostensibly, these views had some resonance within Japan. Japanese leaders regularly affirmed their fidelity to free trade. Certainly, some barriers to Japan's market had come down. Its tariffs were relatively low, and quotas few. Steps were under way to deregulate certain corners of the market, most notably by privatizing national railway and telecommunication companies.

Yet mercantilist reflexes were alive and well in all the crucial realms of power: in the bureaucracy, which ran the government and managed the economy; in business circles, which welcomed government assistance even as it chafed under excessive regulation; among politicians, who mobilized campaign funds by guiding private interests through an extensive and impenetrable regulatory thicket; and in the press, where articles on trade were laced with military metaphors suggesting that one side's gain was another's loss. The very first question put to me by the press on my arrival at Narita Airport in early May 1989 was whether I expected a trade war. I responded that I have always regarded trade as a mutually beneficial activity, not as a zero-sum game. The remark did not seem to make much impression on my Japanese journalistic friends.

The sources of our huge and persistent global trade imbalances were complex and numerous. Both countries bore their share of responsibility. The root cause was to be found in the interaction of the fundamental economic preferences and contrasting macroeconomic policies of the United States and Japan. The difference between what Americans consumed and what they saved showed up in our external deficit, just as the discrepancy between Japan's savings and its domestic investments was reflected in its external surplus. In the 1980s, moreover, the United States attacked stagflation through an expansionary fiscal policy and tight money, while Japan stimulated growth and reduced its budget deficit with contractionary fiscal policies and cheap money. The predictable result was a growing fiscal deficit in the United States and a growing trade surplus and a foreign investment boom by Japan. Coordinated macroeconomic policies were the obvious remedy. But diagnosing the problem proved easier than treating it.

Another factor relates to both countries' trade policies. After World War II, the United States took the lead in creating a liberal international economic order based on free market precepts—most notably, transparency and nondiscrimination. We opened our market to the world and, in periodic GATT negotiations, pressed others to reduce trade barriers. Because of the many benefits flowing from widespread use of the dollar as an international currency, we accepted the constraints this imposed on our domestic economic policies. We used foreign aid, investment flows, and technology transfers to facilitate the growth of many developing countries. By shouldering the lion's share of the Western security burden, we created a stable trading and investment climate and enabled our allies—particularly Japan—to concentrate their attention and resources on economic growth. And in a host of other ways we tempered the pursuit of our own commercial interests by working to define and defend the global economic system. This was a matter of enlightened self-interest. We were the preeminent industrial power in the world, and free trade and open markets served our purposes well. We expected Japan to emulate our values and policies as their economies matured; in the meantime, we benefited from Japan's strategic dependence on us.

While U.S. companies were among the pioneers of globalization, creating many of the most impressive multinational corporations, the majority of firms were content to focus on the U.S. domestic market. Nor did Washington devote special attention to export promotion. The Japanese contention that our trade deficit was a result of the failure of U.S. companies to work hard enough at cultivating the Japanese market contained more than just a kernel of truth. By the late 1980s only about 45 percent of the United States' Fortune 500 companies had a presence in Japan, many involved in joint ventures owned only a minority share, and many local managers appeared not to have the ear of the CEO back at the home office. The Big Three auto makers had long-established relations with Japanese affiliates, for example, but none had tailored products for the local market, none controlled its own distribution system, and none appeared to accord a high priority to expanding market share in Japan or in the wider Asian market. To be sure, the Japanese had done nothing to ease their access to the market. Quite to the contrary: they had erected a complex and formidable array of barriers. But the Big Three had not undertaken credible attempts to overcome them.

Japan's approach to trade was inspired by Friedrich List rather than Adam Smith. Since Commodore Perry had forcefully opened Japan in the 1850s, its overarching national objective was to build up its economic strength in order to defend its traditional culture and national independence. The catch-up capitalism Japan practiced differed substantially from our own freewheeling, entrepreneurial style. The state played a larger role in regulating and managing markets. National power rather than individual welfare was a more central objective. Producer interests were favored over those of the consumer. The public sector was more extensive and more insulated from foreign competition than was ours. The government consistently directed capital into industries like steel, shipbuilding, autos, electronics, telecommunications, and computers, which were deemed consequential for national security. And the regulatory system kept domestic prices high and foreign competitors at bay, thus boosting profits at home and providing a protected base from which to assault foreign markets.

Bilateral and multilateral negotiations in the 1960s, 1970s, and 1980s had gradually loosened access to the Japanese market. Yet in the late 1980s it was still marked by highly internalized labor and capital markets and elaborate formal and informal barriers to market entry by newcomers—whether Japanese or foreigners. For the Japanese, the system was comfortable, egalitarian, and quite stable. For outsiders, regulatory arrangements were arbitrary and nontransparent; the costs of market entry were high; and while national treatment was affirmed, in practice insiders in Japan's clubby capitalist system were regularly accorded preferential treatment.

This is not to say that Japan's market was closed. In 1988 we exported nearly $60 billion worth of goods and services to Japan—more than we exported to the UK, France, and Italy combined. The composition of Japan's trade, moreover, was changing as more and more manufactured imports fueled the growth of its bubble economy. And it appeared that Japan had abandoned export-led growth, since from 1986 to 1990 all the nation's growth came from investment-led increases in domestic demand, as had been recommended in the widely publicized Maekawa Commission Report. Unfortunately, when the bubble subsequently burst, it was apparent that widely heralded structural changes had not taken root.

Our market was not completely open, either. In fact, we were subjecting additional sectors to protection as Japan was gradually relaxing some market access controls. While the Japanese openly practiced industrial policy, we aided sectors indirectly; for example, through government-financed R and D in such disparate sectors as energy, agriculture, aerospace, pharmaceuticals, and defense—all fields, incidentally, in which American exports were highly competitive. Nor were export subsidies entirely unknown, although ours did not begin to compare with Japan's extensive export support system.

All countries resort to protectionism to one degree or another. Some, however, are more purposeful about it than others; they protect their future rather than their past. Japan seemed determined to protect both. Its postwar industrial policy was aimed at establishing and protecting those infant industries on which Japan's future depended. Yet in pursuit of social harmony and political stability, weak and inefficient industries received plenty of government help as well: farmers got quotas and high tariffs; the owners of mom-and-pop stores successfully used the Large-Scale Retail Store Law to limit competition; the domestic financial sector remained heavily regulated by the Ministry of Finance; local construction companies divvied up contracts through the *dango* bidding system, whereby bids are rigged through collusive practices among contractors; defense suppliers were nurtured through the government's insistence on co-assembly, then co-production, and now co-development arrangements with U.S. manufacturers. In other words, both sunrise and sunset industries could count on one or another form of protection.

If the methods of protection favored by Japan were not unique to that country, neither were the rationales for it. Farmers needed protection because of their importance to the governing party; small retailers required it to preserve social stability; stringent interpretations of health and safety certification requirements were essential to protect Japanese consumers; domestic production of key defense systems was justified on national security grounds; special dispensations to high-tech industries were defended with traditional infant industry arguments.

Self-conscious awareness of Japan's protectionism seemed low among its leaders. I got a taste of this during a visit by Secretary of Commerce Bob Mosbacher in 1989. We were meeting with Michio Watanabe, an LDP faction leader and prominent member of the LDP's agricultural *zoku* ("tribe"). Mosbacher was predictably urging market openings; Watanabe responded with complaints about the failure of Americans to comprehend the demanding standards of Japanese consumers. "I visited the market over the weekend," Watanabe said, "and noticed that Bing cherries, which you prize so highly in the United States, were on the shelf alongside our Yamagata cherries. The Bings were thrown carelessly into boxes, and their quality was uneven. Though they were very cheap, there were plenty available, and sales seemed to be slow. Our Yamagata cherries, by contrast, were uniform in quality, larger in size, and packaged individually. Though they were priced four or five times higher than the

Bings, they were virtually sold out. So you see, your people just haven't paid attention to the demanding tastes of our consumers."

"I am pleased that you saw Bing cherries in the market, Mr. Watanabe," I replied, "for it took us years to wear down the Ministry of Agriculture's resistance to their entry. But if your Yamagata cherries are selling out despite this extraordinary price disparity, why was it necessary to keep ours out for so long?" I added that in fact the Bings had quickly established a significant market share, so perhaps some Japanese consumers were eating them and purchasing the Yamagatas to give away as expensive *omiyage*.

The Japanese had demonstrated the utility of invisible barriers to imports in the nineteenth century when the Western powers imposed low tariffs on them through unequal treaties. They responded with a series of import constraints including complex licensing controls, internal taxes, and subsidies to local producers. The cumulative effect of extensive market access controls, past and present, left relatively little space for newcomers, especially foreign businesses, and this became more and more galling as Japan's current account surplus mounted and its manufacturers became the benchmark firms in international competition. While some sectors were, of course, more internationalized than others, opportunities for foreigners to export and invest in Japan seemed limited mainly to those sectors in which Japanese producers were either uninterested or uncompetitive, in which foreign companies possessed technology the Japanese needed, or in which the consequences of denying foreigners access were clear and consequential.

Particularly irritating in the light of the Japanese government's free trade rhetoric, was clear-cut evidence that the public sector was especially difficult for outsiders to penetrate. U.S. construction, transportation, and telecommunications firms were among the world's most efficient. Yet in the late 1980s they won few public procurement contracts in Japan. Catch-22 situations were routine. The most bemusing, if irritating, was the arrangement until 1988 under which foreign construction firms could not operate in Japan without a license and could not obtain a license without five years' experience in the Japanese market. Little wonder that in these sectors foreign market share in Japan was trivial and Japanese price levels extremely high.

Shortly after I arrived in Tokyo, I asked the commercial section for a systematic comparison of the prices of a variety of products in Japan and the United States. Amy Anderson, a student intern from Princeton, did much of the legwork, comparing prices on everything from golf balls to theater tickets, VCRs to airline reservations, and cars to camcorders. The results confirmed our intuitions. Many Japanese export products could be purchased in the USA for prices 40 to 80 percent lower than in Japan. I discovered that disposable cameras with operating instructions in Spanish and other European languages (i.e., exports that had been transported halfway around the world and back) were selling as parallel imports in Tokyo at prices 25 percent lower than those of identical products aimed at local consumers. Whether one described this as dumping or forward pricing, the Japanese buying public was subsidizing the welfare of foreign consumers. And from what I could tell, they seemed neither to know nor to care very much.

Not that the trade picture was unrelievedly gloomy. Evidence of some change in Japanese trading habits and even regulatory practices was visible. The yen-dollar talks, initiated by the Treasury Department and the Ministry of Finance in 1984 to foster deregulation of Tokyo's financial markets, had brought some liberalization of access to Japan's financial market and some decontrol of interest rates. Domestic demand in Japan was up. Our bilateral deficit with Japan had begun to fall. The MOSS talks (on electronics, medical devices, telecommunications, wood products, and transportation) had produced salutary results, and exports in fields covered by those talks were growing rapidly. Japan's investment-led boom was generating significant demand for American capital goods. As Japanese tourism expanded, more and more of its citizens were becoming aware of the price disparities that made Tokyo the most expensive city in the world; discount stores, parallel imports, and catalog buying were among the results. As Japanese companies globalized their operations, their business community was becoming increasingly sensitive to foreign demands for reciprocity. The recently concluded Beef and Citrus Agreement even suggested that further liberalization of Japan's agricultural market might be possible. And more and more Japanese were complaining that their quality of life had not kept up with the accumulation of national wealth.

Adjusting the Balance

Our challenge was to accelerate a process of change that seemed to be gathering some momentum. It would not be easy, for many anticompetitive practices were deeply embedded in Japan's industrial structure and business practices. As U.S. Trade Representative Carla Hills put it, "we sometimes would need a crowbar." Given the consensual nature of Japanese society, moreover, change was destined to be slow and incremental. Our influence could be exerted only at the margins. It would only be effective if it was directed toward reforms that enjoyed significant support within Japan. I considered a GATT agreement to be especially critical, for it could provide multilateral rules for trade in areas where we encountered special problems with the Japanese—specifically, the services, agriculture, and high-technology sectors. And in multilateral negotiations we could enlist the help of other countries disadvantaged by limited access to the Japanese market.

In short, to attack a trade imbalance that exceeded $50 billion, we needed to set our own house in order, engage actively in sectoral negotiations, mount an effort to reduce structural impediments to the orderly adjustment of external accounts, and take aggressive steps to finish up the Uruguay round of the GATT. This was the agenda to which the Bush administration devoted its efforts.

"Physician, Heal Thyself"

A broad intellectual consensus among U.S. economists held that reducing the fiscal deficit and raising our savings and investment levels was central to any serious attack on our trade imbalance. The business community that submitted recommendations to Carla Hills in the spring of 1989 conceded that much. Yet support for the Gramm-Rudman-Hollings approach had flagged, President Bush had committed himself to "no new taxes," and a Democratic Congress had little interest in balancing the budget through reduced federal spending. Although the U.S. trade deficit with the world declined modestly from 1989 to 1992 as a result of a stronger yen and the U.S. recession, our fiscal deficit continued unfortunately to grow.

The Japanese, meanwhile, continued to best us on economic fundamentals. Their savings rate remained far higher than ours; from 1986 to 1992 their investment in new plants and equipment ran nearly 25 percent ahead of ours in absolute terms, though their economy was 40 percent smaller; Japan spent more than we did on civilian R and D; they were turning out larger numbers of engineers than we were; and their high school graduates consistently outperformed ours on international math and science tests.

The Bush administration acknowledged the importance of these issues. It put forward initiatives to address most of them. Few, however, emerged unscathed from Congress. In both Japan and the United States, some complained that the administration put little muscle behind its legislative efforts; others responded that a Democratic Congress was determined to block the president no matter what. The executive and legislative branches had different perceptions and priorities. It was a pity. The administration's Family Savings Plan, its proposed cut in the capital gains tax, new incentives for investment in civilian R and D, and initiatives for educational reform all had merit, though even bolder actions were warranted. The 1990 budget package was well intentioned, required political courage, and achieved some procedural results. But in the end the president paid a significant political price for abandoning his "no new taxes" pledge yet made no real dent in the savings/investment imbalance.

Improving our performance on economic fundamentals was critical not only to improving the performance of our companies but to the credibility of our efforts to alter Tokyo's economic policies. The Japanese were unlikely to accommodate our requests that they change, as long as we refused to tackle our own problems forthrightly. Our macroeconomic shortcomings provided them with ready excuses for foot dragging. Our negotiators in the SII talks were occasionally reduced to arguing that our problems would take care of themselves. I was particularly distressed by our rhetoric on the issue of savings. Washington representatives claimed that the baby boomers had come of age: they had entered the high income brackets; they had completed most needed purchases of consumer durables; their children were approaching college age; and they consequently had both the capacity and the incentives to save. It was a plausible line of argument for which, unfortunately, there was little concrete evidence. More to the point, I feared that an administration that believed the problem would resolve itself was unlikely to spend much time or political capital on fixing it. Certainly, when the Treasury Department and CEA proposed savings stimulus packages, these efforts did not appear to be central to the administration's congressional agenda. And by 1992 our savings rate remained below 5 percent, while Japan's was again climbing beyond 15 percent.

I had hopes that Secretary of State Baker might take these issues on and spoke at some length with him during one of my early trips home for consultations. He understood the problem completely and readily acknowledged its importance. Yet I sensed a certain reluctance on his part to tackle it. I subsequently recalled that in 1986, as secretary of the treasury and chairman of the Economic Policy Council, he had crafted a comprehensive package of measures to enhance America's competitiveness. Despite his devotion of much time and energy to this project, bureaucratic and political interests had altered it beyond recognition. I surmised that, as a pragmatic person with huge problems on his plate, he probably concluded that there were more promising ways of using his scarce time and political capital than hammering away at domestic issues for which other members of the administration bore principal responsibility.

The Bush administration did put together a stronger export promotion effort, and it crafted a modest, low-key technology policy to improve U.S. competitiveness. The Foreign Commercial Service was beefed up, and its director, Susan Schwab, recruited many capable officers with Japanese language credentials. Secretary of Commerce Bob Mosbacher readily supported embassy requests for additional commercial officers both in Tokyo and Osaka. The Commerce Department also initiated its promising Japan Corporate Program designed to interest middle-sized U.S. corporations in a sustained and systematic effort to crack the Japanese market. Mike Farren, Mosbacher's undersecretary of commerce, organized a binational, public-private consortium that successfully promoted design-in arrangements to increase U.S. sales of auto parts to Japanese car makers. Commerce pushed MITI to undertake complementary import promotion efforts. And Dr. Allen Bromley, the president's scientific adviser, undertook a number of steps to raise funds for technology development while easing the regulatory burdens that stifled such activity. Meanwhile, many U.S. companies, chastened by the excesses of the 1980s and alarmed by the formidable competitive challenges they confronted from the Japanese, shouldered the painful restructuring that was to revive our manufacturing industry in the 1990s.

Sectoral Negotiations

Like its predecessors, the Bush administration sought to remove barriers to market entry in Japan through sectoral negotiations. Its selection of sectors was shaped both by complaints from specific firms and industries and by a conscious effort to target industries in which Japanese barriers genuinely impeded sales by competitive U.S. firms. In every case, agreements were pursued on a most-favored-nation basis; we sought no preferential deals. Unlike its predecessors, however, the administration was armed with the Super 301 provision of the 1988 Trade Bill, many provisions of which it did not like but was required to implement. Thus in April 1989 the administration identified Japan as one of the countries that had engaged in unfair trade, specified three practices relating to trade in wood products, supercomputers, and artificial satellites that required redress, and proposed negotiations to remove them. The administration also proposed talks on structural impediments to trade but suggested that these discussions be taken up outside the framework of Super 301.

Between 1989 and 1992 thirteen bilateral sectoral agreements were negotiated. Four covered Japanese government procurement practices and procedures relating to supercomputers, satellites, construction services, and computer hardware and software; five covered Japanese government telecommunications standards, regulations, and licensing procedures; one covered technical standards for wood; and three covered market access problems involving both government policies and private practices regarding amorphous metals, semiconductors, and paper products.[1]

In some sectors, market access improvements were achieved without formal agreements. Extension of Japan's copyright laws to provide additional protection for foreign sound recordings and to curb unauthorized use of such recordings by rental stores was one example. The Commerce/MITI framework for promoting long-term relationships between Japanese auto makers and U.S. auto parts suppliers was another. The Action Plan, released at the time of President Bush's visit to Japan in January 1992, contained other informal understandings concerning glass, paper, and the treatment of foreign lawyers in Japan.

Although the administration pressed for the implementation of the 1986 Semiconductor Agreement, negotiated an action plan on automobiles in 1992 that contained specific numbers, kept very close track

1. Merrit Janow has summarized the dynamics and results of these negotiations admirably in her essay "Trading with an Ally: Progress and Discontent in U.S.-Japan Trade Relations," in Gerald Curtis, ed., *The United States, Japan, and Asia*, pp. 53–95 (New York: Norton, 1994).

of satellite and supercomputer purchases, and left a number of VRAs in place in the U.S. market, in general, it sought to improve the procedures governing market access and to avoid attempts to negotiate specific market shares for American products. This provoked scorn from some critics at home. I regarded such criticisms as misguided. No one involved was interested in negotiations for their own sake nor in achieving cosmetic agreements merely to defuse political pressures from the Congress. The negotiators—hard-nosed individuals with a detailed knowledge of the Japanese market—all realized that without concrete results, agreements were of little value. They sought in every case understandings that included elaborate provisions for monitoring results.

If the focus was on procedures, it was because that is where many of our market access problems arose. Occasionally, we had to overcome misconstructions on this score among our Japanese interlocutors. I well recall one conversation with a leading member of the LDP who had intervened effectively to break impasses on several nettlesome trade issues. The subject was construction, and our objective was to eliminate the designated bidder system in favor of open, transparent procedures for bidding on public construction projects. My interlocutor urged me to put aside the *tatemae* (formalities) in favor of the *honne* (real intentions) in our position; that is, which specific contracts, he asked, did we want for which companies? I demurred, noting that it was not possible for me to give him such an answer: I had no authorization to seek specific deals; the U.S. government could not pick and choose among competing bids from several American companies; and our request for genuine changes in the procedures reflected our real commercial interest. He remained puzzled.

Of course, his proposal would have had the merit of allowing U.S. companies to get at least a limited piece of the action while awaiting the broader systematic reforms we sought. Yet I still believe we were right to insist on transparent procedures. To obtain one or several contracts while leaving in place a dense, opaque, and, in this particular case, corrupt system for handling bids would not get at the heart of the market access problem or address the reciprocity issue that generated political resentment in the United States. This was the sort of dilemma—between standing on principle or getting a toe in the door—that we often faced.

Besides, process changes did lead to results. The results are admittedly difficult to judge, and they were surely mixed. But there was progress. Dick Nanto, who authored a study on the sectoral negotiations for the Congressional Reference Service in 1991, concluded that U.S. exports expanded dramatically faster in those sectors that had been the subject of such negotiations. By one calculation, over the thirteen sectors covered by new agreements achieved between 1988 and 1992, they increased by 57 percent. By early 1990 U.S. firms had won approximately $200 million in construction contracts. We won a significant increase in supercomputer awards from public institutions, though no U.S. bid prevailed in a head-to-head competition with Japanese suppliers. In several instances, Japanese bidders dropped out, presumably at the behest of government officials, with the result that we were not shut out of all public procurement contracts. A number of significant contracts were won by American satellite manufacturers following the June 1990 agreement. Many issues relating to standards were resolved.

Others remained, however. The supercomputer and construction agreements, for example, provoked continuing friction, mainly, in my view, because they were to be implemented by ministries in Tokyo that were either unwilling or unable to change their way of doing business. I believe Japanese officials were eager to accommodate their industry's desire to monopolize public procurement of supercomputers in order to boost their international competitiveness while preventing foreign manufacturers from gaining a strong foothold in university laboratories and corporate research centers. In the private sector, by contrast, U.S. supercomputer manufacturers earned a significant share of the market as Japanese companies sought to augment productivity by acquiring the highest-quality computing power available. Construction contracts, on the other hand, were a honey pot for the Liberal Democratic Party and *dango* bid-rigging arrangements were pervasive within the industry, so foreign pressure produced only modest results in the form of token contracts for foreign joint-venture partners of major Japanese construction firms. The administration did not respond by seeking specified market share understandings in these sectors, but it did let the Japanese know that two could play the game. Japan found itself frozen out of the U.S. public procurement market for supercomputers—mainly but not exclusively for reasons of competitiveness—and Senator Frank Murkowski (R-Alaska) regularly put legislation on the table reminding Tokyo that its entree to U.S. public construction contracts could be comparably limited.

The Semiconductor Agreement, negotiated originally by the Reagan administration in 1986, did represent a significant exception to the administration's approach. Although no explicit market share commitment was contained in that agreement, a side letter signed by the Japanese ambassador to the United States, Nobuo Matsunaga, referred to an expectation of a 20 percent share for foreign producers. In effect, this expectation was our target, and it was incorporated in a somewhat more explicit form into the revised 1991 Semiconductor Agreement.

I was not generally enthusiastic about numerical targets but came to regard this feature of the Semiconductor Agreement as not only useful but indispensable to the success our companies enjoyed in expanding their relationships with Japanese suppliers. Without the target, I do not believe the Japanese government would have pressured the major users to change their practices, nor would users have proven so amenable to design-in arrangements with U.S. suppliers. Our market share might well have languished around the 10 percent level. I believe it was not coincidental that our market share increased substantially only when the deadlines embedded in the agreement approached.

I could imagine other areas where market share targets might be salutary. But I did not regard them as generally desirable, nor was the Semiconductor Agreement a model to be widely replicated. I shared Carla Hills's contention that negotiated targets could be treated as ceilings as easily as floors. And beyond this, I had my doubts about the wisdom of leaving such determinations to bureaucrats. In any case, efforts to establish targets met with ferocious resistance from the Japanese, and even if that resistance were formally overcome, we might succeed perversely in augmenting the authority of the Japanese bureaucracy at a time when our commercial interests were best served by diminishing its power to manage markets arbitrarily.

The precedent was not repeated. To be sure, at the time of President Bush's visit to Tokyo in January 1992, Japanese auto makers did indicate their intent to more than double purchases of auto parts from $9 billion in JFY 1991 to $19 billion by JFY 1994. But that was an expression of industry intentions, not a formal government-to-government agreement. In other sectors, such as glass and paper, specific targets were forsworn in favor of generic language—for example, the promise of "substantially increased market access for foreign firms exporting paper products to Japan." The purpose was to make markets work more efficiently and competitively, not to supplant them with government-managed trade. Sadly, while the intentions of these agreements were admirable and the restraint noteworthy, the results—with respect to paper and glass, at least—were negligible. Subsequently, the Clinton administration struggled with the same problem: how to encourage efficient and competitive markets when Japan's Fair Trade Commission refuses to enforce the antimonopoly law. Expanding market access through negotiations is pick-and-shovel work, and there is no prospect that we shall be able to leave the trenches anytime soon.

The Structural Impediments Initiative

The SII talks were the Bush administration's major innovation in U.S.-Japan trade negotiations. Discussions about structural issues, to be sure, were not an entirely novel idea. Undersecretary of State Allen Wallis had chaired such discussions with Japanese counterparts during the Reagan administration. These reportedly had a rather academic character and were more useful in identifying issues than in resolving them. The Bush administration transformed the talks into a negotiating framework aimed at overcoming structural problems that impeded the orderly adjustment of external payment imbalances.

I had no hand in initiating the SII talks and first learned of the administration's decision to pursue them through a phone call from Carla Hills shortly after my arrival in Tokyo. She described the process and agenda that Washington had in mind and asked whether I thought the Japanese would play. I harbored initial misgivings about the proposal. The issues we intended to put on the table—Japan's savings/investment imbalance, its price mechanism, the distribution system, collusive business practices, land reform, and *keiretsu* arrangements—were sensitive matters that cut very close to the bone of domestic policy. They were subjects only rarely taken up in government-to-government negotiations. And clearly the Japanese had little enthusiasm for sharing decisions on these issues with foreigners.

On reflection, however, I concluded that such an effort was substantively warranted and would be politically manageable, provided we approached the talks in a collaborative spirit. The interdependence between our economies was growing; the domestic policy decisions Washington and Tokyo each made impinged directly on the other's interests; and it was only natural that some forum should exist for harmonizing our industrial structures and business practices. The EC-92 exercise under way at the time in Europe showed that sovereign governments could handle such issues successfully, and other methods of getting at the U.S.-Japan trade imbalance had fallen short. The items on Washington's agenda, moreover, had an undeniable impact on the level of Japan's domestic demand (savings/investment imbalance), the cost of market entry (land prices, collusive business practices, and *keiretsu* arrangements), and the price of imported products (distribution system).

The merits of the administration's proposal were not obvious to the Japanese. Some saw our initiative as an attempt to shift the principal burdens of trade adjustment from the deficit to the surplus country. Others saw Washington taking deliberate aim at features of Japan's economic structure and policy that were considered central to its postwar prosperity. Still others feared such negotiations would create an opening for meddlesome interference that could sour bilateral political relations without relieving the trade imbalance. The opportunity to raise complaints about U.S. policies and practices was little consolation for Japanese bureaucrats who were less interested in apportioning blame for existing trade problems than in protecting their ability to manage the Japanese economy without outside intrusion. Turning the SII talks into a cooperative venture was to prove a daunting challenge.

The formal proposal for SII talks was put on the table at bilateral talks that took place during the late May 1989 G-7 summit in Paris. The Japanese reluctantly agreed to it for several reasons: they could not deny the need to do something about the trade imbalance; the proposal was advanced by President Bush himself; it allowed talks to take place outside the Super 301 framework; and since each side would be able to present its concerns, the Japanese could construe the process as a two-way street.

An inside account of the SII talks will have to come from others. The strategy was conceived in Washington. Negotiations were carried out by subcabinet officials from the capitals. I participated in most plenary meetings and was regularly consulted by members of our team. But neither I nor other embassy representatives sat in on the restricted meetings among the principals—held outside Japan under conditions of considerable secrecy—where much of the real bargaining took place. The embassy did nonetheless exert considerable influence over the content, politics, and outcome of the talks.

For starters, we sought to counter the objections of those Washington officials who resisted the idea that the talks should be a forum in which both governments could put issues on the agenda. An effort to concentrate exclusively on Japanese structural impediments was not logically compelling and had no chance of eliciting support from the Japanese government. The Japanese were in no mood to be placed in the dock by a government they felt was guilty of fiscal profligacy and inattentive to its own competitiveness problems. Besides, I felt we would benefit from Japanese suggestions. Any pressure, I thought, that helped us step up to our own economic problems promptly and forthrightly should be welcomed. Symbolically, a two-way process could underline our resolve to achieve greater reciprocity.

In providing analytic support to the U.S. delegation, the embassy sought to discourage ideas that bore a "Made in the USA" label. Few in Washington possessed a competent grasp of the details of Japan's land-use policies, its distribution system, its price mechanism, or its *keiretsu* arrangements. In any event, proposals for reform were legion in Japan; the trick was to add our voice to thoughtful recommendations for change that already enjoyed resonance with important Japanese constituencies. Thus we compiled an exhaustive survey of suggestions that had emanated from the Maekawa Commission, the Administrative Reform Council, industrial federations like Keidanren and Keizai Doyukai, academic journals, and even the popular press.

Beyond helping to shape our side's proposals, the embassy sought, as the negotiation matured, to tease out of Washington clearer signals as to which items were critical and which were merely desirable. In any complex negotiation, many requests are put on the table. This was particularly true of SII. We had an extensive agenda; many agencies with quite different concerns were represented on our delegation, and it was easier for them to maintain internal harmony when each agency was allowed to pursue its pet projects. But the conclusion of a deal requires the assertion of priorities and tough choices among competing claims. We were interested in striking a deal, not in scoring debater's points. And we knew that getting a deal required that some of our Japanese interlocutors recognize the core elements of what we needed so that they could judge the merits of the package and figure out how to generate the necessary political support for it. So we prodded Washington to assert clearer priorities. Some in Washington were more receptive to this than others. Bob Zoellick, counselor in the State

Department and a close confidant of Secretary Baker, was particularly helpful in this regard.

The embassy also took responsibility for explaining the logic of U.S. proposals to the Japanese public and seeking support for them within the political leadership. Our best shot at mobilizing such support, I thought, lay in concentrating particularly on raising Japanese infrastructure spending to reduce the savings/investment imbalance, urging reform of the distribution system to lower prices for Japanese consumers, encouraging changes in land policy to reduce land prices—a major cost to foreigners of doing business in Japan and a major impediment to more affordable housing for the Japanese, and attacking collusive business practices that contributed to the high cost of living in Japan.

I made our case in scores of public speeches, briefings for editorial writers, lunches for businesspeople and academics, and one-on-one meetings with people influential in politics and the bureaucracy. I did not conceal the commercial motives behind our interest in structural reform but emphasized the benefits such reforms could bring to Japanese citizens, stressed the ways a successful SII negotiation could relieve pressures in the U.S.-Japan relationship, and reminded skeptical Japanese that the agenda they had set for us posed a more demanding political challenge for U.S. leaders than we were requesting of them. After all, they wanted us to consume less, save more, and work harder, while we were simply asking them to invest more of their hard-earned wealth in the welfare of Japanese citizens while making available at more reasonable prices a wider array of quality products to consumers in their own country. Not a bad trade-off—for Japan.

Pinning down the details of the deal required extensive consultations—what the Japanese termed *nemawashi*—with senior officials and politicians. It fell to me, either alone or with Washington visitors in tow, to make these rounds, outline our hopes, explain the political lay of the land at home, and urge timely decisions. My task was not to negotiate the deal but to help create a permissive political atmosphere for concluding it.

I spent considerable time with senior bureaucrats, but they were not my primary target. Senior officials from key ministries were in regular touch with our delegation, and their enthusiasm for the enterprise was distinctly limited. A few senior MITI officials proved to be unexpectedly helpful, however, and progress on loosening access to the distribution system owed much to their efforts. By contrast, some Ministry of Foreign Affairs officials were more cantankerous than I had anticipated. Generally speaking, we looked to them to represent foreign policy considerations to other agencies and to work hard to overcome obstacles to a successful negotiation. Vice Foreign Minister Takakazu Kuriyama, Deputy Foreign Minister Koji Watanabe, and Cabinet Counselor Tatsuo Arima were among those who recognized the importance of attaining an agreement and played helpful roles in reaching it. The going was frequently tough even with old friends, and some of my exchanges with them were prickly, perhaps because they bridled at some requests, considering them impertinent, resented the style of some of our delegates, and wished to preserve their well-deserved reputations for tough-mindedness with their own business and political constituencies.

I included in my rounds ministers and senior officials of particularly parochial ministries like Construction, Transportation, and Post and Telecommunications that controlled or influenced the disposition of billions of dollars worth of public contracts yet rarely took account of foreign concerns in their decisions. The involvement of these officials in the SII process served to broaden their awareness of international considerations and helped create a more efficient early warning network for identifying potential trade problems before they became politicized. It was heartening, for example, to see many of these ministries appoint for the first time vice ministers for international affairs. This institutionalized such concerns and gave us a place to register our views.

While the bulk of our political dialogue was with the LDP, I had periodic contacts with the opposition parties on SII and other trade issues. Initially I thought that the Socialists and Komeito, as parties with strong urban constituencies, might share an active interest in promoting structural reforms. The Socialists were especially disappointing in this regard. For example, I briefly nurtured the forlorn hope of enlisting the interest of Takako Doi, then the leader of the Socialist Party, in the process, but I ran into a brick wall: the Socialists appeared more preoccupied with co-opting traditional rural supporters of the LDP than in expanding their own urban and suburban political base. They exhibited virtually no interest in deregulation.

One of my early contacts with Doi, in fact, cost me a run-in with Ichiro Ozawa, secretary general of the LDP. Though my meeting with

Doi was routine, she described it to the press as a prelude to more intimate links with the embassy. Coming on the heels of dramatic Socialist gains in the 1989 Upper House elections, Ozawa presumably feared that we were giving our contacts with the opposition a higher profile in order to pressure the government in the SII negotiations. He promptly dispatched a letter admonishing me to avoid steps that might be perceived as meddling in Japanese politics during the run-up to early Lower House elections.

I had no Machiavellian purpose in mind when I met with Doi; I was simply looking, as usual, for sympathizers for market liberalization anywhere I could find them. Nor would I have been fazed by a confidential expression of Ozawa's concerns. I regarded his letter, however, as unnecessarily formal and surprisingly defensive. The Japanese embassy in Washington had maintained close contacts with leaders on both sides of our political aisle for years; we were determined to do the same in Tokyo. I told Ozawa this and also asked my deputy chief of mission to inform him quietly that I was not amused to learn that he had dispatched a letter to Secretary Baker complaining about my conduct. That missile, entrusted to an embassy acquaintance of Ozawa's (and mine), was never delivered. Overall, the episode revealed much about the LDP's nervousness over its electoral prospects, as well as Mr. Ozawa's readiness to play hardball. Happily, my subsequent contacts with him were more cordial and productive.

As the first round of SII talks reached their culmination in the spring of 1990, my contacts with senior LDP politicians became more frequent and crucial. Regular contacts included the major faction leaders and senior officials of the party. The purpose of the meetings—invariably characterized in the press as involving the unremitting application of pressure—was to be certain our proposals and priorities were understood, to encourage active political efforts on the part of those who displayed some empathy with our views, and to neutralize any misperceptions about our positions that had resulted from misleading press stories or mischievous rumors. As a result of their clout within the party or the portfolios they managed for the government, noteworthy interlocutors were LDP faction leaders Noboru Takeshita, Shin Kanemaru, Shintaro Abe, Yasuhiro Nakasone, and Michio Watanabe; Ichiro Ozawa, secretary general of the LDP; Finance Minister Ryutaro Hashimoto; and Hiroshi Mitzuzuka, minister of international trade and industry.

I did not routinely include Prime Minister Toshiki Kaifu in these consultations, and this became something of a problem for him and for me. In principle I thought it inappropriate to request appointments with the prime minister unless I had instructions. Conducting more informal *nemawashi* with political leaders was my idea; the talks were not directed by Washington. Beyond this, I assumed that my contacts with members of the cabinet were routinely reported to the prime minister. Nor did I believe I would be doing Mr. Kaifu a favor by dropping in for informal chats—even if he had had the time and inclination for them. My appearance at the prime minister's residence invariably drew extensive press attention and would have invited speculation that I was seeking to pressure him directly. Conduct that I had hoped would indicate my sensitivity to his political situation was, nonetheless, misconstrued by the media, which chose to regard the absence of meetings as reflecting a low U.S. estimate of the prime minister's power and authority. Contrary to such reports, I had a high regard for Mr. Kaifu's commitment to the bilateral relationship and his desire to attenuate trade frictions between our countries. In the end, I got Washington to send me instructions and began to make occasional well-publicized calls on the prime minister. But the rumors persisted.

Occasionally I met with larger gatherings of politicians to discuss trade matters. In the spring of 1990 Shintaro Abe invited me, along with other embassy associates, to meet over breakfast with a representative group of Diet members. Many were highly agitated about key issues. Some questions were blunt, and so were my answers. Criticism was especially intense over our insistence on changes in the Large Scale Retail Store Law, which provided extensive protection for small retailers—a significant constituency of the party. I reminded the Diet members that Isao Nakauchi, owner of Daiei Department Stores, held majority ownership of the Ala Moana Shopping Center in Honolulu, one of the biggest shopping malls in the United States. No U.S. law had impeded that acquisition; no regulation had delayed its consummation; no retailers association, to my knowledge, had attempted to forestall it; and no special public outcry had greeted its announcement. Americans would surely resent it, I observed, if Toys R Us had to wait ten to twelve years for approval of its application to set up stores in Japan—a not unlikely outcome if the Large-Scale Retail Store Law were not amended. Though this and a few other exchanges were a bit feisty, Abe later told me that the meeting had been useful in providing friendly Diet members arguments to use with constituents while allowing hard-liners to blow off steam.

A more decisive result stemmed from a private call on Shin Kanemaru during the culminating phase of the negotiations. We were seeking a sizable increase in Japan's infrastructure spending in order to reduce its savings/investment imbalance. Kanemaru's dialect was notoriously difficult to understand, but when I suggested a figure, he responded with a counterproposal that was crystal clear and eventually stuck.

Ultimately, the SII agreement achieved in June 1990 was hailed as a success. Certainly, I regarded it as such. Each government committed itself to a number of significant steps to ease the adjustment of external trade imbalances. The Japanese pledges were far-reaching and included

- major increases in aggregate infrastructure spending to reduce the imbalance between domestic savings and investment;
- potentially consequential land reform measures, including a review of the tax structure and deregulation of land-use policies;
- steps to lower distribution costs through faster import clearance, improved import infrastructure, and a substantial liberalization of the Large-Retail Store Law;
- more rigorous enforcement of the Anti-Monopoly Law, including criminal suits, higher penalties and the facilitation of private law suits;
- and enhanced disclosure requirements to make *keiretsu* groups more transparent.

Needless to add, the United States made a variety of pledges as well: for example, to take concrete measures to raise the level of domestic savings; to reduce the federal government's fiscal deficit; to encourage higher levels of civilian research and development; to augment export promotion efforts; and to improve the quality of job-training programs.

The Japanese press hailed the outcome. Well it should have. The Japanese people would benefit more from the concessions made by their government than we would—a point to which I referred in remarks to the Foreign Correspondents' Club of Tokyo in late April. I asked:

> Is more Japanese investment on roads and airports a "concession" to outsiders? It improves the standard of living of Japanese citi-

> zens and helps Japanese businesses get products to market more quickly and cheaply.
>
> Is the removal of restrictions on new large stores a "concession" when it permits Japanese shoppers to buy high-quality products at lower prices during more convenient hours?
>
> Is it a concession when Japan deregulates its telecommunications sector, enabling consumers to utilize new products at reasonable prices, while stimulating technological innovation through competition?
>
> Are changes in building codes to permit wider use of safe wood dwellings a "concession," when surveys show that 87 percent of Japanese consumers prefer to live in wooden homes?
>
> Should one regard amendment of Japanese laws to protect U.S. sound recordings a "concession," when one of the principal beneficiaries will be CBS Records, now owned by Sony?[2]

In retrospect, the agreement contained some useful elements, but it brought no historic breakthroughs in our economic relations with Japan. Reform of the Large-Scale Retail Store Law was probably the most significant element. Substantial barriers to the distribution system remained, however, and MITI seemed to lose its enthusiasm for reform thereafter. And while the Fair Trade Commission became somewhat more active, it was positively unhelpful on key issues like paper and glass. And despite the infusion of infrastructure spending, the Japanese economy took a nosedive after the first SII report. Even so, June 1990 proved to be the high-water mark for the SII process. Successful resolution of differences over some unusually sensitive issues had been achieved without provoking a serious nationalist backlash in either country. The U.S. embassy was even hailed by some in the local press as the most effective opposition party in Japan—a tribute predictive of future difficulties. The principle that our governments should work to harmonize our industrial structures, business practices, and economic policies had acquired wider acceptance. Parochial domestic regulatory agencies had been exposed to the external consequences of their day-to-day decisions. And a follow-up mechanism was in place to monitor implementation and—at least so the U.S. delegation hoped—raise new proposals for reform.

2. "A Report on Recent Developments on Trade Issues" (Tokyo: U.S. Embassy, 1990), p. 4.

Regrettably, negotiations went downhill from there. Not that any organized effort on either side sought to roll back the commitments made. But the momentum for collaboration gradually dissipated. Both sides shared the responsibility. The Bush administration failed to deliver on many of its promises. This was a consequence of political gridlock, not bad faith, but the result was the same. To be sure, the 1990 budget package represented an effort to attack the fiscal deficit problem, but the package made scarcely a dent in the deficit, and many of the SII-related legislative proposals submitted by the administration to Congress were bottled up in committee or rejected outright.

On the Japanese side, the bureaucracy, which detested the SII process, dug in its heels about making any new commitments. More generally, the impetus for reform in Japan stalled in 1991 as the bubble economy burst. Implementing an agreement could not command the kind of press attention that negotiating it had, and the public gradually lost interest. Meanwhile, Washington moved on to other priorities, and until President Bush visited Tokyo in January 1992, the bilateral trade issues were relatively quiescent.

Personally, I felt the success of bilateral trade negotiations in the spring of 1990 was achieved at a considerable political price. Nerves were frayed on both sides; the tone of our official relationship with Japan visibly soured. I believed that we needed a breather while the dust settled and was anxious to find some framework in which we could highlight shared interests on trade matters. The Uruguay round of the GATT provided one such opportunity.

The Uruguay Round

With good reason, the Bush administration had identified a successful GATT round as its highest-priority trade objective. A more comprehensive GATT regime would serve U.S. interests well. Many of the sectors in which we were most competitive—such as trade in agricultural commodities, services, and high-technology products—were not regulated by multilateral trading rules. And few nations obtained greater benefits from a liberal global trade regime than Japan; aside from the issue of rice imports into Japan, our respective interests in the Geneva negotiations appeared substantially to converge. I hoped the political benefits of playing an active role in the GATT round would appeal to

Japanese leaders. So we sought Tokyo's help in moving the talks to an early conclusion.

On trade as well as on other matters, the Japanese government had become accustomed to pursuing its narrow commercial interests while leaving most of the responsibility for defining and defending the rules of the international system to us. In my view, the Uruguay round would test Japan's willingness to expend political capital to reshape the global trading system. It could thus serve a political purpose by reminding them of their responsibilities. The structure of the negotiations, unfortunately, limited the scope for collaboration. The centerpiece of the talks throughout the Bush years was reform of agricultural trade. This issue, regrettably, afforded the Japanese little political maneuverability. We went through the periodic ritual of enjoining Tokyo to pay its dues by taking a forthcoming position on agricultural issues, including the principle of tariffication (the process of translating all forms of agricultural protection into tariffs whose transparency made them more susceptible to multilateral adjustment through negotiations). Yet French obstructionism to major liberalization of agricultural trade rules provided Japan with a ready excuse to duck a tough issue and defer an unpalatable choice.

My predecessor had consistently urged Washington to lay off the rice issue in view of Japan's political sensitivities. I was less inclined to do so. Not that I expected we would sell much rice to the Japanese. At most, our industry analysts anticipated sales of perhaps $100 million if the market were partially opened—a figure that would make no dent in our bilateral deficit. Nor did I expect our logic to sway the politicians, bureaucrats, and farming interests that kept the import ban in place: the Ministry of Agriculture was determined to preserve its ironclad control over the market; LDP leaders were not about to jeopardize money and votes from a powerful rural constituency; and the main agricultural lobby, Zenno, had enough money and votes to intimidate any politician who even hinted at possible concessions. In practical terms, only one circumstance was likely to move Tokyo on this issue. Liberalization of the rice market would be realistically possible only when Japan had to choose between accepting a limited opening of that market or taking the blame for the failure of the Uruguay round. In the meanwhile, all we could do was explain why we wanted Japan to step up to this issue.

The argument was relatively simple. The developed countries' interests in market access, intellectual property protection, and wider opportunities to sell services in developing country markets required some accommodation of developing countries' interests in expanding their agricultural exports to developed country markets. Thus the need for reform of agricultural trade. If important countries like Japan, however, insisted on excluding commodities like rice from the negotiations, every other advanced country would demand comparable exemptions and soon there would be little scope for reform.

Japan clearly faced formidable opposition to opening this market from its rice lobby. But that did not make them unique. Farmers exerted disproportionate political clout in Europe and the United States as well. Moreover, the rice import ban had become a powerful symbol to Americans of Japan's habit, despite its enormous trade surplus, of seeking special arrangements to shield inefficient sectors from competition. Besides, contrary to warnings of the scaremongers in the Ministry of Agriculture, the market opening proposed in Geneva was limited and would be phased in over a lengthy period. The principle of tariffication foreshadowed further liberalization later, but the proposals being discussed during the Uruguay round would allow Japan to sustain formidable protective barriers around its rice farmers for years to come.

I registered these points in public speeches and private remonstrances to politicians, bureaucrats, business representatives, and journalists over many months. While individual politicians occasionally acknowledged the force of my arguments, in public I heard only excuses. The arguments found greater resonance in the business community, however, and Keidanren, Japan's most powerful industrial federation, eventually lobbied publicly for liberalization. In poll after poll, moreover, Japanese citizens appeared to recognize that liberalization of the market was both inevitable and, within limits, even desirable. Yet, as expected, the special interests exerted a controlling influence. And they left no stone unturned in their efforts to keep the market closed. The Agriculture Ministry even threatened to arrest our embassy representatives if they displayed U.S. rice at an international food fair in Tokyo in 1991.

We hoped the time for a decision on GATT might arrive in December 1990 when the GATT ministerial was scheduled to convene in Brussels. In anticipation of the meeting, I made my usual rounds. Key LDP leaders were predictably cautious and noncommittal. Some might have been prepared to accept a very limited market opening, if it were decoupled from the principle of tariffication, a step for which none appeared prepared. Former prime minister Takeshita acknowledged to me with a wry smile that when agricultural issues came up at GATT the usual modus operandi for the Japanese delegation was to look at their watches, shift uneasily in their seats, and suggest that the time had come for lunch, another meeting, or an early flight home. On this occasion, such passivity would have been welcomed. But the head of the Japanese delegation, Agriculture Minister Tomio Yamamoto, took the lead in publicly denouncing GATT Chief Arthur Dunkel's proposal that all forms of agricultural protection be converted into tariffs as a means of simplifying negotiations for the equitable removal of barriers.

The Japanese were not responsible for the impasse in Geneva. But it was disappointing to observe the leaders of the world's second-largest economy approach the negotiations so defensively. From the Geneva press reports of the negotiations, one might have wondered whether Japan was even present. Equally disappointing was the fact that when the Japanese did display modest activity, their positions rarely complemented our own. They focused the bulk of their attention on the antidumping and countervailing duties issues. On the broader questions of tariff reductions, market access, service trade, and intellectual property rights, they played their cards extremely close to the vest, shunning the lead, while seeking to withhold their offers until others had disclosed their bids. Their negotiating tactics were a logical means of defending their nation's commercial interests, but they provided dispiriting evidence that Japan's leaders were unprepared to incur significant political risks to facilitate an agreement. A GATT agreement was eventually concluded, but not on my watch. My tour in Tokyo ended, as it began, with little discernible progress on this front.

Macroeconomic Coordination

Coordination of macroeconomic policy was central to any serious effort to reduce our trade imbalance: we could not reduce our trade deficit without saving more and consuming less; Japan could not control its trade surplus without investing more of its savings at home. Regrettably, while thoughtful individuals on both sides understood this, neither side took effective action. Bilateral communications on the subject were at best sporadic, and they rarely inspired mutual confidence. Bureaucratically, the U.S. Treasury and the Japanese Ministry of Finance controlled macroeconomic discussions. While our respective officials worked very effectively on a number of international questions (e.g., Mexican debt, establishment of the European Bank for Reconstruction and Development), I saw little evidence of effective macroeconomic coordination. The bureaucratic fit was not perfect. Japan's MOF possessed authority for managing both tax policy and budget compilation; Treasury did not. In the U.S. Treasury, political appointees controlled policy decisions; in the MOF, the bureaucrats were a law unto themselves. In fact, no component of the U.S. government could begin to match the MOF's considerable power. It recruits the best and the brightest from the finest university in Japan; it dominates the budgetary process; it controls the nation's financial system; it places its retiring senior officials in charge of many of the key private banks, research institutes, insurance companies and securities firms; and it utilizes its control of the tax system to deflect private and public attempts to bring outside pressure to bear on its decision-making process.

I was never much of a player on macroeconomic policy issues, and I learned early that MOF officials did not take kindly to suggestions from me. In my first call on Finance Minister Tatsuo Murayama in May 1989, I asked what I considered an innocent question about why the ministry sought to maintain a sizable surplus in its consolidated budget despite high levels of private savings and widespread complaints about the inadequacies of Japan's public infrastructure. The minister changed the subject. I subsequently learned that his associates were offended that I had even raised it. My subsequent encounters with MOF officials, while invariably cordial, were rarely productive.

It was apparent that both MOF and Treasury preferred to keep discussion of macroeconomic issues, as well as other matters for which they bore responsibility, strictly within their own channels. MOF resented the SII framework not least because it exposed the discussion of financial issues to other Japanese agencies. MOF regularly excluded the Japanese ambassador in Washington from its discussions with Treasury, and I sensed that Treasury would have been happy to reciprocate. At the culmination of the SII discussions on savings/investment issues, the ministry sought—unsuccessfully—to exclude me from a meeting between Minister Ryutaro Hashimoto and Assistant Secretary of the

Treasury Charles Dallara. I informed Vice Minister Makoto Utsumi that how the Ministry of Finance chose to deal with the Japanese ambassador in Washington was its problem, but as long as I was ambassador to Japan, I would decide whether to accompany senior U.S. officials to meetings with ministers.

The need for a discreet channel between central bankers and financial officials is, of course, widely acknowledged. Sensitive subjects like exchange rates cannot be handled in wider fora without chaotic results in the foreign exchange market. Consequently I neither had nor sought any role in deliberations about exchange rates, and I made it a practice never to comment publicly on the subject. Nor was I consistently well informed regarding MOF-Treasury discussions on other issues. The telephone provided a direct line of communications between them, and the gist of such discussions was closely guarded.

Though mostly out of the loop, I was concerned that the discussions between MOF and Treasury did not appear to inspire mutual confidence. Momentum in the yen-dollar talks had dissipated. David Mulford, undersecretary of the Treasury and a frequent visitor to Tokyo in the past, showed up only rarely and appeared preoccupied with other issues. Personal relationships at both ministerial and working levels appeared stiff. As far as I could discern, the cooperative language contained in G-7 summit communiqués regarding macroeconomic policy was not matched by complementary work programs to assure its realization.

In truth, MOF had a decidedly different agenda from ours. Its highest priority was "fiscal reconstruction"—reducing the public indebtedness Japan had incurred from fiscal expansion measures in the late 1970s. The attitude toward deficit financing in the ministry was "Never again." Cheap money, rather than fiscal stimulus, was used to fuel growth in the late 1980s. This allowed Japanese companies to finance the adjustments required to remain competitive in the face of a stronger yen. Improving the social infrastructure of the country was accorded priority only insofar as it could be accommodated within the framework of tight budgets.

Nor did MOF appear interested in rectifying the savings/investment imbalance through more expansive use of the off-budget Fiscal Investment Loan Program, through which postal savings funds were channeled into capital investment projects. The U.S. Treasury believed that Japan possessed the fiscal flexibility to augment such spending dramatically because it was running a large surplus in its consolidated budget. That budget included social security funds, however, and the Japanese argued that prudence required them to build up their reserves to cope with the future burdens of an aging population. This struck our experts as excessively cautious since the real financial burdens of an aging population were at least a decade away. Investments in infrastructure could be amortized so that funds would be back in the treasury when most needed; besides, the elderly population would benefit to a disproportionate degree from improved public facilities such as transportation, hospitals, housing, and other social amenities. But given that Japan's public finances were in better shape than ours, our advice was, perhaps understandably, discounted.

I did consistently urge the Japanese in both public remarks and private conversations to rely more heavily on domestic demand as a means of reducing its external surplus. The Japanese government had ostensibly embraced that concept when the Maekawa Commission Report was issued in 1986. Certainly their government regularly reaffirmed this intent in G-7 communiqués. And, in fact, from 1986 to 1990 domestic demand growth, driven by robust investment levels, was very impressive: imports grew rapidly; Japan's global surplus diminished; and so did our bilateral current accounts imbalance. Yet when the bubble economy burst and the Japanese economy slipped into recession in 1991, domestic demand weakened, and the Ministry of Finance strenuously resisted fiscal stimulus measures that could not be financed within a balanced budget.

Some in Washington suggested that we address the savings/investment imbalance by encouraging the Japanese to save less. This struck me as wrongheaded, and I felt the Japanese would regard such advice as both gratuitous and perverse coming from a nation as improvident as our own. Moreover, since other industrial countries also were saving too little, the global economy depended increasingly on savings generated by Japan and other East Asian nations. Consequently, I preferred to urge Washington to save more, while prodding Japan to channel more of its savings into public investments at home.

Why, I asked, did it make sense for Japan's general government budget to generate high surpluses at a time when personal savings rates remained extremely high? Why was the proportion of GDP devoted to personal consumption declining at a time when most Japanese complained that their national wealth was not matched by the standard of living to which their hard work and prolonged effort entitled them? Wouldn't it be sensible, I asked, for the government of Japan to direct more of its savings into investments in public infrastructure and housing for the Japanese population? The suggestion found some resonance in the Japanese press, if not in the Ministry of Finance.

As Japan's recession deepened and our recovery commenced, I was asked by Washington with increasing regularity to encourage the Japanese to apply more fiscal stimulus. This pressure heightened particularly on the eve of President Bush's visit to Japan in January 1992. Treasury Secretary Nick Brady believed a strong mutual commitment to complementary macroeconomic measures would contribute to the success of the trip, could help stimulate U.S. exports in an election year, and would put pressure on the Germans for comparable steps on interest rates at the upcoming Bonn summit.

The Miyazawa government was preparing to submit its budget for fiscal 1992 to the Diet. It envisaged a 3.5 percent growth rate for the year, with all growth projected to come from domestic demand. Economists at the embassy and many of Japan's most respected private research institutes, however, dismissed the government estimates as highly implausible. I made the rounds of government officials and LDP politicians, soliciting their support for fiscal stimulus measures. It was tough going, but former prime minister Takeshita, Shin Kanemaru, and some members of the LDP Policy Research Council showed some flexibility. When Bob Zoellick, undersecretary of state for economic affairs, came to Tokyo to finalize advance preparations for the president's visit in late December, I took him to see many of the same contacts, as well as Prime Minister Miyazawa, underscoring the U.S. government's interest in this issue.

Negotiations over communiqué language were, of course, conducted by the Treasury and MOF. The latter was predictably unsympathetic. We anticipated some help from Prime Minister Miyazawa, who was widely regarded as a fiscal expansionist and had been the architect of a major public works package in 1987 during his stint as finance minister. This time, however, Miyazawa appeared reluctant. Negotiations continued up to and through the visit. A joint statement was eventually issued. The operative clause from Washington's standpoint involved a reference to the Japanese government's plans to submit to the Diet a budget designed to strengthen domestic demand by increasing public investment and to monitor the progress of those measures in order to assure that the desired effects would be realized.

It soon became evident that the Ministry of Finance did not regard the communiqué as a commitment to undertake any special measures—at least not for the moment. Having front-loaded the disbursement of planned public works expenditures during the first half of the fiscal year, MOF resisted any supplemental expenditures until the effects of the front-loading could be assessed. By the time even they acknowledged that those disbursements had had little effect on Japan's sluggish growth, months had passed. A substantial supplemental public works package was submitted to the Diet in late fall. But it was provoked more by the free fall of the Japanese stock market in August 1992 than by any commitment to coordinated macroeconomic policy.

Unfortunately, Japanese officials could judge our macroeconomic performance just as harshly. In both countries, policy coordination fell victim to gridlock: in the United States, between the executive and legislative branches; in Japan, between politicians and bureaucrats.

More Balanced Investment Flows

While the magnitude of Japan's new investments in the USA—$16 billion in 1988—attracted criticism and some legislative proposals to monitor or even restrict those flows, the Bush administration opposed limits on foreign investment for both ideological and practical reasons. With savings low, foreign funds helped finance our fiscal deficit and created new jobs. My main concern on arriving in Tokyo was to reassure the Japanese that the United States would remain receptive to foreign investment, while encouraging them to avoid actions—for example, hostile takeovers or speculative real estate deals—that could provoke negative political reactions.

A steady stream of prominent Americans visited Tokyo in those days to solicit investment funds, particularly direct investment in new plants and equipment. In my first couple of years in Tokyo, nearly a score of state governors made the trek. More than forty states maintained trade offices in Japan, and their principal aim was to attract Japanese investment funds. They openly competed with one another in putting together attractive packages of tax, zoning, and financial inducements to lure Japanese companies to their states.

The benefits of these investments were increasingly apparent. By

1990 Japanese corporate affiliates in the United States employed as many as 629,000 Americans—at high-quality, well-paying manufacturing and services jobs, to boot. The by-products of those investments—Japanese design, technological, and manufacturing expertise—helped improve the competitiveness of many U.S. industries. Japan's greenfield plants forced companies to compete or lose market share, but they also brought new technology to the United States and encouraged civilian R and D here as Japanese companies established more and more technical design centers.

Of course, these investments were not gifts to the American people. They were motivated by the prospect of high rates of return, the need to hedge against future protectionist sentiment in the Congress, the desire for a direct presence in a consequential market, the lure of lower costs, and the desire to acquire access to new technologies. The last point was especially salient: in the late 1980s Japanese venture capital investment in U.S. high-technology firms quadrupled, from $42 million to $166 million.

In view of these advantages, the Japanese were understandably nervous about the crescendo of criticism their investments were attracting. They noted that British and Dutch investments were larger yet drew scant hostility. Some attributed this to racism. I offered a different explanation: Japan's investment was more recent and was growing more rapidly. Japanese firms—perhaps because of their relative lack of familiarity with our market—tended to stand out. Their affiliates had fewer expatriate managers, procured less from local suppliers, and were less attuned to the philanthropic traditions of our business community. Equally important, Americans accepted British investment, even in sensitive sectors of our economy, without alarm, because they knew that it was just as easy for Americans to invest in comparable activities in the UK. By contrast, foreign investment in Japan at the time was only about 0.3 percent of GNP and falling. This was the lowest figure in the industrial world—low even in comparison with the less developed countries.

In the 1990s the focus of U.S. concerns shifted away from investment in the USA to promoting American investment in Japan. As Japan slipped into recession, it began to dawn on more and more Americans that they needed to worry about obtaining too little rather than receiving too much Japanese investment. At the same time, Japanese barriers to investment became a source of greater concern. Increasing numbers of U.S. companies recognized that a local presence in Japan was critical to their export prospects. Such a presence enabled a firm to tailor products to local tastes, to monitor technological developments in Japan, and to develop local marketing and distribution channels.

A study done at the embassy turned up the fact that only 45 percent of our Fortune 500 companies had such a presence in Japan and frequently they had only a minority stake in a joint venture. Of Japan's top five hundred companies, more than 65 percent were present in our market, invariably in majority-owned ventures. In 1990 the Japanese invested $57 billion overseas, and 48 percent of this investment was in the United States. The same year, U.S. firms invested $32 billion overseas, of which only $1 billion went to Japan—a disparity that can hardly have reflected market considerations alone.

Not that the legal barriers to investment in Japan were particularly formidable; they corresponded roughly to those of other OECD nations. But a host of informal barriers existed, and in conjunction with high land prices and the difficulties of recruiting local staff, these discouraged many investors. Few ventures undertaking their first investment in Japan could expect to turn a profit swiftly. The time horizons of U.S. shareholders permitted all too few companies the luxury of taking a longer strategic view.

The embassy sought to focus more attention on this problem. We worked with the American Chamber of Commerce to identify the practical obstacles to investment in Japan. We sought to get Washington interested in the issue. During trips home, in public speeches, briefings for business groups, and consultations with executive branch officials, I emphasized the need for more investment. I even pressed the AFL-CIO's Tom Donohue on the matter, though to little avail: the unions were persuaded that foreign investment would lead to the migration of U.S. jobs overseas rather than to the creation of new export-related jobs in the United States.

The administration also sought to persuade the Japanese to take initiatives to facilitate inward investment flows. Displaying some interest, MITI cobbled together a package of tax and credit incentives, together with a scheme for bonded warehouses that foreign companies could use to reduce investments in land. Ministry of Finance opposition, however, vitiated these initiatives, and they never got far off the ground. Nor was there much steam behind them in the U.S. business community. Thus I began my tenure worrying about the high levels of

Japanese investment in the United States and finished it anxious about the paltry levels of American investment in Japan.

Gaiatsu (or "Foreign Pressure")

The visible application of U.S. pressure was a common thread in all these trade negotiations. It attracted much press attention and earned me the sobriquet "*Gaiatsu-san*," or "Mr. Foreign Pressure." In the end, its seeming necessity reinforced the frustration of Americans, even as its frequent use provoked nationalist reactions from many Japanese.

Pressure—broadly defined—is present in most negotiations among nations as they seek to remind one another of the incentives for agreement and the consequences of failure to achieve it. In this respect, our trade negotiations were quite typical. What was unique was the degree to which the pressure was palpable, overt, and apparently one-sided. To an unusual degree, we used pressure tactics to precipitate negotiations, move them forward, and bring them to a conclusion.

Of course, Japan directed pressure our way too—mainly toward U.S. competitors in the marketplace, where it belonged. But because Americans accurately perceived that Japan's market was less open than ours, the inclination was greater to respond politically. I used to explain this to Japanese friends by noting the differences in our auto trade with Japan and Germany. Both were formidable manufacturers of cars and major factors in the global market. Yet while we had experienced constant strife with Japan over autos, rarely had we encountered such difficulties with Germany. The main reason was that the Germans were both a major importer and exporter; Japan essentially exported, confining foreigners to a trivial share of the local market. Since our producers knew that they could sell in Germany, when sales there went down they examined their product, its price, and their marketing efforts. Slow sales in Japan, where they had not been able to establish even a toehold, they tended to attribute to Japanese barriers, which prompted them to turn to Washington for help.

And Washington was increasingly inclined to provide it. In some respects it had no choice. The 1988 Trade Bill, which was mainly targeted at Japan, required the administration to remove unfair trading practices through negotiations and invited retaliatory measures when bargaining failed. This congressional search for leverage was scarcely disguised, and the pressure was brandished openly.

The Japanese capacity to resist pressure or to absorb it without yielding much of substance was about as skillful as I have ever seen. The special interests that benefited from protectionist arrangements demanded their retention; the bureaucracy energetically defended them; and the politicians readily acquiesced. As usual, the consumer paid the bill but either did not notice, did not bother to complain, or could not figure out how to translate indignation into effective action. Yet Japanese supporters of market liberalization—both in the private and public sectors—often solicited our pressure to help break bureaucratic and political logjams and to galvanize support for change—although, of course, they did so in confidence and would have been embarrassed to have their fingerprints on such requests exposed. Local agents of change naturally had their own objectives, and once we put pressure on the system, they could utilize it to promote their own agenda. At times our interests converged. For example, at a crucial juncture in the SII talks, I went to LDP faction bosses Takeshita and Kanemaru in search of help in getting the Japanese government to increase its public infrastructure budget dramatically. Both were receptive. I had no doubt that more influential than the persuasiveness of my arguments was the interest of the construction *zoku*—with which both had tight connections—in expanding public works expenditures.

Japan's negotiating style also prompted us to rely on pressure tactics. Ministry officials were staunch defenders of constituency interests. Their defensive skill in deferring or avoiding concessions was widely and justly renowned. Indeed, the personal reputations of their negotiators with their peers and the press seemed to depend on their exhausting every defensive tactic before yielding even the most modest concession. Consequently, all negotiations seemed to end only at the last hour of the last day of talks—if then. These difficulties were compounded in the SII talks, because there were many issues, which touched on the jurisdiction of many ministries. Each official sought to shift the burden of adjustment onto other agencies, and since political leaders were generally weak, impasses were not easily broken.

When agreement was achieved, Japanese politicians often explained the outcome publicly as a compromise necessitated by their interest in getting the Americans off their backs or, more diplomatically, in preserving the U.S. connection. Usually the only concrete benefit highlighted was the negotiators' success in holding concessions to a minimum. While Japanese government spokespeople embraced the rhetoric of free trade, the negotiations increasingly resembled a zero-sum game, and that is how the press portrayed them.

The Japanese press targeted me as the principal practitioner of pressure tactics, but others were equally or more deserving of the compliment. President Bush was among the most skillful. Shortly after the February 1990 Lower House elections, he invited Prime Minister Kaifu to Palm Springs, California, for a working summit. The talks were wide-ranging, but the principal focus was trade. The key discussions were conducted tête-à-tête. The president appealed to Kaifu as a friend and leader who shared responsibility for protecting the bilateral relationship. Politician to politician, he explained the political forces in the United States that could imperil the future of the relationship if trade frictions were allowed to accumulate and current negotiations failed. The president issued no threats. He avoided any attempt to address the details of the negotiation and did not suggest that Japan alone was responsible for the trade imbalance, readily acknowledging the United States' need to bolster its competitiveness and attack the fiscal deficit. And he posed no deadlines (he did not need to: the administration was required to report the results of negotiations with Japan to the Hill by April 30). Instead, the president explained, he sought the prime minister's help in arresting drift toward trade conflict that could poison our political relationship and play into the hands of trade hawks in Congress. And he found a receptive audience in Mr. Kaifu who, with the help of associates at home, produced impressive results in the ensuing negotiations.

In the weeks just before President Bush's visit to Tokyo in January 1992, the pressure was more pointed and less subtle. For domestic political reasons, the president and his entourage were themselves under the gun to produce results. The proximate aims—pledged increases in U.S. auto parts sales, resolution of a host of safety and certification issues, achievement of an agreement on government procurement of computers, and some movement on market access issues in the glass and paper industries—were identified only days before the trip. The inclusion on the trip of U.S. business leaders, including major figures in the auto industry, suggested that the results would be appraised by knowledgeable skeptics. And the unstated message to Japan was clear: throw the incumbent president a lifeline through some tangible concessions on these issues, or risk the prospect of a Democratic president more inclined to economic nationalism and more susceptible to pressure from protectionist legislators on the Hill. Given the brief time available to put together a package, what President Bush got was not insubstantial. But the public paid little heed, since the media focus was on the inclusion of business leaders in his entourage and his unfortunate illness at the prime minister's banquet.

Reliance on *gaiatsu* posed dilemmas for Japanese politicians. It facilitated their efforts to build a consensus for change, but it also exposed them to domestic criticism. During the later years of my tenure in Tokyo, I observed that thoughtful Japanese acknowledged with growing candor the need to take the steps necessary to truly open Japan's market and hasten its deregulation. Akio Morita was perhaps the most visible spokesman for this view. It was evident as well in the Okawara Report, commissioned by the Foreign Ministry and published in late 1992. Japanese calls for reform were generally accompanied by the proviso that Japan should undertake such steps of its own volition. Unfortunately, during my tenure there, resentment of and resistance to our pressure grew more rapidly than Japan's capacity or willingness to undertake needed reforms without it.

Given the size of our bilateral trade and the degree of our economic interdependence, each government's interest in the other's laws and administrative rulings that could affect its economic fortunes was perfectly natural. So were both governments' active efforts to influence these matters. Yet here, as in so many other areas, our relationship with Japan seemed to be structurally out of balance. In undertaking lobbying—that is, in applying pressure—the Japanese enjoyed a distinct advantage: Given the disparity in market access, they were normally seeking to prevent new trade restrictions in the United States, while we were seeking to remove old ones in their country. In the U.S. political system, veto points are legion, hence Japanese representatives could quietly shop around for an amendment here, a procedural delay there, a veto elsewhere, in order to block new trade restrictions. And they encountered little difficulty in recruiting capable help, since many former U.S. trade officials were readily available for an appropriate retainer.

We, on the other hand, were nearly always seeking to get the Japanese government to take positive action to reduce or eliminate formal or informal trade barriers. Such actions usually required an energetic local sponsor and broad support within the bureaucracy, business community, and LDP. Even when we could find allies within the Japanese government, they invariably encountered difficulties in securing the cooperation of problem agencies such as Construction, Transportation, Post and Telecommunications, Health and Welfare, Justice, MITI, and MOF. And whereas in the USA delays left the market open, in Japan they left trade barriers intact. Beyond this, I had no money to utilize for lobbying and would have found it exceedingly difficult to recruit knowledgeable Japanese for this purpose had I tried. Since the contest was so unbalanced, I was bemused to find that most of the accusations of using pressure tactics were directed at me.

A Balance Sheet

I left Japan in mid-1993 somewhat dispirited about our economic relationship. The bilateral trade imbalance was climbing back toward the 1989 levels, despite a substantial appreciation of the yen. Our business cycles were again out of sync. Support in Japan for major adjustments in the saving/investment imbalance was only lukewarm in political circles and virtually nonexistent in the Ministry of Finance. Even though the Japanese had slipped into recession in 1991, in 1993 it surpassed the United States to become the world's largest manufacturing economy. Its savings continued to outpace our own, and the USA had solidified its position as the world's largest debtor nation. And whereas in 1989, when the Tokyo Stock Market was at its peak, Japan's economy was roughly 55 percent of America's economic size, by 1993 that figure exceeded 65 percent. The Clinton administration had taken its time to formulate a trade policy toward Japan, and clumsy talk about numerical targets allowed the Japanese trade bureaucracy—in a monumental act of chutzpah—to seize the high political ground by posing as a world champion of free trade. A framework agreement signed during the president's visit to Tokyo in July 1993 merely papered over decidedly different and conflicting agendas. And the prospects for Japanese market-opening initiatives were scarcely promising in the midst of a recession. Another collision between an irresistible force and an immovable object appeared imminent.

In other respects, however, the situation had improved. Undeniably, the Japanese market had become more porous. Sectoral and structural agreements had broken down many obstacles to market entry. More and more American firms acknowledged the need to be in Japan. The success of U.S. companies in virtually every segment of the market—

producers of consumer products such as Procter and Gamble or Kodak; industrial giants such as Motorola, GE, Monsanto, or Merck; high-tech firms such as Intel, Applied Materials, Apple, Compaq, and DEC; service companies such as McCann Erickson, McDonald's, AFLAC, Peat Marwick, and Kentucky Fried Chicken; financial firms such as Salomon Bros., Morgan Stanley, and Goldman Sachs; even auto parts producers such as TRW—provided evidence that highly profitable operations could be undertaken in Japan in virtually all sectors. And U.S. companies, spurred in many cases by Japan's ferocious competition, had undergone restructuring that had resulted in leaner staffs, lower costs, greater attentiveness to quality, renewed interest in the manufacturing process, and growing skill in capturing the rents from innovative technology.

Even in politically sensitive sectors such as cars and consumer electronics, we were slowly reclaiming market share. By 1993, if one included Japanese transplants, the United States was the low cost auto producer in the world; the Big Three were increasing their market share at home against both German and Japanese competitors; through design-in arrangements with Japanese makers, our auto parts manufacturers were beginning to make some headway into Japanese supply networks; and exports from Japan's U.S. production sites were gaining momentum. Between 1989 and 1993 our share in Japan's semiconductor market increased from less than 9 percent to more than 20 percent. The USA had also reasserted its technological leadership in many fields, including a number on which Japan had set its sights—for example, HDTV, the high–value-added sectors of the computer industry, telecommunications, and multimedia products. While a strong yen cut the profit margins of Japan's flagship exporting firms to the bone, the Clinton administration made it a priority to reduce the fiscal deficit and promised a new partnership with the United States' exporters.

Meanwhile, Japan was forced to pay for the excesses of the 1980s. A Bank of Japan–triggered recession continued much longer than anticipated. By mid-1993 the Japanese stock market stood at roughly half its 1989 value. Property values continued to depreciate. The banking sector struggled under a mountain of nonperforming loans. Business community confidence was at its lowest point in decades. And these developments—with the help of a series of scandals—pushed the LDP out of office for the first time in decades. Its successor—a fragile, somewhat conservative, yet reformist coalition—proclaimed its interest in political reform, deregulating the economy, promoting fiscal stimulus through tax cuts, and readjusting the balance between producer and consumer interests—all in all, an agenda Americans could applaud.

Strategic alliances between U.S. and Japanese firms continued to proliferate, and more and more frequently the Japanese took the initiative for them. More broadly, some convergence was evident in our decidedly different forms of capitalism. In the United States, Japan was no longer perceived as invincible, and successful restructuring was reviving the productivity of our manufacturing sector. As we regained our self-confidence, we were likely to be easier for others to live with; in Japan, sobering reminders of their own vulnerability had pushed into retreat the hubris and arrogance that had accompanied the bubble economy. Thus, though trade rivalry remained inevitable, some of the objective conditions that threatened to transform commercial competition into a broader political conflict appeared by 1993 to be in retreat.

Only some, however. Because the U.S. and Japanese business cycles were again out of sync—ours in a strong recovery phase, theirs mired in recession—the trade imbalance was destined to grow. More importantly, the Clinton administration seemed inclined to adopt a more confrontational stance on trade issues, and 1993 proved to be a year that did in fact bring more intense political conflict.