

UNITED STATES-JAPAN  
ECONOMIC AND TRADE RELATIONS

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HEARING  
BEFORE THE  
COMMITTEE ON WAYS AND MEANS  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED NINTH CONGRESS  
FIRST SESSION

SEPTEMBER 28, 2005

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**UNITED STATES–JAPAN ECONOMIC AND  
TRADE RELATIONS**

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**WEDNESDAY, SEPTEMBER 28, 2005**

U.S. HOUSE OF REPRESENTATIVES,  
COMMITTEE ON WAYS AND MEANS,  
*Washington, DC.*

The Committee met, pursuant to notice, at 2:06 p.m., in room 1100, Longworth House Office Building, Hon. Bill Thomas (Chairman of the Committee) presiding.

[The advisory announcing the hearing follows:]

# ADVISORY

## FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE  
September 20, 2005  
No. FC-13

CONTACT: (202) 225-1721

### **Thomas Announces Hearing on United States– Japan Economic and Trade Relations**

Congressman Bill Thomas (R-CA), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on economic and trade issues with Japan. **The hearing will take place on Wednesday, September 28, 2005, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 1:00 p.m.**

Oral testimony at this hearing will be from both invited and public witnesses. Invited witnesses will include Wendy Cutler, Assistant U.S. Trade Representative (USTR) for Japan, Korea and Asia-Pacific Economic Cooperation Affairs; A. Ellen Terpstra, Administrator, Foreign Agricultural Service; and David Loevinger, Deputy Assistant Secretary of the Treasury for Africa, Middle East and South Asia. Any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

#### **BACKGROUND:**

The World Bank lists Japan as the second-largest economy in the world after the United States, and the U.S. Department of Commerce lists Japan as the fourth-largest trading partner with the United States after Canada, China and Mexico. The United States is Japan's largest export market. In 2004, imports from Japan to the United States totaled \$129 billion. United States exports to Japan were \$54 billion, resulting in a deficit of \$75 billion. Major U.S. imports from Japan are passenger cars and parts, computers and components, office machinery parts and electrical machinery. Major U.S. exports to Japan include computers, computer components, gas turbines, office machinery, electrical machinery, optical and medical equipment, and agricultural products.

Japan has maintained a significant trade surplus with the United States for many years. The surplus was generally increasing during the 1990s, however it dropped abruptly from \$81 billion in 2000 to \$69 billion in 2001 and 2002. During the same period, Chinese exports to the United States began significantly increasing. The sectors in which the United States runs the largest trade deficits with Japan are automobiles and automobile parts.

Japan presents many areas of concern. Japan's persistent trade surplus with the United States, coupled with its staunchly protectionist attitudes reflected in high tariffs, non-tariff barriers, and discriminatory government action toward foreign products, has led to frequent tension in the trade relationship. For example, Japan only recently announced it would eliminate discriminatory sanitary and phytosanitary standards against U.S. apples after a protracted World Trade Organization (WTO) dispute. Japan has not reopened its market for U.S. beef (nor announced a definite time for doing so) despite extensive testing and safety protections in the United States to prevent bovine spongiform encephalopathy in cattle. Many other similar barriers remain, however, but do not receive the same degree of attention.

Japan's economy went into recession in 1990, averaging only 1.2 percent growth between 1993 and 2003. Growth picked up in 2004 to 2.7 percent. However in July 2005, various economic data suggested that the recovery, despite improvement, has not yet become firm—household spending dropped 3.7 percent from 2004, unemploy-

ment surged to 4.4 percent, and prices continued to deflate by 0.6 percent from 2004 levels. In an effort to improve the business climate in Japan, USTR and Japanese officials continue to participate in the U.S.-Japan Regulatory Reform and Competition Policy Initiative launched in 2001. USTR's recommendations cover key areas such as information technologies, telecommunications, medical devices and pharmaceuticals, energy, and competition policy. USTR also recommended privatization of the \$3 trillion Kampo, a government agency performing various functions of a postal service, national insurance agency, and retirement savings bank among others. Indeed, the recent election in Japan that returned the ruling Liberal Democrat Party (led by Prime Minister Junichiro Koizumi) to a strengthened position of power was brought about in part because of controversial legislative proposals to privatize and reform Kampo. The heavy government involvement in these areas has led to objections from the U.S. couriers, insurance, and financial services industries, which seek to compete in Japan.

The goal of this hearing is to discuss Japan's continuing importance as an economic partner to the United States and the issues surrounding the U.S.-Japan economic and trade relationship.

In announcing the hearing, Chairman Thomas stated, "Japan remains one of our most important trading partners, and recent political and economic reform movements in Japan raise our hopes that our trade relationship will greatly improve. Yet after all these years, U.S. firms do not have full access to Japanese markets. For example, the U.S. agriculture, automobile, insurance, healthcare, and express delivery industries are only a few of the competitive industries that have long sought fair access to the Japanese market. If Japan becomes a 'normal' country, as its leaders are now emphasizing as their goal, we anticipate trade improvements that will benefit both U.S. firms and Japanese consumers."

#### **FOCUS OF THE HEARING:**

The hearing will focus on U.S.-Japan economic and trade relations and Japan's role in the world economy, with a narrower focus on the following: (1) Japan's economic problems, their causes, and the impact on the United States and the world economy; (2) Japan's barriers to trade including sanitary and phytosanitary barriers to agriculture imports such as the ban on U.S. beef, discriminatory government actions against U.S. products, and general non-tariff barriers; (3) Japan's role in the current WTO negotiations; and (4) the recent economic and regulatory reforms attempts in Japan, including the proposed legislation to privatize major components of Kampo.

#### **DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:**

Requests to be heard at the hearing must be made by telephone to Michael Morrow or Kevin Herms at (202) 225-1721 no later than the close of business **Thursday, September 22, 2005**. The telephone request should be followed by a formal written request faxed to Allison Giles, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515, at (202) 225-2610. The staff of the Committee will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Committee staff at (202) 225-1721.

**In view of the limited time available to hear witnesses, the Committee may not be able to accommodate all requests to be heard.** Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing in lieu of a personal appearance. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE-MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record, in accordance with House Rules.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Committee are required to submit 300 copies, along with an *IBM compatible 3.5-inch diskette* in

*WordPerfect* or *MS Word* format, of their prepared statement for review by Members prior to the hearing. **Testimony should arrive at the full Committee office, 1102 Longworth House Office Building, no later than close of business on Monday, September 26, 2005.** The 300 copies can be delivered to the Committee staff in one of two ways: (1) Government agency employees can deliver their copies to 1102 Longworth House Office Building in an open and searchable box, but must carry with them their respective government issued identification to show the U.S. Capitol Police, or (2) for non-government officials, the copies must be sent to the new Congressional Courier Acceptance Site at the location of 2<sup>nd</sup> and D Streets, N.E., **at least 48 hours prior to the hearing date. Please ensure that you have the address of the Committee, 1102 Longworth House Office Building, on your package, and contact the staff of the Committee at (202) 225-1721 of its impending arrival.** Due to new House mailing procedures, please avoid using mail couriers such as the U.S. Postal Service, UPS, and FedEx. When a couriered item arrives at this facility, it will be opened, screened, and then delivered to the Committee office, within one of the following two time frames: (1) expected or confirmed deliveries will be delivered in approximately 2 to 3 hours, and (2) unexpected items, or items not approved by the Committee office, will be delivered the morning of the next business day. The U.S. Capitol Police will refuse all non-governmental courier deliveries to all House Office Buildings.

#### **WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:**

**Please Note:** Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select "109th Congress" from the menu entitled, "Hearing Archives" (<http://waysandmeans.house.gov/Hearings.asp?congress=17>). Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the on-line instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You **MUST REPLY** to the email and **ATTACH** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business Wednesday, February 23, 2005. **Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225-1721.

#### **FORMATTING REQUIREMENTS:**

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and **MUST NOT** exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including avail-



ability of Committee materials in alternative formats) may be directed to the Committee as noted above.

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Chairman THOMAS. Good afternoon. Today the Committee is examining the United States' trade relationship with Japan because it is so important to U.S. producers, workers, consumers, farmers, and ranchers, particularly at a time when self-protectionism and isolationism threaten the current World Trade Organization negotiations and possibly poison the atmosphere for free trade. This Committee last held a hearing on Japan in July 1998. I think it is more than appropriate to look at the relationship again to measure the degree of change, if measurable, between 1998 and today, and also to look at the recent elections in Japan and other developments.

China attracts a great deal of media and congressional attention, but China is right now only a developing market. The World Bank lists Japan as the second largest economy in the world. And then when we look at our trading partners, other than those in which we have a common border—Canada and Mexico—China and Japan are next in order. The United States is Japan's largest export market, and Japan's large, thrifty, modern, and wealthy population should be a major buyer of American goods today, but it is not, in large part because the Japanese have built a wall of complex protectionist practices and regulatory systems.

Today we will hear from witnesses from various U.S. industries and a Member of Congress to discuss the difficulties they have in selling to the Japanese market, including beef, medical devices, and insurance, to name only a few.

Much has been written and much speculation has been presented about the results of the recent Japanese election, and especially the change in the Membership of the Diet. Once again that is about the possibility for "tomorrow." In the Chair's opinion, too much of our relationship with Japan has been waiting for "tomorrow." Pick your cliché: "Tomorrow is forever," or "Tomorrow never comes." Either one pretty well represents the relationship that we have had with Japan.

All of us are in hopes that the election indicates that there will truly be a new "tomorrow." The purpose of this hearing, primarily, is not to speculate about "tomorrow," but to determine what "today" looks like, and especially in comparison with what "today" looks like and what "yesterday" looked like—from 1998 until today. Just what movement has been evident in the Japanese willingness to open up their markets, notwithstanding all the promises of a bright tomorrow?

And with that, I will yield to the Chairman of the Trade Subcommittee, the gentleman from Florida, Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman.

This afternoon we once again gather in a bipartisan manner to help comprehend the practices and policies of a vital trading partner. In recent months, this Committee has been proactive in providing Members the opportunity to hear from government, business, and industry leaders on trade relations with specific foreign governments. Today we turn our attention and focus on United

States trade relations with Japan. It is time for Japan to know that the United States is serious about a free, fair, and transparent trading relationship.

According to the World Bank, Japan is the world's second largest economy. The Department of Commerce lists Japan as the United States' fourth largest export market behind Canada, China, and Mexico. In addition, Japan is a key partner in our efforts to expand American products into the Pacific Rim. However, it is most unfortunate that the protectionist views in Tokyo have placed American business and industry at a severe disadvantage.

I have heard directly from a number of industries, including the automobile industry, the medical device industry, and the insurance industry, to name only three. I have discussed with them the issues surrounding trade with Japan. Overwhelmingly, the serious concern that I share with these industry leaders is the numerous and unfair tariff and nontariff barriers which exist today.

The Office of the U.S. Trade Representative produced a book entitled "Barriers to Trade." This document provides detailed country-by-country barriers on a host of products. The United States Trade Representative, USTR, section on Japan, which I have here, is an astounding 30-page document. Protectionist measures currently in place include high tariffs, support programs, quotas, and discriminatory standards. Japan's average bound tariff rate on agricultural goods stands at 51 percent compared to 12 percent for the United States. The average applied tariff rate for agricultural products in Japan is 29.4 percent compared to 2.4 percent for the United States.

The United States has always been and will always be a leader within the World Trade Organization in seeking the removal of trade barriers, including those unfair barriers in Japan. We must pressure our Japanese friends to negotiate in good faith toward moving its market to one that is fair, transparent, and less regulated.

On September 11th, the Prime Minister was re-elected with tremendous support. An issue that he based his re-election on was the privatization of Japan's post-insurance arm, the Kampo. I understand legislation will move toward the Diet to reform Kampo by offering a competitive environment for the United States insurance industry. United States life insurers make up an estimated \$38 billion in annual policy premiums in Japan. As Tokyo moves forward in privatizing Kampo, a transition period will take place. Regardless of the amount of time the Japanese deem necessary to transition into a competitive market, I urge the Japanese to conduct the Kampo reform in an open and transparent process which will eliminate any hint of unfair practices. A transparent process is tremendously important.

I am also concerned about regulations imposed on the medical device industry. The decision to establish reimbursement rates based on foreign pricing is perplexing. I look forward to hearing from our witnesses addressing this area as well.

Finally, during our focus on China and its currency peg, I have heard a number of times that we should not overlook the Japanese yen. Over a 3-year period, 2000 to 2003, the Japanese government took steps that thwarted the yen from appreciating significantly

against the dollar, making U.S. exports to Japan more expensive and Japan imports to the United States less expensive. While the yen has raised almost 15 percent against the dollar in the last 2 years, many economists feel that it is still undervalued. I look forward to hearing from our witnesses regarding the Japanese yen.

Mr. Chairman, I appreciate today's witnesses and their willingness to educate us on this bilateral relationship. I hope to hear their views about whether the recent election will usher in reforms. I look forward to working with my friend, Ben Cardin, in addressing these concerns and others raised this afternoon. And I yield back.

Chairman THOMAS. The Chair now recognizes the gentleman from Maryland, the Ranking Member on the Trade Subcommittee, Mr. Cardin.

Mr. CARDIN. Thank you very much, Mr. Chairman, and let me thank you for holding this hearing and say that I am in total agreement with the statements that have been made by our Chairman and the Chairman of the Trade Subcommittee.

My concern has been that with all the attention on China, we may have lost focus on Japan and making sure that we have enforcement of our trade rules with Japan and opening up more markets. So, this hearing, I think, is an important step in establishing the record as to the current relationship between our two countries as it relates to commerce.

It has already been pointed out that Japan is our next largest trading partner outside of North America behind China. We had a \$75 billion trade imbalance in 2004. I think all of us are very concerned about that. Japanese investors are the leading foreign holders of U.S. Treasury securities. At the end of 2003, they held 15 percent of all privately held Federal securities.

As Mr. Shaw pointed out, there is serious concern as to the intervention of Japan into the currency market that is used in a way to manipulate the currency in order to give Japanese imports into our market an unfair advantage. We need to take a look at that and see, in fact, what is being done here and look at the impact it has not only on the market today but on the future vulnerability of our Nation.

Mr. Chairman, I appreciate the witnesses that you have, particularly on the private sector panel, because I think they represent the challenges that we have in our relationship with Japan in trading. We have representatives from the auto and auto parts industry, and we know that nontariff barriers in Japan have worked to the detriment of the auto and auto parts industry here in the United States. We have representatives from the agriculture/beef industry. We know about the high tariffs in Japan on agricultural products and the use of sanitary requirements, the standards that go well beyond the protection of the health of the people of Japan. We need to look at that and see how these distortions are affecting the market here and in Japan.

Representatives from the life sciences are here to talk about the medical equipment issue that has been mentioned by both the Chairman and the Ranking Member. And representatives from the life insurance or service industries are here. Mr. Shaw mentioned the privatization of Kampo. It has been delayed for a long time. We

would like to know the reasons why. And as the Chairman said, we are losing patience in promises that have been made and not kept. And the issue goes well beyond just Kampo. It has to do also with opening up opportunities in other service areas.

Mr. Chairman, these issues are very important. I have, along with many of my colleagues on the Democratic side of the aisle, been urging the administration to be more aggressive in enforcing our trade rules. In March of this year, I joined Ranking Member Rangel and other Members of the Democratic House leadership in urging the administration to take action in the WTO and under section 301 of the U.S. trade laws to address some of our trade issues with Japan, particularly in the area of nontariff barriers.

Mr. Chairman, I can assure you and I can assure our witnesses today that we are united to work with all the Members of this Committee to make sure that we pay strict attention to our relationship with Japan, with the goal of removing distorting practices that are now being imposed in Japan, that affects access of U.S. companies to the markets in Japan. We want to see action, and we look forward to the testimony of the witnesses today.

Chairman THOMAS. I thank the gentleman.

Before we hear from those panels that the gentleman from Maryland described, it is our pleasure to hear from a senior Member of the Agriculture Committee, our friend and colleague Jerry Moran, from the State of Kansas, for, as far as the Chair is concerned, two principal reasons: one, being a Member who is not on this Committee, the depth and breadth of the rank-and-file's attitude about this issue; and, two, because he does come from the heartland. The question of agriculture is probably as egregious as any in the United States-Japan relationship.

I would tell the gentleman from Kansas any written statement he may have will be made a part of the record, without objection, and he can address the Committee in any way he sees fit.

**STATEMENT OF HON. JERRY MORAN, A REPRESENTATIVE IN  
CONGRESS FROM THE STATE OF KANSAS**

Mr. MORAN. Mr. Chairman, thank you so very much for those remarks and for allowing me the opportunity to join you and the other distinguished Members of the House Committee on Ways and Means and for this opportunity to testify. While I know this hearing will cover a number of Japanese trade concerns, I want to focus my comments and remarks on the economic harm that U.S. farmers, ranchers, processors, and retailers have experienced because of a Japanese embargo on American beef.

Japan has prohibited the import of beef from the United States since December of 2003, when a single case of BSE was found in a Canadian-born animal. Since that time, we have had only two cases of BSE in our country, yet the market remains closed.

Since 2003, the United States has undertaken rigorous and thorough surveillance programs for BSE testing and has implemented safeguards to protect human and animal health. That list is lengthy. We have removed SRMs from the food supply. From June 1st of 2004 to August of 2005, we have tested more than 450,000 animals. They have tested negative for BSE. We have placed a ban on imports of live cattle and most ruminant products from high-

risk countries; FDA's 1997 prohibition on the use of most mammalian protein in cattle feed; an aggressive surveillance program has been in place for more than a decade; the banning of non-ambulatory cattle from the human food chain; requirements for establishing the use of advanced meat recovery systems; prohibition against air injection stunning of cattle; and if an animal is presented for slaughter and is sampled for BSE, they hold the carcass until the test results have been confirmed negative.

These safeguards have exceeded internationally recognized standards promoted by the World Organization on Animal Health, of which Japan is a Member. And while the Sanitary and Phytosanitary Agreement provides members of WTO the right to take measures to protect human, animal, and plant health under the principles of sound science, the SPS Agreement does not provide WTO Members the right to discriminate and restrict trade arbitrarily.

So, despite the discovery of only two animals, despite all these steps taken, Japan continues to refuse to purchase meat products from the United States.

The Department of State, the Office of the USTR, and the U.S. Department of Agriculture have worked tirelessly to open this export market, and I commend them for their efforts. And on October 23, 2004, almost a year ago, the United States and Japan concluded an understanding that established a process to lead to the resumption of beef imports from the United States. Despite these efforts, the government of Japan continues to delay imports of beef from the United States on the basis of factors not grounded in science or consumer safety.

We are losing \$1.7 billion of export market to Japan. It is the largest export market for the livestock industry. The 2-year delay has now totaled more than \$3.4 billion in losses. And whether you are a farmer or a rancher or a retailer or processor, the loss of those markets have a detrimental effect upon many communities and the agriculture economy. We are losing \$100 million each month Japan remains closed to the United States, and we have lost an estimated 10,000 jobs.

Mr. Chairman, this issue is very important in Kansas. I know we are thought of as a wheat State, but my district produces approximately 5 billion pounds of beef a year, making it the largest beef-producing congressional district in the Nation.

It is estimated by my cattlemen that we are losing \$6 to \$8 a hundredweight as a result of the Japanese ban. There is no more important trade issue in Kansas than resumption of beef sales, livestock sales to Japan.

In March, Mr. Chairman, as you know, I introduced House Resolution 137 which has approximately 80 cosponsors of our colleagues. That resolution is a sense of the House of Representatives that if Japan fails to meet its obligations under that agreement reached nearly a year ago, USTR should immediately impose retaliatory economic measures against Japan. While I do not wish for the U.S. and Japan to enter into a drawn-out trade dispute, the reality is that Japan must be encouraged, must uphold its trade agreements. I urge this Committee to bring this resolution to the floor and show Japan the serious nature of this trade issue.

Congress works to promote trade agreements. Mr. Chairman, as you indicated, I am a Member of the House Agriculture Committee. We are often asked to support trade agreements, CAFTA being the most recent example. And among my colleagues and among my constituents, I don't see any problem in reducing tariffs, but they wonder what happens after we enter into that trade agreement. Why doesn't it result in additional sales? So, reducing that tariff, leveling the playingfield in that regard is important, but our failure to make certain that the markets are open once the agreement is entered into creates a real interest on the part of Members of Congress and my constituents as to whether trade agreements—what the value of a trade agreement is.

Mr. Chairman, in my opinion, Japan cannot have it both ways. They benefit from exports to the U.S. while denying imports, such as beef, with no scientific evidence to support their actions. In 2004, as Mr. Cardin indicated, our trade deficit with Japan was in excess of \$75 billion. I urge support of House Resolution 137 and ask that this Committee bring that resolution to the House floor for a vote.

I again thank the Chairman for the opportunity to be here on behalf of the Agriculture Committee and on behalf of Kansans back home.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Moran follows:]

**Statement of The Honorable Jerry Moran, a Representative in Congress  
from the State of Kansas**

Good Morning and thank you Chairman Thomas, Ranking Member Rangel, and distinguished members of this Committee for the opportunity to testify today. While this hearing will cover a number of Japanese trade concerns, I will focus just on the economic harm that U.S. farmers, ranchers, processors, and retailers have experienced because of the Japanese embargo of American beef.

Japan has prohibited imports of beef from the United States since December 2003, when a single case of Bovine Spongiform Encephalopathy (BSE) was found in a Canadian-born animal. Since that time, there have only been two cases of BSE in this country compared to 20 BSE cases in Japan. With a herd size of only 1.5 million beef and dairy cattle in Japan, this same ratio would translate to over 560 cases of BSE in a U.S. herd size of over 42 million.

Since 2003, the United States has undertaken a rigorous and thorough surveillance program for BSE testing and has implemented safeguards to protect human and animal health. These safeguards have exceeded internationally recognized standards promoted by the World Organization for Animal Health (OIE), for which Japan is a member.

While the Sanitary and Phytosanitary (SPS) Agreement provides members of the WTO the right to take measures to protect human, animal, and plant health under the principles of sound science, the SPS Agreement does not provide WTO members the right to discriminate and restrict trade arbitrarily.

The U.S. State Department, the Office of the United States Trade Representative and the U.S. Department of Agriculture have worked tirelessly to reopen this export market for U.S. beef, and they should be commended for their efforts. On October 23, 2004, the United States and Japan concluded an understanding that established a process to lead to the resumption of beef imports from the United States. Despite these efforts, the Government of Japan continues to delay imports of beef from the U.S. on the basis of factors not grounded in science or consumer safety.

Losing our annual 1.7 billion dollar export market to Japan is having a large and negative impact on our entire beef industry and it also puts at risk our well-established bilateral trade relationship. This two year delay has now totaled almost \$3.4 billion in losses. Whether you are a farmer or rancher, a beef processor or retailer, the loss of these markets is having a detrimental effect on our rural communities and our agriculture economy. The U.S. cattle and beef industries are losing \$100

million each month Japan remains closed to U.S. beef. Since December, 2003 the U.S. meat industry has lost 10,000 jobs, mostly attributed to lost export markets.

Mr. Chairman, this issue is very important to my constituents of the First Congressional District in Kansas. When you think of Kansas you probably think of mostly wheat growing on the plains. However, my district produces approximately 5 billion pounds of beef a year, making it the largest beef producing congressional district in the nation.

In March of this year I introduced House Resolution 137 which currently has 80 cosponsors. This Resolution is a sense of the House of Representatives that if the Government of Japan continues to delay in meeting its obligations under the understanding reached with the U.S. on October 23, 2004, the U.S. Trade Representative should immediately impose retaliatory economic measures on Japan. While I do not wish for the U.S. and Japan to enter a drawn out trade dispute, the reality is Japan must be encouraged to uphold its trade agreements. I urge the committee to help bring this resolution to the floor and show Japan the serious nature of this trade issue.

Before the August recess, I also had the opportunity to discuss this issue with President Bush and Ambassador Portman. As Congress works to promote free trade agreements throughout the world, it is important for our trading partners to honor current agreements and international standards. Without these assurances, support for future free trade agreements will erode.

Just this week, I was also joined by over 100 members of Congress in sending a letter to President Bush asking that he make restoring market access for U.S. beef to Japan his highest economic priority. I support our government's efforts to reopen our beef exports to Japan but the Japanese continue to unjustifiably delay the process.

The Senate has voiced similar concerns with letters to the President, Senator Thune's companion resolution, and amendments in the agriculture appropriations process.

Mr. Chairman, Japan cannot have it both ways. They cannot benefit from exports to the U.S. while denying our imports, such as beef, with no scientific evidence to support their actions. Congressional patience has been exhausted. I urge you to support House Resolution 137 and help bring this resolution to the House floor for a vote.

Thank you Mr. Chairman again for the opportunity to come before you today to discuss an issue of great importance to the state of Kansas and of the nation.

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Chairman THOMAS. Thank you very much, and as a Member from California, I think that beef on the plate would go well with a starch and quality vegetable or fruit, with a glass of wine, so that the Japanese consumer can appreciate the full agricultural blessings of this country.

Any Member wish to inquire of the gentleman from Kansas? The gentleman from Pennsylvania.

Mr. ENGLISH. I want to thank the gentleman for his testimony, and I wonder for context, because you have obviously been a leader in this effort, have you experienced any other markets that have been as protectionist as Japan with regard to our agricultural products?

Mr. MORAN. Well, I am not sure how to compare the two, but certainly the European Community has created a significant number of trade barriers for agricultural products being sold into the European Community. But at the moment—and that is a long-standing dispute. At the moment, clearly the issue in agriculture today is the failure of Japan. And I cannot see how they can stand on any ground for their position, no basis, no scientific basis, no consumer safety, no food safety issue. We exceed the standards by the agreement which they have entered into. And so, clearly, Japan is at the top of the list in my mind.

Mr. ENGLISH. I want to thank the gentleman for his advocacy and the fine work he has done with this resolution, and I yield back the balance of my time.

Mr. MORAN. Thank you, Mr. English.

Chairman THOMAS. Any additional—the gentleman from North Dakota.

Mr. POMEROY. Mr. Chairman, I want to commend my colleague, Jerry Moran. It is my privilege to serve on the Subcommittee he leads in the House Agriculture Committee. I strongly agree with his testimony this morning—this afternoon, I should say.

One question is this business of the U.S. Department of Agriculture seeming to open the door to Japanese beef imports to us. It seems to me most curious that that would move forward while they are holding our product out. That was a measure—they announced the proposal in August of 2005. The Senate voted as part of the 2006 agriculture appropriations bill to prohibit implementing this proposal. Do you have a thought specifically on that action by the U.S. Department of Agriculture?

Mr. MORAN. Mr. Pomeroy, clearly a question that should be asked of USDA as to their thinking. My guess, as I explain it to my constituents, is that USDA wants to have the United States' trade regimen operate based upon sound science, abide by the rules so that we have no—so that Japan has no opportunity to claim that we are not doing something we should be doing. I have explained this at home that my guess is USDA was trying to provide a carrot to Japan, but what I would suggest that we need is a stick, not a carrot. This is stick time, not carrot time.

Mr. POMEROY. I have explained it slightly differently. I have said it is totally crazy for the United States to bring in Japanese beef when we cannot get our beef out, and perhaps it is part of the explanation as to how we have dug ourselves into this current account deficit in trade. We have to simply be much more aggressive, I believe, in demanding fair treatment. I very much appreciate the gentleman's leadership on this issue. You are terrific on these matters.

Mr. MORAN. Mr. Pomeroy, I have not been in Congress quite as long as you, but I have been here nearly 10 years, and every one of these instances, the conversation I have with colleagues but, more importantly, with people at USTR, at USDA, is we cannot rock the boat. And I think we simply have heard this expression, we have this attitude it has gone on far too long. We have to rock the boat or we remain with the status quo. And in my opinion, it is time to rock the boat.

Mr. POMEROY. I agree with you completely. I think that those watching this exchange should note bipartisan Members of Congress have had their belly full and we intend to rock the boat, as you say.

I yield back, Mr. Chairman.

Mr. MORAN. Mr. Chairman, Mr. Pomeroy is one of my most difficult Subcommittee Members, and I am glad we are in agreement today.

[Laughter.]



Chairman THOMAS. Well, the Chair only wants to indicate that if anybody wants any carrots, we have quality carrots in the old-fashioned version.

[Laughter.]

Chairman THOMAS. Or the ever more popular small carrots in bags available, even in Japan, if we could get them in.

Does the gentleman from Missouri wish to be recognized?

Mr. HULSHOF. I do, Mr. Chairman. Thank you, and I, too, wish to associate myself with my friend from Kansas' remarks, just as I am on his resolution and just as I was proud to be a signatory of the letter that you sent to the President of the United States, and to echo what my friend from North Dakota has said.

You know, at the time when there was a bit of controversy here in our country about reopening the border, beef coming across the Canadian border, and there was a lot of angst about this, and probably in the gentleman from North Dakota's home State, I know that there was a lot of concern among cattle producers in my home State of Missouri about this. And my response to constituents was, the science is there. We cannot have a different set of standards dealing with our partners to the North if, in fact, we are wanting to push the Japanese market on beef. And so at least that was the story that I had as far as why the USDA was pushing so hard to have Canadian beef flow back South into our country.

So, again, not to belabor the point, but I would say to my friend from North Dakota, just as we had a meeting—what was it, Mr. Chairman?—10 days ago with the European Union Ag Commissioner, and the gentleman from Kansas is absolutely correct as far as protectionist measures with the European Community. You know, we are the most open country on the face of the Earth as far as having access to our markets. And when you see other nations that have thrown up protection barriers simply to keep our products out of their markets, it is time that I think the administration—and we have shared this not only with the EU Ag Commissioner but with our own former colleague of this Committee, the U.S. Trade Representative, that it is time for us to be much more aggressive, and that is why I commend the gentleman again for the resolution, for the letter, for all of your efforts, because I think the science is on our side, and this is an issue that we must be aggressive.

And I appreciate the Chairman yielding me time.

Mr. BEAUPREZ. Mr. Chairman?

Chairman THOMAS. The gentleman from Colorado, would you yield briefly?

Mr. BEAUPREZ. I would, Mr. Chairman.

Chairman THOMAS. I have heard it told that the Japanese actually do rely on science in terms of allowing products in. The trouble is it was weather science. And whenever there was bad weather in short supply in Japan, somehow the market was open; when the weather is good, the market is not open. So, they may be relying on science, but it is weather science rather than the science we usually refer to in terms of quality and protection under sanitary and phytosanitary reasons.

The gentleman from Colorado, thank you.

Mr. BEAUPREZ. I thank the Chairman. I thank my colleague from Kansas, Mr. Moran, as well for his outspokenness and leadership on this issue and for the resolution you have introduced as well.

Being a neighbor from Colorado and having an economy that is very, very similar, we finish a little beef in Colorado, too, as the gentleman knows. And I don't think that there is a more raw nor sensitive subject right now among Colorado ranchers and farmers and beef growers than the one that you raise today.

Unfortunately, it is too symptomatic of other trade barriers, trade problems we have, and probably the reason why we are having this hearing today, with our friends in Japan. I have some personal familiarity with the issue that you raise, Jerry. Back through the eighties, we were in the dairy cattle business, pure-bred dairy cattle, and we exported cattle all over the world. The Japanese market was much coveted because if you could manage to get it over there, they always wanted the best, and they were willing to pay for it.

Unfortunately, they had a barrier—not just a tariff barrier, which we are all familiar with, but we called it a functional barrier with unbelievably restrictive health requirements. I am going to guess that my colleague from Kansas would agree with me that the American farmer—and I think rightfully—always prided themselves in producing the best and the finest and the safest food in the world, and in abundance, I might add. And it absolutely confounded me that these artificial barriers were put up against U.S. ag products then and, unfortunately, they still exist today.

So, again, I applaud you. I associate myself with your comments and your fine leadership on this, and I hope that maybe today's hearing brings some light to a subject that is causing otherwise very good friends and allies to have a considerable point of disagreement right now, and that is this issue of truly fair and free trade.

Mr. MORAN. I thank the gentleman from Colorado for associating himself with my remarks, as well as the gentleman from Missouri. And, Mr. Chairman, I failed to mention that even as late as this week, the Japanese Commission chief that is reviewing the science on this issue has announced that there is no hurry to make a decision. There is no need to give into the pressure to a rush. Again, I think the message ought to be that there is a reason and that people simply cannot continue to ignore agreements that have been entered into with impunity.

Chairman THOMAS. The Chair recognizes the gentleman from Iowa, Mr. Nussle.

Mr. NUSSLE. Thank you, Mr. Chairman.

My question is—maybe it underscores something that you said already. I would ask my friend from Kansas, we are coming up on the 1-year anniversary of the agreement that was made to resume these commitments, and I guess my first question to the gentleman is—and I am a cosponsor of your resolution. Are you aware whether or not the United States has—my understanding is we have fulfilled our part of the bargain here, that we have fulfilled our part of the commitment when it comes to this agreement that was made in October of 2004. Is that your understanding?

Mr. MORAN. It is my understanding.

Mr. NUSSLE. And if it is true that, in fact, the Commissioner in Japan has indicated that there is no rush and a year is not long enough for Japan to fulfill its part of the bargain when, in fact, I believe 70 other markets have now been reopened to American beef—and I am asking this from a strategic standpoint, recognizing that the Senate last week, as part of their appropriations process, if I am not mistaken, adopted a resolution that is very similar to the one that you wrote here in the House. What should our strategy be from a congressional standpoint? Obviously, we are going to have administration witnesses before us today, but what is your suggestion or your proposal of how the House could or should proceed as we not only try and deal with this but also put pressure on Japan short of locking down markets and initiating what would be tantamount to a trade war?

Mr. MORAN. I thank the gentleman from Iowa. I don't think the Senate has yet passed this resolution. It has been introduced. The Senator from South Dakota, Mr. Thune, has introduced a companion resolution. The Senate this week did take steps in the appropriations process, in the agriculture appropriations bill, to deal with this issue. Mostly I think their effort was to prohibit the importation of Kobe Japanese beef into the United States until the reverse market is open for us.

So, the Senate is taking steps in regard to their displeasure with our trading relationship with Japan, particularly as it relates to beef.

I do think that this is—a year is a long time. In fact, Mr. Nussle, I got most interested in this topic when I was reading that the Food Safety Commission was meeting once every 4 weeks. This is back in February of this year. The Committee that was designed to determine how to implement the October of 2004 agreement was only meeting once every month. It seemed to me that the expediency demanded of this process should be greater than that. And so this resolution was introduced last March.

I think it is time for the House of Representatives to pass this resolution or a similar resolution, appropriately worded, determined by the Ways and Means Committee, and that particularly in light of a potential visit by the Prime Minister of Japan to the United States in the near future, an awfully good time for the House of Representatives to express its opinion in this regard.

We often talk in Congress about, delivering a message, and I am happy to deliver the message. The last thing I would want is a trade war, an unnecessary trade war, difficult trading relations with the Japanese. But, again, I go back to what I indicated to Mr. Pomeroy, that we cannot always take the position that rocking the boat, creating dissension, creating difficulties—we have to go through that process to have a desirable outcome, and the status quo, again, remains unsatisfactory.

So, I think the timing for action by this Committee and by the House of Representatives is here. My own constituents, your constituents, Mr. Nussle, would say it is past time, that this has gone on too long.

Mr. NUSSLE. And I would say to my friend from North Dakota, I am not sure we are rocking the boat. The boat is rocking. It is

a matter of trying to prevent it from tipping over completely, because that is where we are at at this point in time. And my judgment is that we are—the boat is—we are in a storm right now, and we have got to figure out how to get out of this storm, and it is about time that that occur. Otherwise, this, in fact, may capsize and we may get into a situation that neither country, particularly countries that are friends and that have had a longstanding relationship, a good relationship in certainly the last number of decades—we need to prevent that from happening. But it appears that most of that onus is, unfortunately, outside of our control other than to express our displeasure and put whatever pressure we can. And I think we should—I think that process should continue, and I appreciate your leadership in giving us advice on how we could continue that pressure.

Thank you.

Mr. MORAN. I thank the gentleman, and I appreciate his analogy.

Chairman THOMAS. I thank the gentleman.

The Chair thanks the gentleman from Kansas and appreciates his focusing on one particular aspect of an ongoing festering—

Mr. MORAN. Mr. Chairman, thank you, and I would be politically inept and remiss if I did not mention that California is the largest agriculture-producing State in the Nation, although Kansas is thought to be an agriculture State. We are that, but California is much more, and between you and Mr. Herger and Mr. Nunes, I recognize that these issues have huge consequences to your economy.

Chairman THOMAS. Quality beef and quality wheat is always appreciated to augment the broad and vast agricultural wealth found in California.

I thank the gentleman very much.

Chairman THOMAS. The Chair would ask the first panel to come forward: Wendy Cutler, who is the Assistant U.S. Trade Representative for Japan, Korea, and Asia-Pacific Economic Cooperation Affairs, Office of the U.S. Trade Representative; David Loevinger, who is the Deputy Assistant Secretary for Africa, the Middle East, and Asia, United States Department of Treasury; A. Ellen Terpstra, who is the Administrator, Foreign Agricultural Service, U.S. Department of Agriculture; and Mr. A.G. Kawamura, who is the Secretary of Agriculture in the California Department of Food and Agriculture.

The Chair would indicate that any written statement that the panel has will be made a part of the record. You can address the Committee in any way you see fit. The microphones are in front of you. They may need to be turned on individually. And beginning, with Ms. Cutler, we move then across the panel.

**STATEMENT OF WENDY S. CUTLER, ASSISTANT U.S. TRADE REPRESENTATIVE FOR JAPAN, KOREA, AND ASIA-PACIFIC ECONOMIC COOPERATION AFFAIRS, OFFICE OF THE U.S. TRADE REPRESENTATIVE**

Ms. CUTLER. Thank you, Mr. Chairman. On behalf of the Office of the U.S. Trade Representative, I would like to thank you, the Ranking Member, and other Members of the Committee for con-

vening today's hearing. I am Wendy Cutler, Assistant USTR for Japan, Korea, and APEC Affairs, and I very much welcome the opportunity to provide testimony today.

Japan is currently our fourth largest trading partner with \$180 billion in total two-way goods trade, our third largest export market, and our third largest market for U.S. agricultural exports.

Over the years, the bilateral trade relationship has grown from one dominated by acrimony to one where we are increasingly seeking ways to work together to find win-win solutions. That said, old ways die hard in Japan. While we continue to make progress, we still run into heavy resistance to change. So, let me start with some good news.

Since your last hearing in 1998, Japan has become one of the most competitive broadband markets in the world, which has really been a boon to U.S. suppliers. Japan has dramatically reduced customs processing fees at its ports. It has significantly strengthened its IPR regime. It has liberalized its energy sector. And it has fostered the independence and staffing of the Japan Fair Trade Commission.

More recent reforms will be detailed in our next soon-to-be-completed annual Report to the Leaders under our Regulatory Reform Initiative. Mr. Chairman, you will find in this year's Report to the Leaders a new section on agriculture, where we are addressing specific ongoing concerns with Japan's phytosanitary regime, and we attained encouraging progress. Japan, for example, has removed three citrus pests from its fumigation list, eliminating over \$1 million in annual costs on imports of U.S. citrus. And I should add that Japan last month eliminated its unjustified fire blight measures on imports of U.S. apples, following a resounding U.S. victory for the United States in the WTO.

There are, nevertheless, formidable problems in our bilateral trade relationship with Japan. Foremost among them is Japan's continued ban on U.S. beef imports. The administration shares your frustration over Japan's glacial speed at reopening its market. We have repeatedly and consistently engaged Japan at all levels on this issue. Ambassador Portman has devoted considerable time to this problem. He raised this issue just yesterday with Ambassador Kato after reading press reports coming out of the Food Safety Commission's deliberations on Monday.

The Food Safety Commission appears to be in the final stages of its deliberations. Unfortunately, it is not there yet, and this is very disappointing. By any reasonable measure, Japan has had ample time to reach a conclusion on this issue and reopen its market. We will continue to press hard on Japan.

Another priority issue for the administration is Japan Post privatization. We are urging Japan to take three steps to ensure fair competition for its market participants in the banking, insurance, and express delivery sectors. We want Japan to completely eliminate the tax, regulatory, and other advantages that Japan Post continues to enjoy over its competitors. We want Japan to ensure that Japan Post is not allowed to make new product offerings in these markets until a fully level playingfield is achieved. And we want to ensure full transparency throughout the process.

We are also devoting much attention to Japan's health care reform efforts and specifically what they mean for the U.S. medical device and pharmaceutical industries. Our focus right now is on the biennial review of the reimbursement prices Japan assigns to devices and drugs, a process that in the past has presented many problems and one that should be done in a fair and transparent manner and in a manner which rewards innovation.

Working with industry and in close cooperation with the Department of Commerce, we will continue to press Japan to find solutions to the pricing and product approvals issues in these sectors.

Before closing, allow me to turn to the Doha Development Agenda. Ambassador Portman has been urging Japan to play a more forward-learning role. To be sure, Japan has been doing some good work, particularly with respect to the industrial tariff or NAMA negotiations. But with respect to agriculture, the Japanese regrettably have allowed their protectionist domestic agriculture interests to prevail, and this is disappointing. As a result, they have been incapable of finding a solution at home that would permit them to take a constructive position on the market access piece of agriculture. If the DDA is to succeed, Japan will have to substantially reduce its tariffs on agricultural products and ensure meaningful improvements in market access.

Mr. Chairman, we have come a long way with Japan over the years and have found ways of doing business on the trade front that are increasingly yielding positive results. This has been an incremental process in sector after sector, and while we welcome the progress we have made, we cannot and will not become complacent. We have some very real trade problems with Japan today that are subject to this hearing, and they require our focus and constant attention and engagement with Japan at all levels. I can tell you that USTR will do everything in its power to ensure these problems are resolved in a timely and fair manner.

Thank you.

[The prepared statement of Ms. Cutler follows:]

**Statement of Wendy Cutler, Assistant U.S. Trade Representative for Japan, Korea and Asia-Pacific Economic Cooperation Affairs, Office of the U.S. Trade Representative**

On behalf of the U.S. Trade Representative, I would like to thank the Chairman, Ranking Member, and the other members of this Committee for convening this hearing today. I am Wendy Cutler, Assistant USTR for Japan, Korea and APEC Affairs and I very much welcome this opportunity to provide testimony on the state of our economic and trade relationship with Japan.

As you point out in your announcement for this hearing, Japan is currently our fourth largest goods trading partner with \$180 billion in total two-way goods trade during 2004. It is a huge magnet for the things we produce and grow. Overall, Japan is our third largest export market. It is also our third largest market for U.S. agricultural exports.

Not only is our trade relationship enormous in volume, it is also rich in complexity and it has significant ramifications for the Asian region and the world. Over the years, that relationship has grown from one dominated by acrimony to one where we are increasingly working together to find win-win solutions where possible. There is much that underlies this shift, including our changed world in the post-9/11 era and the spectacular economic dynamism of the Asian region. There is also the close friendship President Bush shares with Prime Minister Koizumi, which has helped create an environment conducive to good cooperation between our two Governments. And I should add that the Prime Minister, who just won re-election by an historic landslide, has done his part to accelerate economic reform in Japan, which in turn makes our job a little easier.

That said, old ways die hard in Japan. While we continue to make good progress up and down the trade front, we still run into heavily reinforced bulwarks against change.

Today, I would like to sketch out some of the progress we have made in recent years with Japan as well as underscore that there remains substantial inertia at work in the enormous and critically important Japanese market—inertia that continues to frustrate our efforts to do business there. Japan's inability to move expeditiously to reopen its beef market is an example of this.

#### *Achieving Progress*

So let's start with the good news. In recent years, Japan has significantly lowered retail rates for calling mobile networks, and by reducing monopoly control over networks and equipment, Japan has created conditions for one of the most competitive broadband markets in the world. It has dramatically reduced certain customs processing fees at its ports, thereby lowering the cost of doing business for U.S. exporters and express carriers. Japan has undertaken significant liberalization of both its electricity and gas sectors. It has significantly strengthened its intellectual property rights regime by, for example, extending the term of copyright protection for cinematographic works from 50 to 70 years. And it has bolstered the independence and staffing of its antitrust watchdog, the Japan Fair Trade Commission or JFTC, so that it can better promote a competitive environment in the Japanese market for domestic and foreign companies alike.

More recent progress will be detailed in our next annual Report to the Leaders under the Regulatory Reform and Competition Policy Initiative, which was established by President Bush and Prime Minister Koizumi in 2001. That Initiative is the chief mechanism we use to manage our trade and economic relationship with Japan. The Leaders Report, which should be finished shortly, will include a myriad of regulatory reform steps Japan has, or will be taking, in the key sectors.

In the telecommunications sector, Japan is poised to make substantial blocks of spectrum available primarily for new wireless entrants, helping break a long-standing oligopoly and thereby creating opportunities not only for U.S. telecommunications companies wanting to expand into the wireless business in Japan, but also equipment suppliers to those companies.

Japan is also removing numerous regulatory impediments to e-commerce, further strengthening copyright protection, cooperating closely with the private sector to combat spam, improving government network security, ensuring effective and transparent implementation of its new Privacy Law, and improving foreign firms' access to bidding on government IT systems.

Though not going far enough, the Japanese have finally made the decision to reduce landing fees at Narita International Airport, a step that will lower costs in Japan for U.S. airlines and express delivery companies.

Mr. Chairman, you will also find in this year's Report to the Leaders a new section on agriculture where we are addressing specific, ongoing concerns with Japan's phytosanitary regime—and we have obtained very encouraging progress. As you know, for years we have had problems with Japan's requirements to fumigate fruits and vegetables upon import for pests that are also reportedly present in Japan. That fumigation has either adversely affected the quality of the product (particularly for lettuce) or added unnecessary costs (for example on citrus) or both.

In response to U.S. concerns, we have recently obtained Japan's commitment to take steps to bring its phytosanitary measures in line with international standards. Japan has committed to conduct import risk assessments for quarantine pests in accordance with the relevant International Plant Protection Convention standard to use science to determine if these pests should be subject to quarantine measures. In concrete terms, Japan has removed three citrus pests from its fumigation target list, thereby eliminating over \$1 million in annual fumigation costs on imports of U.S. citrus. In another step in the right direction, Japan also has agreed to assess certain pests of lettuce to determine if fumigation requirements for them are really necessary. All told, we believe this effort under the Regulatory Reform Initiative is a positive and constructive path to addressing systemic phytosanitary regulatory impediments in Japan.

While I am on the issue of agriculture, I might add that we finally reached resolution with Japan on a long-standing WTO dispute over apples. (You may recall that we won a related case against Japan on testing of varietal fruits in the late 1990's.) Last month, Japan eliminated its unjustified fire blight measures on imports of U.S. apples, following a resounding victory for the United States in the WTO. As a result, we expect U.S. apples will be shipped to Japan later this year.

Turning to some more comprehensive cross-cutting areas, this year's Report to the Leaders specifies that Japan has taken further steps to strengthen the JFTC's en-

forcement capabilities through recent amendments to the Antimonopoly Act that will increase penalties on companies participating in price-fixing and introduce a leniency program to combat cartels effective January 2006.

In addition, Japan passed legislation just last June to strengthen its Public Comment Procedures. That legislation was not as robust as we would have liked, but it should help increase transparency in the development and implementation of regulations in a system that has been notorious in the past for its opaqueness.

In another step forward, the Japanese Corporate Code has been amended in ways that will ultimately permit U.S. and other foreign firms to use modern merger techniques (such as triangular mergers) when making acquisitions in Japan.

Achieving progress in these cross-cutting areas is crucial for our companies as these are the areas where some deeply ingrained impediments to trade and investment remain. The automotive industry, for example, continues to face systemic issues such as regulatory transparency and competition policy concerns that can make Japan a difficult place to do business. That is why the cross-cutting issues are such a priority for us.

In sum, we have and will continue to make good progress in our efforts to further open markets in Japan in key sectors such as telecommunications, information technologies, medical devices and pharmaceuticals, energy, and agriculture. And we will continue to go after the hard-to-get-to impediments to trade in cross-sectoral areas such as competition policy and transparency.

That said, there are some formidable problem areas in our bilateral trade relations.

#### *Fighting Inertia*

Foremost among these is Japan's continued ban on beef imports from the United States. I know my USDA colleague Ellen Terpstra will have much to say about this, but allow me to offer a few words here as Ambassador Portman has devoted significant time to this problem and raised it on every possible occasion with his Japanese counterparts. In fact, he just delivered a strong message on the beef ban to Japan's Trade Minister, who was here in Washington earlier this month. This issue also remains a top priority for President Bush, who has raised it directly with Prime Minister Koizumi on several occasions.

We share your frustration over the glacial speed with which Japan has been moving to reopen its market to U.S. beef. We have repeatedly and consistently engaged Japan at all levels on this issue. This Administration has transmitted a huge amount of scientific information to the Japanese Government on the safety of U.S. beef.

The Food Safety Commission (FSC), charged with conducting the risk assessment of the safety of U.S. beef, appears to be in the final stages of its deliberations. But unfortunately, it is not there yet and this is very disappointing. Once the FSC completes its work, we understand that will initiate a 30-day public comment period, followed by a reopening of the market shortly thereafter.

By any reasonable measure, Japan has had ample time to reach a conclusion to this issue. We will continue to press hard on Japan at all levels until it does the right thing in line with science and fully reopens its market to U.S. beef.

Another item high on our bilateral agenda is the privatization of Japan Post. Whether or not privatization should be enacted is of course Japan's choice. Certainly Prime Minister Koizumi has pursued this major reform with great determination, and he has been most articulate about the broad domestic objectives that underpin his commitment to seeing his initiative achieved.

The ripple effects of these reforms are substantial, however, and the Administration is focused on the impact they will have on competition in Japan's banking, insurance, and express delivery markets where Japan Post is such a major player. Unequal conditions of competition in these markets between Japan Post and U.S. and other private companies have long been high on our list of concerns. The Administration is urging Japan to take this opportunity to make the policy choices that are necessary to finally achieve a level playing field.

In order for Japan to achieve fair play for all participants in these key markets, we are urging Japan to take three steps. First, we are calling on Japan to fully eliminate the web of legal, tax, and regulatory advantages that have allowed Japan Post to grow its businesses while putting U.S. and other companies at a substantial competitive disadvantage. Second, it is important that Japan Post not be permitted to expand its product offerings in those businesses where it competes with the private sector until a level playing field has been established. Third, it is imperative that Japan undertake the privatization process in manner that is fully transparent to all parties.



The Administration has been responding with a concerted interagency effort, using every opportunity at all levels of government, to urge Japan to embrace the three basic elements I have just described to you. Importantly, our views are also echoed by others, including key Japanese insurance companies, as well as Japanese, European, and Canadian business associations. We will remain vigilant as the process unfolds and urge Japan to do the same in its efforts to ensure that fair competition is actually achieved.

We are also devoting much attention to issues related to health care reform in Japan, particularly how these reform policies impact U.S. medical devices and pharmaceuticals industries. Over the years, we have worked very closely with these industries to ensure they get a fair shake in Japan. And we have seen some success as Japan has taken steps to expedite regulatory approvals and make its reimbursement pricing process more transparent than in the past.

Japan is currently cycling into yet another biennial review of the reimbursement prices it assigns to medical devices and pharmaceuticals, a process that has presented many problems in the past. Our chief concern is that the process is done in a transparent and fair manner. While we fully understand the need for Japan to reduce rising costs related to its national healthcare system, we also strongly believe innovation should be rewarded for these products. Indeed, by rewarding innovation, Japan ensures that Japanese patients can obtain the best drugs and devices, which in turn shortens the time they stay in hospitals, improves their lives, makes them more productive to society, and contributes to economic growth.

Even so, it is crucial these devices and drugs get to Japanese patients in a timely fashion. As I believe you will hear later today from industry, Japan's recent efforts to speed regulatory approvals through a merger of administrative agencies have, to our dismay, yielded poor results. Approvals, in fact, are slower now than before—thus undermining some past achievements.

Many important decisions on these pricing and approvals issues will be made in the coming months in Japan. Working closely with industry and in close cooperation with the Department of Commerce, we will continue to press Japan to find solutions in these problem areas that are both fair and equitable.

Before closing, I would like to highlight two other, broader aspects of our economic relationship with Japan.

#### *Doha Development Agenda*

First, as you know, Ambassador Portman is working hard in the run-up to the Hong Kong Ministerial meeting in December to set the stage to complete the Doha Development Agenda, or DDA, by the end of 2006. He spent most of last week in Paris conducting intensive discussions with the European Union and other WTO Members on this.

With the two largest economies in the world, the United States and Japan share a special responsibility to work together to use the power of open markets to pull people up and expand political as well as economic freedom. And there may be no other single action we could take to deliver the broad and long-term economic benefits of trade than successfully concluding the current round of global trade talks.

To this end, Ambassador Portman has been urging Japan to be more constructive and play a more forward-leaning role in the DDA. The good news is that we have begun seeing some positive efforts by Japan in recent months. Japan has, for example, stepped forward by focusing the attention of other Asian capitals on the non-agricultural market access (NAMA) issues to help set the stage for more progress this fall and has been an important leader in sponsoring and helping to push our agenda on sectoral initiatives. Japan will also be showing some leadership by hosting a Senior Officials Meeting in Geneva later this week to discuss the DDA. In addition, Japan, like us, has been utilizing the APEC process to help build momentum for Doha.

These steps are welcome, but as Ambassador Portman has been reminding Japan and others, all countries must pitch in to make substantial progress in the three agriculture pillars of export subsidies, market access, and domestic support. Frankly, the Japanese have allowed their protectionist domestic agriculture interests to prevail, and this has been disappointing. As a result, they have been incapable of finding a solution at home that would permit them to take a forward-leaning position on the market access piece of agriculture, which is the key concern of the U.S. agricultural community when it comes to Japan. If the DDA is to succeed, Japan will have to substantially reduce its tariffs on agricultural products and ensure meaningful improvements in market access. It's now up to Japan to decide whether or not it wants to get on the train as it leaves the station.

*U.S.-Japan Cooperation in Asia*

The other broader aspect of our economic relationship I would like to comment on is the importance of U.S.-Japan cooperation vis-à-vis Asia.

With its vibrant economies, able work forces, and enormous consumer markets, Asia has assumed greater economic, strategic and political relevance to the United States and Japan than ever before. For a whole host of reasons, it is very important that our two countries promote more growth and development in the region. And it is important that we set a good example in the way we conduct our trade relations, opening our markets to goods and services from around the region, and above all, ensuring fair play in the marketplace.

In particular, the United States and Japan are working together to help ensure China's integration into the global economy is a smooth one. One of the ways we have been doing this is by working closely together to strengthen intellectual property rights protection and enforcement in China and around the region. Over the past year, officials from the U.S. and Japanese Governments have met on numerous occasions to discuss this topic. Those discussions have led to Japan's endorsement of an important new IPR initiative we have been promoting in APEC.

My central point here is that while we do have several difficult bilateral trade issues with Japan, we are still friends and allies with a great deal to gain from close cooperation on matters of global concern, such as advancing DDA, as well as matters of regional concern, such as strengthening intellectual property rights protection and enforcement.

*Continued Vigilance Necessary*

We have come a long way with Japan over the years and have found ways of doing business on the trade front that are generally yielding good results. This has been an incremental process occurring in sector after sector. The Japanese market is more open than it used to be. Japan's ministries are coming to grips with the importance of transparency in policy-making and are taking steps to improve this. And its IPR regime has seen vast improvements over the years. While we very much welcome all this progress, we should not be complacent. We have some very real trade problems with Japan today that require our focused and constant attention and engagement at all levels. I can tell you that USTR will do everything in its power to ensure these problems are resolved in a timely and fair manner. Thank you.

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Chairman THOMAS. Thank you.  
Mr. Loevinger.

**STATEMENT OF DAVID LOEVINGER, DEPUTY ASSISTANT SECRETARY FOR AFRICA, MIDDLE EAST, AND ASIA, U.S. DEPARTMENT OF THE TREASURY**

Mr. LOEVINGER. Thank you, Mr. Chairman, other Committee members, for this opportunity to talk about the administration's engagement with Japan. Mr. Chairman, as you mentioned, this hearing is timely, as it is taking place at a time both of growing optimism about the possibility of sustained domestic demand-led growth in the Japanese economy and about the prospects for more rapid economic reforms following this month's elections.

My colleagues have testified and will testify today on a number of sectoral trade issues. The Treasury Department works closely with USTR, Commerce, and other agencies on these issues. Treasury has focused particularly on access to the Japanese market for U.S. financial services providers.

In addition to these sectoral issues, Treasury pays very close attention to the overall growth of the Japanese economy. Strong, sustained, and domestic demand-led growth in Japan—and as many of you have mentioned today, which is the second-largest economy in the world and one of our largest trading partners—would boost

growth in U.S. exports and jobs and contribute to more balanced global growth.

Japan has struggled for the past decade and a half to overcome the effects of the collapse in the late eighties of the asset price bubble. The government responded to the economic downturn with a series of fiscal stimulus packages, mostly public works spending that yielded low results. Regulatory forbearance allowed banks to remain technically solvent without dealing with their growing bad loans. This led to the eventual failure of many banks.

Japan's slowness in dealing with failing banks and delinquent corporate debtors kept it, until now, from achieving sustained domestic demand-led growth. Evergreening loans to what we call zombie borrowers locked resources up in non-productive activities, and heavy debt burdens limited new investment in new activities. Short-lived economic rebounds in 1993, 1995-96, and 1999-2000 faded quickly back into recession once the initial fiscal or export stimulus faded. The protracted economic slowdown led to persistent deflation.

Japan's struggle to emerge from deflation, sluggish growth, and banking sector problems may be finally coming to an end. The Koizumi Administration made clear that restoring growth would require structural reforms and Japan could no longer rely on fiscal stimulus. The Koizumi government also brought tougher banking regulation, which forced banks to raise capital and deal with their problem borrowers.

There are growing signs that the labor market is finally strengthening. While exports, especially to China, helped fuel the early stages of Japan's current recovery, household consumption and investment have been key engines of growth in recent quarters. So, Mr. Chairman, at least for the Japanese economy, after several false dawns, a new day may finally have arrived.

But the Japanese economy still faces numerous headwinds. Deflation still persists. Many small banks are still weak. And after years of failed fiscal stimulus, Japan now has the largest fiscal deficit and government debt, relatively to its economy, of any G7 economy. Moreover, a rapidly aging population will necessitate increased public spending on health care and pensions, while a shrinking work force will limit the growth of income and payroll tax receipts.

Japan's long-term growth potential is estimated to be only about 1.5 percent a year compared to over 3 percent for the U.S.. Given these headwinds, far-reaching structural reforms are needed to boost growth so Japan can make a larger contribution to global growth.

On financial sector issues, there have been regular discussions between Treasury, Japan's Ministry of Finance, and Japan's financial services agencies. These have continued to expand opportunities for U.S. firms.

Ten years ago, foreign participation in Japan's domestic financial market was almost unthinkable. Now U.S. investors own several Japanese banks, and market share of U.S. and other foreign securities firms is growing. U.S. direct investment in Japan in the financial services sector has grown from about \$6 billion 10 years ago to over \$38 billion last year.

On exchange rate policy, an issue which you, Mr. Chairman, and many other Members have raised, we are aware that Japan has intervened in the foreign exchange market in the past, sometimes in large amounts. We have discussed foreign exchange market issues with Japanese officials, and they are fully aware of our views that the world economy works best with free trade, free flow of capital, and flexible exchange rates in large economies. The Japanese authorities have not intervened in the foreign exchange market since March 2004. Japan has also supported the U.S. in the G7 on exchange rates, and this has been expressed in a series of G7 communiqués calling for greater exchange rate flexibility. Japan is also working with us to bring about greater exchange rate flexibility in China and in other large economies in East Asia. We will continue to express our view that major economies should have flexible exchange rates, with market intervention kept to a minimum.

Thank you.

[The prepared statement of Mr. Loevinger follows:]

**Statement of David Loevinger, Deputy Assistant Secretary for Africa,  
Middle East, and Asia, U.S. Department of the Treasury**

Chairman Thomas, Ranking Member Rangel, and other Committee members, thank you for this opportunity to talk about developments in the Japanese economy and the Administration's engagement with Japan on macroeconomic and financial issues. This hearing is timely, as it is taking place at a time of growing optimism both about the possibility of sustained domestic demand-led growth in Japan and more rapid economic reforms following this month's elections.

My colleagues have testified on a number of sectoral trade issues. The Treasury Department works closely with USTR, Commerce, and other agencies on these issues through the Trade Policy Review Group. Moreover, Treasury has focused particular attention on access to the Japanese market by US financial services providers.

In addition to these sectoral issues, Treasury pays close attention to the overall growth of the Japanese economy. Strong, sustained, and domestic demand-led growth in Japan—the world's second largest economy—would boost US exports and jobs and would also contribute to more balanced global growth. For the last decade Treasury has consulted closely with Japanese authorities on ways to achieve this.

Japan has struggled for the past decade and a half to overcome the effects of the collapse of the late-1980s asset price "bubble." Falling property prices—with commercial land prices down more than 80% in Japan's major metropolitan areas between 1991 and 2004—hit corporate and household balance sheets. Banks were hit by the financial stress of their customers and by falling collateral values when they tried to foreclose.

Firms that had built up capacity and staffing during the late-1980s boom reduced their investment spending. They also held down hiring, cut back on overtime and bonuses, and replaced permanent employees with part-time workers. The resulting drop in wages slowed household consumption.

The government responded to the economic downturn with a series of fiscal stimulus packages, mostly public works spending yielding low returns. Regulatory forbearance allowed banks to remain technically solvent without dealing with their growing bad loans. This led to the eventual failure of many banks, including some systemically large institutions, and large infusions of public funds since the late 1990s.

Japan's slowness in dealing with failing banks and delinquent corporate debtors kept it, until now, from achieving sustained domestic demand-led growth. Evergreening loans to zombie borrowers locked resources up in non-productive activities, and heavy debt burdens limited investment in new activities. Short-lived economic rebounds in 1993, 1995–96, and 1999–2000 faded quickly back into recession once the initial fiscal or export stimulus faded. The protracted economic slowdown led to persistent deflation.

Over the past decade US engagement with Japan focused on resolving banking sector problems; overcoming deflation, and restoring sustained, domestic demand-led growth. At times this discussion was acrimonious. The Bush Administration established a quieter, more cooperative dialogue with Japan, focused on creating the fun-

damentals for sustained growth rather than encouraging fiscal stimulus to pump up growth over the next few quarters.

Japan's struggle to emerge from the deflation, sluggish growth, and banking sector problems may finally be coming to an end. The Koizumi Administration made clear that restoring growth would require structural reforms such as increasing competition in domestic markets and improving the efficiency of financial intermediation, and could no longer rely on fiscal stimulus. The Koizumi government also brought tougher banking regulation, which forced the banks to raise capital and deal with their problem borrowers. Corporate restructuring has strengthened firms' finances and reduced excess debt and capacity.

There are also growing signs that the labor market is finally strengthening: the number of full-time employees rose recently for the first time in seven years, and the number of part-time workers fell for the first time in a decade. While exports, especially to China, helped fuel the early stages of Japan's current recovery, household consumption and investment have been the key growth engines in recent quarters. So, at least for the Japanese economy, after several false dawns, a new day may have finally arrived.

But the Japanese economy still faces numerous headwinds. Deflation, though diminished, still persists. Many small banks and small firms still remain weak. After years of stimuli, Japan now has the largest fiscal deficit and government debt, relative to GDP, of any G7 country. A large fiscal retrenchment is inevitable. Moreover, a rapidly aging population will necessitate increased limit the growth of income and payroll tax receipts, making the fiscal retrenchment more difficult. By 2025, public spending on health care and pensions, while a shrinking workforce will

Japan is projected to have more than half as many elderly as working-age people, up from less than one-third today. In the United States, in contrast, that ratio is projected to rise from about one-in-five today to about one-in-three by 2025.

Japan's long-term potential growth rate is estimated to be only about 1Yz percent per year, vs. 3Yi-4 percent in the United States. We share Prime Minister Koizumi's view that, given these headwinds, far-reaching structural reforms are needed to boost productivity so that the Japanese economy can navigate the challenges of the 21st century and make a larger contribution to global growth.

### **Financial Sector Issues**

The length of the post-bubble economic troubles and the high costs of cleaning up the banking sector owe much to the financial system that Japan maintained after the Second World War. Bank-dominated, heavily segmented and regulated, and closed to outsiders, the Japanese financial system failed to innovate and develop the credit analysis and risk assessment tools that financial institutions in the United States introduced.

For the past two decades, starting with the Yen-Dollar talks in the 1980's, the Treasury has pressed Japanese financial regulators to reform and modernize Japan's financial system and open the sector up to foreign investment. The US-Japan Financial Services Agreement, negotiated in

1995, opened up a number of sectors for US financial services firms, including the management of public pension funds. The "Big Bang" financial liberalization decontrolled prices and fees, opened up financial markets to new entry and new products, and shifted regulation and supervision to a modern market—and risk-based system. Regular discussions between Treasury, Japan's Ministry of Finance and Japan's Financial Services Agency have continued to expand opportunities for US firms—in managing the assets of Postal Savings system and offering 401K pension products, structured asset products, investment advisory and custodial services, and many others.

Ten years ago, foreign participation in Japan's domestic financial market was almost unthinkable. Today, market access and national-treatment are no longer prominent issues in our financial sector dialogue. US investors own two large Japanese banks and several small ones. And the market share of US and other foreign securities firms is growing, as it is for foreign pension and mutual fund managers. Those developments are reflected in the rapid growth of

U.S. direct financial services investment in Japan, which has grown from \$6Yi billion in 1994 to more than \$38 billion last year on a historical cost basis. Income from those investments has grown even more rapidly, from around \$400 million in 1994 to nearly \$5 billion last year.

We still have a very active engagement with Japan on financial sector issues, but the issues have shifted from market access to market development. These have included restrictions on short sale transactions, the ability to conduct global risk management across financial entities, participation of global custodians in government bond settlement, and taxation of mutual funds.

One recent example illustrates the importance of this engagement. A revision of section 821 of Japan's proposed Corporation Law, submitted to the Diet this year, could have required many foreign financial and non-financial firms to reincorporate as Japanese subsidiaries, in many cases with substantial tax liability on realized capital gains. Our Financial Attaché in Tokyo worked closely with US firms and the Japanese Diet to craft a legislative history exempting foreign firms. We continue to monitor this issue to determine if this will suffice or if corrective legislation is necessary.

The most important financial sector issue now is the privatization of Japan's Postal financial institutions—Postal Savings and Postal Life. These are huge institutions, by far the world's largest savings bank and life insurer, accounting for a third of Japan's deposits and 40% of its life insurance policies. We believe Prime Minister Koizumi's postal privatization bills can help increase the efficiency of financial intermediation, and potentially reduce the need for such high precautionary savings, boosting growth and imports. One key to success, as Secretary Snow and other Treasury officials have stressed to our Japanese counterparts, will be ensuring a level playing field so that the competitive advantages enjoyed by the privatized postal savings and postal life insurance firms are eliminated. Another key will be strict regulation, especially to limit risk transfers or cross-subsidization among the privatized financial and non-financial corporations.

But postal privatization will not be enough, as Prime Minister Koizumi recognized when he called for sweeping reforms including labor and product market deregulation and fundamental reforms of government lending institutions. Japan also needs continued progress in capital market and corporate governance reforms to ensure that corporate managers are focused on shareholder value. Our own experience shows that allowing the full range of foreign and domestic M&A activity helps develop the market for corporate control, which can contribute to better resource allocation, higher returns on investment, and faster growth and jobs.

#### **Exchange Rate Policy**

Japan has intervened in the foreign exchange market in the past, sometimes in large amounts. We have discussed foreign exchange market issues with Japanese officials, and they are fully aware of our views that the world economy works best with free trade, free flow of capital, and flexible exchange rates for large economies. Japanese authorities have not intervened in the foreign exchange market since March 2004. Japan has also supported the G7 position on exchange rates, expressed in a series of G7 Communiqués, calling for greater exchange rate flexibility. And Japan has worked with us to bring about greater exchange rate flexibility in China and in other large economies in East Asia. We will continue to strongly express our views that major economies should have flexible exchange rates, determined in the market with intervention kept to a minimum.

Thank you again for this opportunity to testify before you. Ensuring vigorous, domestic demand-led growth, increased financial sector dynamism and opportunities for US firms, and flexible, market-determined exchange rates in Japan and other large economies will continue to be priorities for the Treasury and the Administration.

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Chairman THOMAS. Ms. Terpstra?

#### **STATEMENT OF A. ELLEN TERPSTRA, ADMINISTRATOR, FOREIGN AGRICULTURAL SERVICE, U.S. DEPARTMENT OF AGRICULTURE**

Ms. TERPSTRA. Thank you, Mr. Chairman. Members of the Committee, I am pleased to be here with my colleagues today to discuss trade with Japan.

For the past 45 years, United States agriculture has posted a positive trade balance. In 2004, exports reached a record \$62.4 billion, and this year we expect strong sales of \$62 billion. For 2006, we are forecasting yet another historical record—\$63.5 billion. And this is while major markets, including most notably Japan, remain unjustifiably closed to the United States products.

While we highly value Japan as an important market, we have had major difficulties in maintaining that market. The source of many difficulties is protectionism reflected through unjustified use of sanitary and phytosanitary regulations. The inconsistent use of a scientific underpinning for an SPS regulatory structure has resulted in many disputes, some very protracted.

None of the disputes has been of the same magnitude as the closure of Japan's market to our beef and beef products. Until recently, Japan was the leading market for U.S. beef, buying \$1.4 billion worth in 2003. This issue has received the highest level of attention in our government, involving the President, Secretary Johanns, Ambassador Portman, and many other high-level officials. Many Members of Congress, including some on this Committee, have been very actively involved in this issue as well.

We have worked hard to restore the market. We have responded to requests for information, hosted technical teams, and traveled to Japan for countless meetings. We have stressed the use of international standards and the propriety of science-based decisions. We have urged Japan to promptly complete review of its import rules and to reopen the market to our beef.

The Japanese assure us that they are working through the process, but as time quickly passes, those assurances ring hollow. The time to resume trade has long passed.

Let me address another priority issue: Japan's official control policy. This policy calls for fumigating for pests that are present in Japan but are neither being eradicated nor contained as required by international standards. This longstanding issue particularly affects fresh fruits and vegetables, such as citrus and lettuce.

This year we have made some progress toward changing the quarantine status of these pests, a critical first step toward eliminating unnecessary fumigations. For example, in April, Japan removed fumigation requirements for certain citrus pests, a priority issue for our citrus industry. Also in April, Japan's official control policy was raised at the Regulatory Reform Dialog, an initiative launched by President Bush and Prime Minister Koizumi. These talks resulted in Japan agreeing to bring its official control policy into compliance with international standards.

Japan has also agreed to assess certain pests of lettuce with the aim of removing fumigation requirements for them. We continue to press for improved market access to U.S. lettuce into the Japanese market.

I would also like to talk about the WTO negotiations and Japan's role in those talks. Throughout the summer, despite the best efforts by many, little progress was made on key issues in the negotiations. It is my perception that Japan has taken a protectionist approach, especially on market access, and it has, thus, been of little help. We have significant differences in the approach to tariff reductions. The United States is seeking substantial reductions in tariffs. Our tariffs average 12 percent on agricultural products, in comparison to Japan's average of 51 percent. Japan strongly opposes progressive tariff cutting and any tariff cap. We advocate for an aggressive formula that cuts the highest tariffs the most, and we insist on a cap on tariffs that are unreasonably high.

As in the past, Japan appears primarily interested in protecting its agricultural industries from import competition. It has lobbied for continued use of safeguards and to expand product eligibility for the safeguard currently available. In contrast, the United States and other ambitious countries would like to eliminate developed countries' use of such safeguards. We also differ on sensitive products. We want to limit the number of products a country may identify as sensitive, while Japan wants to maximize the use of such products.

We have made very clear what we are seeking in these talks. Our goal is to level the playingfield for our farmers and ranchers. Our markets are relatively open. Our domestic supports are relatively low. We insist upon substantial progress in all three pillars in the agriculture negotiations. We are encouraging Japan to constructively engage in these negotiations, to work with us to obtain a Doha outcome that will underpin our continuing, mutually advantageous trading relationship.

Mr. Chairman, Japan is an important market for U.S. farmers and ranchers, our number three market in calendar year 2004. We highly value that commercial relationship, and we want it to contribute to a further strengthening of our overall bilateral relationship.

That concludes my statement. I would be pleased to answer questions. Thank you.

[The prepared statement of Ms. Terpstra follows:]

**Statement of A. Ellen Terpstra, Administrator, Foreign Agricultural Service, U.S. Department of Agriculture**

Mr. Chairman, members of the Committee, I am pleased to come before you today with my colleagues from the Department of Treasury and the Office of the U.S. Trade Representative to discuss trade with Japan.

*Importance of Exports to U.S. Agriculture*

My focus today is the agriculture and food sector of our economy. I will discuss the importance of agricultural exports to our economy, trade issues with Japan, and Japan's role in the agriculture negotiations in the World Trade Organization's (WTO) Doha Development Agenda.

Agriculture long has been a true bright spot in our nation's trade balance. For the past 45 years, agriculture has posted a positive trade balance. U.S. sales abroad have grown from \$4.5 billion in 1960 to a record \$62.4 billion in 2004. This year, we foresee still strong sales of \$62 billion, just shy of the record. We now are forecasting yet another record—\$63.5 billion—for 2006. And, I should add that these estimates reflect the fact that several major markets—including most notably Japan—with additional sales of some \$3 billion remain unjustifiably closed to the United States.

The benefits of agricultural exports extend far beyond the farmgate. Last year's sales of \$62.4 billion generated \$158 billion in overall economic activity. These sales support additional services to harvest, process, package, store, transport, and market the products. High-value fresh and processed foods and beverages—which have become a bigger share of our overseas sales—now represent more than 40 percent of total export value, and they generate more additional economic activity than bulk commodities.

Agricultural exports also mean jobs. Our research indicates that every billion dollars in agricultural exports supports 15,300 jobs—in trade, transportation, services, food processing, and other manufacturing sectors. That means our total exports support nearly one million jobs. These are good jobs—with one third in rural areas and two thirds in metro areas. In our rural communities, agricultural exports generate more employment benefits than any other export industry.

I cannot emphasize enough that the future financial health of American agriculture depends on its success in the international marketplace. Historically, we have been the world's largest agricultural exporter. U.S. farmers last year earned



27 percent of their total cash receipts from foreign customers. For many products, the dependence is far greater—up to 70 percent for some items. And, increasingly, we are exporting more livestock and horticultural products, high-value products that further stimulate our economy.

*Trade with Japan*

Now, let me turn to Japan which long has played an important role in American agriculture's success story. In the early post-war years, Japan was a U.S. food aid recipient, but soon grew to be the top export market for our farmers and ranchers. It remained there for over 20 years, but recently has been replaced by Canada and Mexico, our two partners in the North American Free Trade Agreement. In fiscal year 2004, Japan purchased \$8.5 billion worth of U.S. food and agricultural products. This year, sales to Japan are forecast at only \$7.7 billion, reflecting in part lower prices for corn and soybeans.

While we highly value Japan as an important market, we have had major difficulties in maintaining the market and mixed success in trying to enable it to reach its full potential. The source of many difficulties is the arbitrary use of sanitary and phytosanitary (SPS) regulations. This has resulted in many disputes, some very protracted, over the years.

*Reopening the Japanese Market to U.S. Beef*

None of the disputes has been of the magnitude nor of the intensity as one still pending before us. That, as everyone here today well knows, is the closure of Japan's market to our beef and beef products owing to the discovery of BSE in the United States in 2003. Japan was the leading market for U.S. beef, buying some \$1.4 billion worth in 2003.

This issue has received the highest attention in our government, involving the President on several occasions—and has commanded the full attention of Secretary Johanns and his predecessor Secretary Veneman, Vice President Cheney, Secretary of State Rice and her predecessor Secretary Powell, U.S. Trade Representative Portman and his predecessor Ambassador Zoellick, and many other high-level officials. Many Members of Congress, including some on this committee, have been very actively involved in the issue, as well.

We have worked diligently from the outset to restore this market. We have responded to numerous requests for information, hosted several technical teams, and traveled extensively to Japan for countless meetings. We have emphasized the role and guidelines of the international standard-setting body, the World Animal Health Organization (OIE) and the need for science-based decision-making. We have urged the Japanese Food Safety Commission to complete its review of import rules expeditiously and the Government of Japan to take prompt action to reopen the market to our beef.

We have repeatedly told the Japanese government that it is critically important to resolve this issue so that we can eliminate this source of friction between our countries and instead focus on broadening and deepening our overall trade and economic relationship. The Japanese assure us they are working through the process to reopen their market to safe U.S. beef. As time quickly passes, those assurances ring hollow—the time to act is now.

*Official Control*

Beyond beef, let me address another trade priority, and that is Japan's official control policy that frustrates our ability to ship a variety of fruits and vegetables. This policy, which calls for fumigating pests that are not being eradicated or contained in Japan as required by international standards, has been an issue of long-standing concern. This particularly affects fresh fruits and vegetables such as citrus and lettuce.

In December 2004, Japan's official control policy was raised at the Regulatory Reform Dialogue, an economic reform initiative launched by President Bush and Prime Minister Koizumi. These talks resulted in Japan agreeing to bring its official control policy into compliance with international standards.

As a result of raising this matter through the Regulatory Reform Initiative, this year we have seen some progress toward changing the quarantine status of these pests, a critical first step toward eliminating unnecessary fumigations. In April, Japan removed fumigation requirements for certain citrus pests, a priority issue for our citrus industry. This action significantly reduced fumigation costs for citrus traders and will enhance product quality, greatly improving consumer acceptance in the local market.

Japan also has agreed to assess certain pests associated with lettuce production, with the aim of minimizing the need for fumigation. Japan confirmed earlier this year that it is conducting a pest risk assessment for several different pests, includ-

ing Western Flower Thrips, one of the most frequently intercepted pests on lettuce. We will continue to press for improved market access for U.S. lettuce into the Japanese market.

USDA also remains active in addressing market issues for many other products. For example, we work closely with our rice industry to ensure that Japan meets its WTO commitments for market access. To date, they have purchased the required amounts. However, we are seeking to secure improved access, particularly to reach Japanese consumers more directly.

#### *Fire Blight*

I can report one success among our many, long-standing efforts to open Japan's market. As you know, we were successful in our WTO challenge of Japan's fire blight restrictions against our apples to bring its restrictions into conformity with the WTO SPS agreement.

On August 25, Japan published the detailed rules for U.S. apple imports, which comply with the WTO fire blight ruling. We have reviewed the work plan described in the rules and can confirm that the work plan will be in operation for the upcoming season.

Japan's compliance with the WTO decision is a clear victory for the United States, for our apple industry, and most importantly for the credibility of the international trading rules. As a result, the Japanese market now is open to our apples under reasonable and science-based terms. This outcome also signifies the importance of WTO SPS obligations and the need for commitment from WTO members to adhere to science-based, risk-based import and export standards and to apply them equitably without discrimination.

#### *Doha Negotiations*

Before concluding, I want to mention the WTO negotiations and Japan's role in the talks. Throughout the summer, despite the best efforts by many, little progress was made on key issues in the negotiations. It is my perception that Japan has taken a protectionist approach, especially on market access, and thus has not helped move the process forward.

As in past negotiations, Japan appears primarily interested in protecting its agricultural industries from import competition. It has actively lobbied for continued use of safeguards and to expand product eligibility for the safeguards currently available to members. In contrast, the United States and other countries with high ambition would like to eliminate developed countries' use of such safeguards.

We also differ on use of "sensitive products". We want to limit the number of products a country may identify as sensitive, while Japan wants to maximize the use of such products.

We also have significant differences in the approach to tariff reduction. Our agricultural tariffs only average 12 percent in contrast to Japan's average of 51 percent. Japan strongly opposes use of any type of progressive tariff-cutting formula and any tariff cap. It still prefers the old fashioned, go-slow approach of the Uruguay Round. In sharp contrast, we advocate an aggressive formula that cuts the highest tariffs the most, and we insist upon a cap on tariffs that are unreasonably high.

We have made very clear what we are seeking. We simply want to level the playing field for our farmers and ranchers. Our markets are relatively open, and yet, we have stepped forward and put our domestic supports on the table. We insist upon substantial progress in all three pillars of the negotiations: market access; trade-distorting domestic support; and export competition. We are encouraging Japan to constructively engage in the negotiations, to work with us in obtaining a Doha outcome that will underpin our continuing, mutually advantageous trading relationship.

#### *Conclusion*

Mr. Chairman, Japan is an important market for U.S. farmers and ranchers—our number three market in calendar year 2004. We highly value that commercial relationship—and we want it to contribute to a further strengthening of our overall bilateral relationship.

To accomplish this, for our mutual benefit, we want to find ways to expand our cooperation with Japan—to focus on our bilateral relationship and also to find ways to cooperate more effectively in the international arenas. As we move forward in the Doha talks, we intend to aggressively seek additional market access gains, including important markets like Japan.

Mr. Chairman, that concludes my statement. I would be pleased to answer any questions.

Chairman THOMAS. Mr. Kawamura?

**STATEMENT OF A.G. KAWAMURA, SECRETARY OF AGRICULTURE, CALIFORNIA DEPARTMENT OF FOOD AND AGRICULTURE, SACRAMENTO, CALIFORNIA**

Mr. KAWAMURA. Thank you, Chairman Thomas, Ranking Member Shaw, and Members of the Committee, for calling this hearing to discuss the importance of our trading relationship with Japan. I am A.G. Kawamura, Secretary of the Department of Agriculture, and I am here today as Governor Schwarzenegger's representative. In California, we are working very hard to share our understanding that access—and it is an important word, “access”—to nutritious California-grown foods or U.S. foods is an essential component of a healthy lifestyle and is a key part of our State and national economy.

As you know, California's agricultural production—\$31.8 billion in 2004 in farm-gate value—if ranked separately would rank economically as the fifth largest agricultural region in the world.

California is the number one dairy State in the Nation, accounting for more than 20 percent of this Nation's milk supply. And California is also the number two producer of cheese, rice, poultry, and cotton for the Nation. We are the sole producer of 12 commodities and the national leader in 81 other commodities. And in terms of global markets, the important part for this discussion, California is the national leader accounting for 10 percent of U.S. agricultural exports. All of this leads to an economic impact in the State—and, of course, for the Nation—of more than \$130 billion, if the multiplier could be used conservatively. Clearly, given these important facts, any opportunities to expand California agriculture's success in access to foreign markets, including Japan, would benefit our entire Nation.

The critical importance of Japan as an economic partner to the United States, especially to our State of California, is clear when you look at the numbers. Japan consistently ranks as the number two or three market for California's agricultural exports. In 2003, this totaled \$913 million. Our top five commodities for that year were rice, almonds, beef, hay, and wine. Additionally, in 2003, as was mentioned throughout, California's share of that beef production number was \$86 million in beef and beef products exported to Japan, more than half of the 2003 number. This figure comprises 40 percent of all California beef exports for that year, and as Congressman Moran mentioned, that is a \$1.5 billion loss for the 2004-05 for zero shipments during the ban.

This continuing ban on U.S. beef, despite our rigorous surveillance and testing protocols, is of great concern to all of us who believe in the validity of science-based measures to ensure food safety.

In fact, the harmonization of sanitary and phytosanitary standards and other trade barriers between the U.S. and Japan can greatly enhance the potential for export of many crops. For example, as was mentioned, California's stone fruits, lettuce, and rice face restrictive policies that significantly limit shipments of those commodities into Japan. In California, we understand the need for phytosanitary caution. Our Department of Agriculture expends ap-

proximately \$197 million per year to protect our agricultural commodities and ensure that only quality food products reach the consumer. All agricultural trade then can suffer from foodborne disease and pest outbreaks. And for this reason, all nations have a stake in being alert to the enormous challenges caused by introduction of unwanted species of pests and diseases. However, with California's stringent environmental and conservation practices and with strict Federal guidelines that ensure food safety and quality, our farmers and ranchers produce a finished product that meets or exceeds the highest standards in the world. These exacting standards are just what the Japanese consumer demands.

As the WTO process works to promote market access, we would clearly expect the agricultural trading relationship between Japan and the United States to continue to expand. Working together, I am confident that the issues that we face today with Japan can be resolved to our mutual benefit.

In fact,, we look forward to building upon the relationship between our Governor and Prime Minister Koizumi and his new government.

Over the last 2 years, Japan has been in the process of transitioning maximum residue limited from a negative list system to that of a positive. This will result in determination of allowable chemical residues for a wide variety of agricultural products, especially those from the specialty crop arena and value-added foods. We have faith that this new process will be a facilitation of our ability to send products to Japan and not restrict the access to these high-quality, safe, and nutritious U.S. products.

The clear benefits of trade are often more than just impressive numbers, though. We live in a time where California's farmers and ranchers comprise one of the largest delivery systems of food and fiber in the world. And it is this extraordinary and dependable supply of farm products that provides all consumers with food security and stability. It is this food security and stability that Japanese consumers demand. The existence of trade barriers limits our ability to enjoy full access to the market. The goal of every Nation should be to provide a wide array of safe and nutritious farm products throughout the year to its citizens. So, choice, affordability, and availability help to create and maintain a nation's health, not just our Nation's health but Japan's as well.

California, again, is committed to ensuring the economic security and competitiveness for our growers while providing a safe and secure food supply. We are all witness to the amazing globalization of this very small planet of ours. Globalization is not a threat but an opportunity. Human progress then will be measured by every nation's ability to deliver an abundance of affordable goods, including those products that are essential to health and well-being. We believe that the Japanese consumer deserves access to high-quality foods that this Nation so expertly produces. Trade policies that limit the availability of these goods should be revisited and revised.

The 21st century will bring many challenges but none greater than achieving a renewed commitment to agriculture and its fundamental role in all societies. We are all stakeholders in this future, and I thank you for this testimony opportunity today.

[The prepared statement of Mr. Kawamura follows:]

**Statement of A.G. Kawamura, Secretary of Agriculture, California  
Department of Food and Agriculture, Sacramento, CA**

**Introduction**

Thank you Chairman Thomas, members of the committee, for calling this hearing to discuss the importance of our trading relationship with Japan. I am A.G. Kawamura, Secretary of the California Department of Food and Agriculture. I'm here today as Governor Schwarzenegger's representative. In California, we are working hard to share our understanding that access to nutritious California grown foods is an essential component of a healthy lifestyle and is a key part of our state and national economy.

**California feeds the world**

As you know, California's agricultural production—\$31.8 billion dollars in farm-gate value—if ranked separately would make it economically the fifth largest agricultural region in the world.

California is the No. 1 dairy state in the nation, accounting for more than 20 percent of the milk consumed by Americans. California is also the No. 2 cheese, rice, poultry and cotton state in the nation. We are the sole producer of 12 commodities and the national leader in 81 other commodities. In terms of global markets, California is the national leader accounting for 10 percent of U.S. agricultural exports. All of this leads to an economic impact in the state of more than \$130 billion dollars. Clearly, given these important facts, any opportunities to expand California agriculture's access to foreign markets, including Japan, would benefit our entire nation.

**U.S.-Japan trade relations are of vital importance**

The critical importance of Japan as an economic partner to the U.S., especially to the state of California, is clear when you look at the numbers. Japan consistently ranks as the No. 2 or No. 3 market for California's agricultural exports. In 2003, this totaled \$913 million dollars. Our top five commodities for that year were rice, almonds, beef, hay and wine. Additionally, in 2003 California beef producers shipped \$86 million in beef and beef products to Japan. This figure comprised 40 percent of all California beef exports that year.

The continuing ban on U.S. beef, despite our rigorous surveillance and testing protocols, is of great concern to all of us who believe in the validity of science-based measures to ensure food safety.

**Harmonization of standards**

In fact, the harmonization of sanitary and phytosanitary standards and other trade barriers between the U.S. and Japan can greatly enhance the potential for export of many crops. For example, California's stone fruits, lettuce and rice face restrictive policies that significantly limit shipments of those commodities into Japan. In California, we understand the need for phytosanitary caution. The California Department of Food and Agriculture expends approximately \$197 million per year to protect our agricultural commodities and ensure that only quality food products reach the consumer. All agricultural trade can suffer from food borne disease and pest outbreaks. For this reason, all nations have a stake in being alert to the enormous challenges caused by introduction of unwanted species of pests and diseases. However, with California's stringent environmental and conservation practices, and with strict federal guidelines that ensure food safety and quality, our farmers and ranchers produce a finished product that meets or exceeds the highest standards in the world. These exacting standards are just what the Japanese consumer demands.

As the WTO process works to promote market access, we would clearly expect the agricultural trading relationship between Japan and the U.S. to continue to expand. Working together, I'm confident that the issues that we face today with Japan can be resolved to our mutual benefit.

Over the last two years, Japan has been in the process of transitioning maximum residue limits from a negative list system to that of a positive. This will result in determination of allowable chemical residues for a wide variety of agricultural products, including specialty crops and value-added foods. With full faith in scientific standards, recognizing food safety and security, California stresses that these standards must reflect production needs and establish criteria for new compound evaluations that facilitate, not restrict, the access to high quality, safe and nutritious U.S. agricultural products.

Increased consumption of nutritious foods

The clear benefits of trade are often more than just impressive numbers. We live in a time where California's farmers and ranchers comprise one of the largest delivery systems of food and fiber in the world. It is this extraordinary and dependable supply of farm products that provides all consumers with food security and stability.

It is this food security and stability that Japanese consumers demand. However, the existence of trade barriers limits our ability to enjoy full access to the market. The goal of every nation should be to provide a wide array of safe and nutritious farm products throughout the year to its citizens. Choice, affordability and availability help to create and maintain a nation's health—whether it is here in the U.S. or in Japan.

#### **Conclusion**

California is a major gateway in providing both domestic and imported agricultural goods to the nation. Governor Schwarzenegger is committed to ensuring economic security and competitiveness for our growers, while providing a safe and secure food supply. We are all witness to the amazing globalization of this very small planet of ours. Globalization is not a threat but an opportunity. Human progress will be measured by every nation's ability to deliver an abundance of affordable goods, including those products that are essential to health and well-being. We believe that the Japanese consumer deserves access to high-quality foods that this nation so expertly produces. Trade policies that limit the availability of these goods should be revisited and revised.

California agriculture is leading the world in achieving a safe and reliable supply of farm products produced through responsible stewardship of our resources under the watchful eye of caring farm families. The 21st century will bring many challenges, but none greater than achieving a renewed commitment to agriculture and its fundamental role in all societies. We are all stakeholders in this future. Thank you for taking testimony today and for your support.

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Chairman THOMAS. Thank you very much.

Let me say initially, in terms of the administration testimony, I just flat out couldn't be more disappointed. I said at the beginning of this hearing that we didn't want to talk about tomorrow, I didn't want to hear a lot of verbiage in terms of positive spin.

Let me give you a feeling of what I heard from your testimony in terms of the high points. Ms. Cutler, "removal of unjustified ban." Wow. I call that progress. "Appears to be in the final stages of deliberations." Aggressive.

Mr. Loevinger, optimism. "Prospects for the future based upon recent elections." That is tomorrow. You brag about the fact that in March of 2004 they finally quit spending hundreds of billions of yen trying to artificially shore up their currency. You talked about zombie loans. I guess you meant it may be morning in the night of the living dead. "May finally be coming to an end." "A new day may have finally arrived."

Now, in the second largest economy in the world, you held up, I assume admirably, a five-fold growth in a decade from \$6 billion to \$35 billion, at a time when the world in terms of truly open trading partners had multiplied far beyond that shabby number.

Ms. Terpstra, they "remain unjustifiably closed." Well, the question is: If they remain unjustifiably closed, how long are you going to let them remain unjustifiably closed? And when are you going to do something about the fact that they are unjustifiably closed? "This year we made some progress. . . ." "With the aim of. . . we have been very clear on what we are seeking." "Seeking."

Seeking, seeking, seeking. When are you going to find it? I am a little disappointed in you folks coming here and being apologists for whatever Japanese regime happens to be in.

Now, if you are not result-oriented, I want to assure you that this Congress in a bipartisan way is going to be. The world has changed, and the world is changing. The government of Korea is

interested in a free trade agreement, and I am interested in working a free trade agreement with the country of Korea.

China—we are going to examine China. In the short time that they have been in, they have made more promises and actually honored more commitments than Japan has in the decades in which Japan has promised a better tomorrow.

And for you to come here and to talk about tomorrow and seeking and possibly hoping that things will be better, in other areas of interpersonal human behavior, that is called “enablers.” And we expect something different. And if we don’t get something different, you will get clear, understanding, behavioral measures from this Congress.

And this is coming from someone who is more than willing to let people try, but that is all we have ever done, and that is all we have ever gotten, and that is “try,” “tomorrow.” I said at the beginning of this hearing I am not interested in tomorrow. Changes have to be made. Yes, there has just been an election, but I think at some point you draw the line.

This hearing today, at least under whatever power I have, is drawing the line. There are no more tomorrows.

The gentleman from Florida?

Mr. SHAW. Thank you, Mr. Chairman.

I am somewhat confused as to the motivation of the Japanese in some areas. We have heard from several witnesses now the ban on American beef coming into Japan, and we know that there are no logical sanitary barriers that could be put up, and that we have a better situation than they have certainly in that regard. Also, I have been told and I understand that we are not really competing with their markets.

So, would one of you like to tell me what is their motivation in blocking American beef coming into Japan? Who wants to take that? Ms. Terpstra, you testified in that area.

Ms. TERPSTRA. Thank you. I will try to answer that question. You are very right, I think, in the history of our working to export U.S. beef to Japan. Early on, it used to be to protect their domestic producers. Today it seems to be, I think, symptomatic of a larger problem, and that is their lack of an effective regulatory system that generates confidence in it by their consumers. They seem to be, I would say, somewhat adrift in terms of how to deal with SPS measures.

Some of their actions I think are continuing to try to protect, perhaps more in the fruit and vegetable area, their own producers. But with regard to beef, you have made the point that we are not competing with their producers. Their consumers enjoy our products. There seems to be no good economic reason for keeping out our product. I think Japan is truly struggling with how to deal with consumer concerns over the food safety system.

Chairman THOMAS. Would the gentleman yield?

Mr. SHAW. Yes, I will yield.

Chairman THOMAS. Have you ever heard of stonewalling?

Ms. TERPSTRA. Yes.

Chairman THOMAS. Wouldn’t it be very difficult for Japan if they had scientific tests and allowed beef, in which there is no true competitor, and wouldn’t they, therefore, have to respond in a num-

ber of others areas with scientific tests to open up the market and that once they start, there is no stopping it? And that rather than some confusion or inability to understand what is going on, it is an absolute stonewall in which if they show any movement whatsoever, they have to show movement across the board. That is not hard to understand, and it is not confusion. It is stonewalling.

I thank the gentleman.

Mr. SHAW. You hit right on the point. In fact, many years ago when I was a Mayor, I was trying to—we were looking to have an experimental rail system put in by the Japanese, and I was told at that time—given sort of instructions on how to negotiate with the Japanese. And I was told that it was like there is a curtain and you throw an idea over and just wait for something else to be thrown back, and you never knew how long it was going to take for it to come back.

Our way of negotiation in the West is more or less we want to sit down and make a deal. We want to discuss it and work it out and make a deal.

I think our difference in our negotiation tactics has probably worked very much to our disadvantage. And this brings up the stonewalling because that is exactly what is involved. While we are waiting for them to come back and them saying that they are in no hurry to respond to us, I think we need to put in place some penalties for stonewalling so that we will be believed as doing something. When we make an agreement, we stick with it, and we should expect and require other countries to do that.

Where are they getting most of their beef, by the way? Does anybody know that?

Ms. TERPSTRA. In the interim, without U.S. product, I would say from Australia.

Mr. SHAW. One last question. If all of these tariffs and barriers were to come down and they were to mirror our structure here in the United States, what effect would that have on our balance of trade? Does anybody care to—

Mr. KAWAMURA. Those of us in California believe there would be tremendous results in terms of the value-added products that we can send over there, everything from salad in a bag to the fresh fruits and stone fruits that we have, including rice would be an immediate winner in that arena. Of course, you know that beef would be a large part of that product line that we can send there. We would be very happy—including the different nut products we have. We would be very excited. It is a wonderful, developed, as a previous speaker mentioned, mature economy that can afford to buy so many of our products, and much of their economy can afford to buy even our more affordable products as well. And so these trade barriers limit that potentiality tremendously.

Mr. SHAW. Mr. Chairman, just to sum up, I think that it is very apparent from what you are hearing from the dais up here, from both sides of the aisle, is that we are out of patience, and it is time to move.

Thank you.

Mr. LEVIN. Thank you very much.

In my opening statement, I mentioned a series of concerns, three of them—the appeal issue, the beneficiary rights issues, and also



the evidentiary record issue. Let me start with one of them, and I am going to stick within 5 minutes. I think the Chairman might insist on that anyway. Then others can pick up these other concerns.

Let's take the evidentiary issue, the appeal process. The proposed limitation would apply to what would be, what, the third step of the process?

Ms. BARNHART. It would be the third step of the process, the DDS, the reviewing official, and then the administrative law judge, yes.

Mr. LEVIN. Now, what percentage of the cases more or less goes to the ALJ?

Ms. BARNHART. If I could describe it a little differently than that, I have some numbers I think may make it clear. If you look at initial claims and you take a hundred cases, Mr. Levin, the number that go to the second level, which is reconsideration, is 22. So, 22 out of the 63 that are denied at the first level move on to the DDS level. Of those 22, 19 move on to the ALJ level of appeal.

Mr. LEVIN. So, of the hundred cases—

Ms. BARNHART. Sixty-three are denied at the first step by the DDS, 37 allowed. Of those 63, 22 of those appeal for reconsideration. Of those 22, 3 are allowed, 19 are denied. Nineteen appeal—virtually all appeal to the next stage.

Mr. LEVIN. Now, in what percentage more or less of these cases is there an attorney, do you know?

Ms. BARNHART. In terms of representation?

Mr. LEVIN. It doesn't have to be an attorney.

Ms. BARNHART. Representation in general for—I can give it to you by Title 2 as well as SSI. In Title 2 it is 74 percent are represented. The vast majority of those are attorneys, I would point out. I don't have that breakout for you, but I can get that for the record. And for SSI, 47 percent are represented.

Mr. LEVIN. Now, is there any evidence now of a problem of submittal of evidence? You are changing the rule. You are proposing to change the rule, and what evidence is there that it is now a problem?

Ms. BARNHART. Well, it is not a matter of what—I cannot categorize the evidence for you, Mr. Levin, but I do know that based on the number of postponements and rescheduling of hearings that are requested, a number of them the request is made because of things other than a no-show, for example, by the claimant.

Chairman THOMAS. Thank the gentleman. If you want an absolute number, in visiting with a sake maker outside Tokyo, he indicated that if he could import cow rose rice from California versus the price he is forced to buy domestic Japanese rice for, he could cut the price of his sake by 50 percent and not diminish quality whatsoever.

Gentleman from Michigan.

Mr. LEVIN. Thank you, Mr. Chairman. It was good that you called this hearing. You mentioned that you thought in many sectors the Japanese have been stonewalling the U.S., and I must say, listening to your testimony, I think you are stonewalling us and the American people, because maybe it is because they are the largest holder, the Japanese, of U.S. Treasury Securities, that you

come here and you are afraid to kind of tell it like it is. I don't think you have done that.

Ms. Cutler, you say we have come a long way, I quote, with Japan over the years. A long ways. I don't know, in view of the facts, how you can say that. I was just looking at the trade figures, the merchandise trade figures, and in dollar terms they are worse than they were 7, 8 years ago. You know this. The surest figures, if you look at those—and you kind of lauded it—the change in the trade balance has been so small. The '97 figures merchandise trade, the trade balance was 56.1 billion. Now it is 75.2 billion. I looked at the auto figures. You know, we have been working on this for 15 years. The total passenger exports in 1990 were 2.2. Then they went down to 1.2 billion. Now they are up to 1.7 billion from Japan to here. Our trade deficit has gone from 30 billion in the auto sector to \$43 billion. That has come a long ways.

And then, Mr. Loevinger, you talk about the currency manipulation. I forget the billions that they spent in '04, the billions. The reports of Treasury always hesitated to say that Japan was manipulating. Tell me in a word why? I don't understand that. I think Treasury was stonewalling the American people. When they spent all of those billions and billions, you say that—they were manipulating their currency, weren't they? Yes or no?

Mr. LOEVINGER. Thank you, Congressman.

Mr. LEVIN. Maybe you don't want to thank me.

[Laughter.]

Mr. LOEVINGER. No, no, no. Also I want to say to you and other Members of the Committee that we hear the message.

Mr. LEVIN. Tell me, were they manipulating the currency in '03-'04?

Mr. LOEVINGER. As you know, Mr. Congressman, the Treasury reports for those periods concluded that no country met the technical requirements of the 1988 Trade Act, but as I said, we were very aware of the intervention going on. We had very clear and tough discussions with them. We made our views known, and in March of 2004 they stopped and they have not intervened since then.

Mr. LEVIN. We will get into that first. I have not met a Member of Congress who buys the Treasury Department explanation about technical compliance. So, in my last 30 seconds, Ms. Terpstra, in terms of beef, do you think Japan has been violating its WTO obligations?

Ms. TERPSTRA. I think that their policies are not consistent with the international obligations under the SBS agreement, and—

Mr. LEVIN. So, the answer is?

Ms. TERPSTRA. Yes.

Mr. LEVIN. Why did we not file action with the WTO? Why are we here so much longer? Just tell our constituents. We worked on the WTO. We worked to change the dispute settlement system. We worked to give it finality. A lot of us here worked hard to bring that about. Why did we not use it?

Ms. TERPSTRA. Because the first stage in the WTO is having bilateral consultations. last October we felt that we had a way for—

ward for both of our countries to move toward resuming trade in a manner that was consistent with our obligations.

Mr. LEVIN. That was a year ago.

Ms. TERPSTRA. Yes. And we share the frustration. Secretary Johanns has also said enough is enough. That process has run its course.

Mr. LEVIN. American will believe enough is enough only when there is action, not rhetoric. I for the life of me don't understand the hesitation to use our WTO rights.

Thank you, Mr. Chairman.

Mr. SHAW. [Presiding] The time of the gentleman has expired.

Mrs. Johnson.

Mrs. JOHNSON OF CONNECTICUT. Thank you very much, Mr. Chairman.

Ms. Cutler, in your testimony you make the statement on page 4 that in sum, we have and will continue to make good progress in our efforts to further open markets in Japan and key sectors such as telecommunications, information technology, medical devices and pharmaceuticals, energy and agriculture.

Just in medical devices Japan has the slowest and most costly system of approving new medical technologies of any developed country, and on top of that, they have just added a new very burdensome regulatory regime that will require our companies to expend \$1.5 billion just to comply with yet additional regulatory requirements by 2010.

In addition, the Japanese government has made significant reductions. In fact, in some cases deep cuts in the price they will pay for medical technology, signifying that they have absolutely no intention of providing research and development resources that medical technology depends on to make life-saving changes in how we are able to help people who need medical devices for survival and for a functional life.

Now, what makes you think we are making progress? How can you even include medical devices in the list of things in which we are making good progress, because it looks to me like we are going backward.

I would say the same about life insurance. You know, Kampo is not supposed to put in any new products, they put out new products, which they are still paying no taxes and while the government still takes responsibility for backing risk.

So, it is not just that they are continuing to do the kinds of things that they have done that represent non-tariff barriers. It is no wonder we have a trade deficit; it is a wonder it isn't deeper. But there are many areas in which we currently trade, where we could be trading in a fair regimen and not have a trade deficit. So, I see them as going backward.

Furthermore, I see their actions as duplicitous. To say that we are going to have Kampo privatized and compete, and before they do that, give it a new advantage in new products. I don't know how you can be as optimistic as you have been in your presentations. I can see that maybe the relationship isn't as hostile as it has been before that. Maybe now you get a response in weeks rather than years. But where do you see the opportunity for progress on now the

many pressing fronts on which their behavior is grossly, totally unacceptable as part of the world trading community?

I am directing this to Ms. Cutler first, but if any of you want to comment afterward, I would be happy to hear your comments.

Ms. CUTLER. I have been at USTR working on Japan trade issues since 1991, and perhaps—it has been quite a long time, and I think in a lot of these sectors maybe I have a good recollection of the starting point and how bad things, really bad things used to be. So, for example, in the medical device industry we made enormous breakthroughs in terms of achieving transparency improvements for industry so they could provide input into the pricing deliberations, to they could have a seat at the table when other decisions were being taken that would affect their industry.

That said, I totally understand that we have a lot of work ahead of us. In the past we have worked closely with industry, and a number of cycles of these biennial pricing reviews to head off some of the worst price cuts that were under consideration. We are determined to work with industry and to work with Congress again in this cycle to head off price cuts that are discriminatory, unfair, and that disproportionately ask our companies to take on the burden of Japan's desire to reduce its health care cost.

I have work for many years on the Japan insurance issue, including on the negotiation of the '94 and '96 bilateral insurance agreements. I don't have statistics from back then, but in 1998 U.S. market share in the life insurance market in Japan, the private sector market, was 4.6 percent. In 2004 it was 18.8 percent. That is progress, and perhaps in my view that is good progress, but maybe I have been working with Japan for too long if I think that is good progress.

That said, the challenges presented by postal privatization and the implications it might have for our industry is a priority issue on our agenda. We are working very closely with industry.

Mrs. JOHNSON OF CONNECTICUT. Let me, because my time is about to expire and I know you can't go through the whole list of things you would like to go through.

Let me just say that a group of us backed Secretary Baldrige when he was negotiating with the Japanese on machine tool issues and later on auto issues. We saw what it was like then. It has changed a little, but not enough for the modern world, and Japan is a major economy of the modern world. They have simply got to change their ways at a speed that has not been traditional in their society because if they don't we will have to use the tools at our disposal to override the negotiating process. That would not be good for us or for them, but it will be necessary if we can't change the style and the process and the speed at which problems between us are resolved.

Thank you.

Mr. SHAW. Mr. Cardin?

Mr. CARDIN. Thank you very much, Mr. Chairman.

It is a pleasure to have you before us. I think the frustration is—and you saw the passion of our Chairman, and I must tell you, those on my side of the aisle don't always agree with our Chairman, but we always admire his passion on issues. We would like

to see some of that from the Executive Department, particularly as it relates to trade issues.

I think we would feel more comfortable if we felt that there was outrage as to the delaying tactics being used by Japan and other trading partners to resolve issues. We don't see that. We don't see that in your testimony. We don't see that in your action.

On Treasury, on currency manipulation and China's intervention into the currency market if I am correct, I think since 2000 the intervened somewhere around 150 times, and, yes, now you have gotten some action on their part, we believe, after a lot of damage has been done. It took 150 interventions before we could get any action done? And we never filed claims. I think we are concerned as to whose side are you on. I say that with a great deal of respect for the public service of the people who serve in your agencies. We have been waiting a long time on beef, waiting too long.

And on Kambo, you mentioned that we have greater penetration in the insurance market, but how would you like to be a company in the United States competing against a company in Japan that has the relationship with its government so it doesn't have to pay taxes, it doesn't have to do anything else and you have to compete with them. That is wrong. You know it is wrong, we know it is wrong. And they are delaying dealing with it and we don't do anything about it. Japan files claims against us, Byrd amendment. WTO claims filed. They are taking retaliatory action. They don't have the niceties of saying, well, gee, we will wait and talk and talk.

You talk about consultation before you file a WTO case. Let me just ask you, Ms. Cutler, are we in consultation before filing a WTO? Have we put them on notice that we are going to be filing a WTO claim?

Ms. CUTLER. With respect to insurance?

Mr. CARDIN. Beef, insurance, you pick the ones. Where are we in the queue to file WTO claims actions against Japan? Have we told them we are in our consultation period before filing claims? Are we prepared to claim or are we going to continue to wait?

Ms. CUTLER. With respect to insurance, we are working with our industry, exchanging information in terms of the strength of the case we might have in the WTO, but I think—and Governor Keating will testify later—I think we are in agreement that the best strategy now is to try and work with the Japanese government to head off the harmful implications of postal privatization that would impact our companies and make them compete, as you said, on an unfair basis with a huge entity that gets special advantages.

Mr. CARDIN. So, we are not in the process of seriously preparing for a WTO challenge?

Ms. CUTLER. We are keeping that option open, and our lawyers are working with our insurance industry lawyers, looking at a case, but once again, we look at the most appropriate avenue for trying to solve the issue and gain access and forestall barriers put up against our companies so they can compete in the market.

Mr. CARDIN. Japan as a developed Nation has historically supported the U.S. position on rules, countervailing duties and anti-dumping duties. Many of us think that because of these barriers that they have, and protectionist policies, that they can get the

benefit of profits by protecting their market so that they can join the developing countries in trying to weaken the anti-dumping rules. What action have you taken wipl in the Doha Development Agenda on the rules agenda, the rules issues?

Ms. CUTLER. You are correct. In the rules area Japan is working with a number of other countries to try and weaken our dumping and countervailing—

Mr. CARDIN. Doesn't that get you? Aren't you outraged by that?

Ms. CUTLER. We are—

Mr. CARDIN. It is counter-intuitive that they are doing this. There is something wrong.

Ms. CUTLER. We are working in the rules group to forestall this and to make sure that we can continue using these rules in accordance with the WTO rules.

Mr. CARDIN. I can tell you, you are going to have a lot of problems with Democrats who have supported trade legislation historically if we find that you are making compromises on rules because you have a tough going because you don't have the allies that you need because you haven't done the necessary preparation with our allies on this issue. It seems to me if we were tougher on the trade distortions with Japan, we wouldn't have the same problem we are having now in the Doha Development Agenda. I think it is going to have serious ramifications if we don't take a tougher position with our traditional friends.

Thank you, Mr. Chairman.

Mr. SHAW. Mr. Herger?

Mr. HERGER. Thank you, Mr. Chairman.

Mr. Kawamura, it is good to have you from California. Thank you for the great job you are doing representing us in agriculture. All of this panel, I am sure sense the frustration that we have in the Ways and Means Committee, which is responsible for trade.

And I represent one of the most productive, fertile agricultural districts in the world in Northern California, and certainly I am hearing not only from my agriculture, but as you know, Mrs. Cutler and others, that California has a number of companies that would like to be doing business on a more fair basis with our friends in Japan, which aren't able to. I have heard concern from some of the groups that Mrs. Johnson mentioned, the medical device industry, which leads the world in life science research and is encountering regulatory obstacles in Japan now. I have heard from the life insurance industry, which has a very large interest in the direction of deregulation of Japan post, and I have heard from some of my dairy people in my district and livestock industry.

But what I would like to focus on, my question to you, Ms. Cutler, is the many rice growing constituents in my Northern California district, which is the second largest rice growing area in the Nation, it is my understanding that the Japanese government recently announced a new discriminatory policy that will provide selected end users in Japan with access to imported rice stocks held by the Japanese government, and that these rice stocks are mostly of U.S. origin. I understand that Japan's Food Department will make imported rice available to industrial users in Japan if these users agree to reduce imports of a product called rice cake.

I have two concerns with this proposed policy. First, Japan appears to be in possible violation of its WTO obligations by treating imported rice differently than domestic rice; and second, Japan is apparently pursuing an import substitution policy by targeting approximately 20 million in the trade of rice cake mixes. Japan will reportedly make this new policy operational in late October or November.

Ms. Cutler, I would like to find out from you how the USTR and the administration plan to move forward in addressing this discriminatory policy?

Ms. TERPSTRA. Congressman, if I could first attempt to answer that.

Mr. HERGER. Please.

Ms. TERPSTRA. I think you very well described the new proposal from the Japanese government that would seem to be undermining the access we have for our rice and rice products into Japan. This is something we just recently learned about. We will be working with the rice industry. We have raised it through our embassy in Tokyo, but we will go and fully explore what the WTO issues are here and pursue it. We don't want to see our access undermined any further than it already is.

Mr. HERGER. I would like to continue our discussion, and I am very interested in what the results are. Again, this is one more example of something—not only are we not making progress, but we are actually digressing in this areas, so I would like to have you report back to me as soon as you can on what you find out.

Thank you.

Mr. SHAW. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman.

Ms. Cutler, let me congratulate you. The panel today, as assembled and the answers you have given, this is the only time in 10 years we have all agreed on something. I think it speaks to the seriousness of the matter that is before us.

A simple question to begin with. What can Congress be doing to speak to some of these issues? Then I will address a couple of specific questions to you on the life insurance and medical devices fields.

Ms. CUTLER. I think the letters we receive and the letters that are sent directly to Japanese Ministers and the Japanese Ambassadors really help underscore that it is Congress and the administration that are concerned in a wide range of areas. I also believe a hearing like the one you are holding today is very useful in underscoring to our Japanese colleagues the seriousness that Congress attaches to all of these issues. Frankly, I think sometimes they think that Congress is not paying attention to them, and so hearings like this and the letters help us do our job.

Mr. NEAL. Specifically in the insurance industry, as Kambo moves down the road, to what some of us believe will be privatization, what assurance can you give the life insurance industry here in America, that as they proceed to privatization, that we are not going to be in an unfair position, given opportunities for growth here in America?

Ms. CUTLER. The assurance we can give them is that we will work hand in glove with them at senior levels of this administra-

tion to make sure that the inroads that we have made into this market over the years are sustained, and that our presence in Japan in the life and non-life market will continue to grow. This is an issue of high priority for the Administration. It is not just USTR that is attaching the highest concern to this issue. I am working closely with my colleagues in the White House, at the Treasury Department, at the State Department. Our embassy is holding weekly meetings with key players who work on this subject in Japan.

So, we are attaching top priority and doing everything we can, and working with the insurance industry. And also, this time around in the insurance area we have allies within Japan, and we are working with them, so we have domestic support for our position as well in Japan, and that is very helpful.

Mr. NEAL. Are you prepared to name any of those allies that we have?

Ms. CUTLER. They are business groups in Japan. They are the Japanese life insurance companies that are supporting our position. Our industry is working—and I am sure Governor Keating will talk about this later—closely with the European and Canadian insurance providers who also share our position, and there are many, frankly, in the Japanese government that are very sympathetic to our position.

Mr. NEAL. Part of what you are hearing today is the tension that exists between the Legislative Branch of government and the Executive Branch, and as you know, the Framers intended that we would respond more quickly than the executive branch to concerns that we hear, but the frequency with which we receive these complaints is very important. I think that as we pass them on to you, it was pretty clear today that we would like some action. And as the next panel arrives we are going to have a chance to talk to them about medical devices as well.

But where I live, Ms. Cutler, these are substantial issues. The whole question, as Mr. Cardin, I think, accurately depicted of the notion of free trade, where we are constantly on our side asked to take that leap of faith—and most of us frequently do, incidentally—oftentimes the reward for it is to run up against these sort of obstacles which make it in the end much more difficult for us to convince our own constituents of the merits and worthiness of free trade.

Thank you, Mr. Chairman.

Mr. SHAW. Mr. Camp?

Mr. CAMP. Thank you, Mr. Chairman.

I guess I will address my remarks to the entire panel, but as I listen to this testimony, I agree with all that I have heard my colleagues say. I don't think the lack of progress have been for lack of trying, and it doesn't seem as though we have a government that is responsive to the numerous negotiations that we have put forward. I look at my State of Michigan and I look at autos and auto parts, and it seems as if we have gone backward. The bilateral agreement expired in 2000, where the Japanese had agreed to change the regulations that discourage the import of U.S. made cars and parts, and that agreement expired. There has been no negotiation of that. They have overly restrictive regulations. They



lack transparency. They have a unique and complex set of rules for certifying foreign automobiles in that country, which just doesn't stand public scrutiny.

I look to the areas of beef, which we have heard discussed. There is a lot of beef in Michigan, and apples particularly, where I don't know that they are allowing imports yet, even though the WTO has ruled decisively in our favor. Before the WTO ruling, the Japanese failed to even meet with or respond to us for 3 years.

It seems to me as though they are using rules, regulations and sanitary and phytosanitary standards as trade barriers and restrictive trade practices, and I for one would like to hear your comments on the general merits of these agricultural standards in Japan, and any comments you might have on how we can make improvement, because we have not seemed to move forward in the channels that you have all been working on for so many years. Those have not been successful.

While incremental progress is being made, we are in an era where that just isn't good enough. I think to compare back to 15 years ago, the world has changed in 15 years, and we really need to see quicker progress, more substantial progress in all of these areas, whether it be auto, auto parts, beef, apples, agricultural products, insurance products. This is significant. We would hope to have a productive trading relationship with the Japanese, but I wonder if that is really being called into question, and it might even be in something that we should seriously act.

So, I would be interested in any one who would care to comment. Yes?

Mr. KAWAMURA. Congressman Camp and Committee Members, I think it would be fair to mention that in the course of 10, 15 years a lot has changed in the way the world operates, and in the area of agriculture certainly we have seen world class competitors come out of countries that we never thought 15 years ago would be competing in our arenas of agricultural products. In the arena of beef, we certainly are alarmed and concerned at the lack of progress in that arena, but at the same time the fact that there is another country that has an adequate supply of beef that can quickly be a replaceable supplier of our U.S. product line makes us all take pause as how we look at the future of U.S. agriculture.

And as I look at these Members here in this Committee and all the different Committees within Congress, about our future in agriculture, one of the things that I would encourage all of us to think long and hard about is, is that future—are we just replaceable suppliers in this Nation, or are we part of the resource base, if you will, are we part of the environment?

So, with that, I think where we need to help—two things—understand in this difficult trade arena, in this international globalization of how things move around the world, we recognize that there are winners and losers, sometimes for no reason of our own.

Mr. CAMP. I am about ready to lose my time. I appreciate your comment.

Mr. KAWAMURA. Sorry about that.

Mr. CAMP. I don't think we are afraid of competition, but we are afraid of competition from people who don't follow the rules, who

create false sanitary and phytosanitary standards, and are even reluctant to explain the rationale for these rules and standards.

So, I guess my message is, I don't think we have done enough, whether it be in the Trade Office or Agriculture or Treasury, or the State Department. We need to do more. And I think we need to hammer hard and not just sit back and say, well, let us have another meeting. We haven't made enough progress in any of the areas I mentioned, and I would like to see all of you go back—I don't necessarily fault all of you. Clearly, we are not negotiating with somebody who is coming to the table in good faith. So, I think we need to change tactics and do everything we can to move forward.

Thank you, Mr. Chairman.

Chairman THOMAS. [Presiding] Thank the gentleman.

The Chair will announce that—with apologies to the other Members—that the Chair will dismiss this panel. Thank you very much.

Any Member may submit questions in written form to expect a response in written form. And the Chair will indicate to those individuals who are to comprise the second panel, that the Committee will recess to the call of the Chair, and the Chair anticipates, if at all possible, that the Committee will reconvene within the hour.

The Committee stands in recess.

[Whereupon, at 2:55 p.m., the Committee recessed, to reconvene at the call of the Chair.]

Mr. SHAW. [Presiding.] If the guests would take their seats. To the second panel, my apologies, but there has been a lot of things going on outside of this room that have required our presence.

The second panel right now is the Honorable Governor Frank Keating, who is President of the American Council of Life Insurers; Michael A. Mussallem, chief executive officer, Edwards Lifesciences Corp.; Jim McAdams, President of the National Cattlemen's Beef Association. You are going to have to help me. I was introduced to you earlier, but I am having problems.

Mr. MOHATAREM. Mustafa Mohatarem.

Mr. SHAW. Yes. He is Chief Economist for General Motors in Detroit; and Deborah Howard, who is President of Japan Market Resource Network, Tokyo, Japan, and she is here on behalf of the American Chamber of Commerce in Japan.

Welcome, all of you. As is our custom, your entire statement is made a part of the record, and you may proceed as you see fit. Governor?

**STATEMENT OF HON. FRANK KEATING, PRESIDENT,  
AMERICAN COUNCIL OF LIFE INSURERS**

Mr. KEATING. Chairman Shaw and Congressman Levin, thank you for the opportunity for us to be able to appear before you. I have two studies that are referenced in my formal testimony that has been made a part of the record. I would appreciate it if those two studies could be made a part of the record as well.

I represent the American Council of Life Insurers, as you have noted, Mr. Shaw, which represents some 400 life insurance companies in the United States. A number of our companies do business in Japan. Those businesses are significant to the companies involved. As has been referenced, some \$38 billion in premium in-

come has been provided to those companies as a result of product sales in Japan.

We have been successful in moving our market share from some 3, 4 percent of the market to over 15 percent of the market. We think a competitive opportunity for us good for the people of Japan, it is good for the consumers and policy holders of Japan, because it gives them more product at less cost.

I was there in late January and early February and spoke to a number of Members of the Diet as well as ministerial officials about the postal privatization initiative of Prime Minister Koizumi. We did not take a position for or against privatization. That is a decision of the Japanese people. But it is very important, consistent with GATS. The market does require, the statute does require that national treatment be afforded our companies as well as the Japanese companies that are doing business in that country.

We are very concerned because the conduct that we have observed has been violative of GATS. It is the position of our British friends, it is the position of our Canadian friends, it is certainly the position of the life insurance companies that I represent that the conduct of the Japanese government with respect to Kampo's size and weight and breadth and bulk and conduct is violative of their GATS agreements.

Why is that? Well, because, as has been noted, they don't pay taxes. They are not under FSA regulation as we are. They enjoy the full faith and credit of the Japanese government, something obviously we do not do. And they don't have to pay into a policy holder protection fund in the event of insolvency or some other risk event. That gives them an enormous advantage. They are some 40 percent of the Japanese market.

Now, during the course of the privatization, we are concerned about two things:

First, that there will be partial privatization, and that is not good. We think consistent with the law, which is being drafted, that there should be full privatization and during that privatization period that there be no new or modified products introduced to the Japanese public to put us at a further competitive disadvantage and further violate the GATS agreement.

Second, we are very concerned about transparency, that the structure that will be constructed around this privatization model will not be such that we cannot and other competitors cannot see what is going on so that there cannot be the opportunity of sending money from one ailing part of the ship to another.

So, we have worked very closely with the USTR. I want to say that the Trade Rep has been very good, Wendy and her staff, as well as the senior officials, Mr. Portman, and before him Mr. Zoellick. They have been very helpful. The same thing with the Department of Commerce, the same thing with the Department of State. They have been our advocates and friends. But this is a devil-in-the-details moment.

So, we would hope that the Committee—the comments made from both the minority and the majority we embrace. We think that this is a very concerning time during the transition process. We want to see a successful and a competitive marketplace, which

means no new or modified products introduced to the Japanese market until such time as privatization is complete.

As has been noted, in 2004, there was a product introduced, in spite of our objections, in spite of the objections of our government, and that product now is 10 percent of Kampo's sales. So, we are very concerned about that, and we congratulate the Committee on its vigilance, and we hope that our government will continue to be vigilant during the course of this process.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Keating follows:]

**Statement of The Honorable Frank Keating, President, American Council of Life Insurers**

Reform of Japan Post's Insurance Business

Mr. Chairman, Members of the Committee, Ladies and Gentlemen:

My name is Frank Keating, President and Chief Executive Officer of the American Council of Life Insurers (ACLI). I speak today on behalf of many of our members who have operations in Japan's vibrant life insurance marketplace. We welcome this opportunity to briefly discuss with you our observations and concerns with regard to implementation of the privatization of Japan Post, and in particular, its life insurance arm, *Kampo*, which is the largest life insurer in the world.

Mr. Chairman, it might be useful for the Committee to focus briefly on the importance of the U.S. presence in Japan's life insurance marketplace. That presence has grown over more than three decades from a very small toehold in an otherwise closed market to 15% of what is now a far more open market. To put it into perspective, U.S. pharmaceuticals account for sales in Japan of slightly over \$14 billion annually. The U.S. medical devices export market to Japan is just over \$3 billion annually. Beef exports to Japan from the United States are approximately \$1.5 billion annually. By contrast, U.S. life insurers account for \$38 billion annually in policy premiums in Japan. *This is truly an American success story.*

This success has not come easily. There is a long history of trade friction and negotiations with Japan regarding the conditions of competition in its life insurance marketplace. Year after year, through successive U.S. administrations, USTR has urged Japan to "level the playing field" so as to counteract *Kampo's* looming presence. *Kampo* was originally established in 1916 to provide life insurance to consumers who could not acquire insurance from private suppliers. The private sector can now fully meet all consumers' insurance needs and the original reason for *Kampo's* existence is long gone. However, despite regulatory constraints competition from this government insurance entity has weakened and impeded the development of Japan's private insurance industry.

In the 1990's, there were two bilateral agreements that were in part designed to set forth the limits of *Kampo's* ability to market commercially competitive products given its special government-provided advantages. There were later discussions concerning the pace and conditions of opening up all sectors of the market pursuant to those agreements. The U.S. expressed a high level of concern in late 2003 about a product *Kampo* planned to market which appeared to require Diet approval under the bilateral agreements. Before discussions could be completed Japan Post went ahead and issued a new product in direct competition with private insurers. Also during this period, U.S. companies were faced with extremely high contribution requirements to the Life Insurance Policyholder Protection Fund (LIPPC) caused by the failures of several domestic Japanese insurers. *Kampo* is not required to make such payments, and questions persist about the level of exposure it may impose on current private sector contributors should it be made subject to the LIPPC. Despite these hurdles, some of which continue as problems, U.S. companies have introduced innovative products in Japan, and Japanese consumers have responded with extraordinary enthusiasm. We have made significant gains in market share. U.S. insurance suppliers are also admired in Japan for their stability and soundness.

In March of 2004, ACLI issued a comprehensive study of *Japan's Expanding Postal Life Insurance Business*, which outlined in detail *Kampo's* inconsistencies with the GATS and its impact on the goals of Japanese economic reform. The study pointed out several policy concerns regarding the continuation of *Kampo's* preferred position:

- It undermines economic reform efforts.
- It is inconsistent with longstanding bilateral understandings.

- It is inconsistent with Japan's commitment to Article XVII of the GATS, providing that *"each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favorable than it accords to its own like services suppliers."*

Despite having some restrictions on what products it can offer, *Kampo*, the insurance arm of Japan Post, has captured 40% of the marketplace. It pays no taxes, contributes nothing to policyholder protection funds, enjoys separate and more lenient regulation and oversight, and receives full, unique government guarantees for all of its products. These many government-provided benefits have greatly contributed to the growth of *Kampo*, and its unprecedented size is itself an advantage. *The continuation of these advantages over the years, in the face of repeated U.S. and other nations' entreaties to remedy the situation, calls into question Japan's commitment to the GATS.*

ACLI's study addressed Japan's assertion that it could offer *Kampo* preferential treatment "in the exercise of governmental authority" (using the GATS definition to show that the term does not apply to *Kampo's* operations); rebutted the notion that because other Japanese suppliers were equally disadvantaged "national treatment" does not apply (under GATS only one preferred domestic supplier [*Kampo*] is necessary to trigger a violation); rebutted the alleged need to demonstrate "adverse effects" in order to establish a national treatment violation; successfully rejected the notion that Japan's "intention to discriminate" was relevant; and characterized *Kampo's* special privileges, which led to the erosion of the private insurance sector, as "anti-prudential." ACLI is submitting the study to this Committee with a request that it be made part of the record of this proceeding. The prospect of postal privatization, which requires revision of existing legislation with respect to Japan Post, offers an opportunity for Japan to bring itself into conformity with its national treatment commitments under GATS.

As you know, the matter of privatization of Japan Post was the central reason for the recent elections in Japan. Those elections resulted in a resounding mandate to Prime Minister Koizumi to follow through on his privatization initiative. Key for U.S. companies in Japan is the fact that privatization legislation will *at some point* clear the way for Japan Post to sell products it is now not permitted to market. Now that it is clear that postal privatization will go forward, it is vital that U.S. market participants be reassured that Japan will comply with its international trade obligations *before* new or modified postal insurance products are introduced. It is also *required* by the General Agreement on Trade in Services (the "GATS").

Prime Minister Koizumi should be complimented on attempting reforms of Japan Post—an entity that clearly impacts the whole of Japan's economy. ACLI recognizes the enormous challenge that the Prime Minister and his government have accepted in tackling postal reform, and view the reform process as a vehicle for Japan to "level the playing field", and thereby bring itself into compliance with its national treatment commitments.

**However, a partial or incomplete "reform" of Kampo should not be allowed to deprive U.S. and other foreign market participants of the market presence they have worked so hard to develop in Japan.**

How could that happen? Japan Post employs 280,000 people and has thousands of post office outlets for the exclusive sales of its products throughout Japan. In terms of its distribution capacity, it dwarfs Japan's next largest life insurers, as well as the several American companies operating in this market. *Our fundamental concern is the prospect of an "incomplete privatization" under which the postal insurance corporation would retain some of its special privileges (including the benefits of its unprecedented size) but at the same time would enjoy greatly enhanced freedom to compete (offer new products) with the private sector.* Unleashing *Kampo's* enormous size and any retained government privileges would jeopardize the market developed by sustained innovative effort by U.S. companies.

**It is the very real prospect of sanctioned, unbalanced, competition that makes Japan Post privatization the number one trade issue for our association.**

In the wake of its recent election Japan is about to pass postal privatization legislation which *may* require *Kampo* to pay taxes, operate under the same regulations and regulators as its competitors, make contributions to a policyholder protection fund, and drop its government guarantees from products to be issued in the future. While this sounds positive, the problem is that it could take up to 10 years under the legislation to achieve those objectives, if in fact they are achieved. At present, it is not clear under the legislation whether during this potentially long interval *Kampo's* successor will be permitted to sell products that compete with U.S. and

other companies' offerings *before a level playing field is achieved*. If it is prematurely granted that ability (referred to often as "management freedom"), while still enjoying some form of advantages, the result could be serious damage to the \$38 billion level of premiums generated annually by U.S. life insurers in Japan.

An excellent monograph on this subject was prepared by the Privatization Task Force of the American Chamber of Commerce in Japan (ACCJ) in August of 2004. *Applying Privatization Global Best Practices to Japan Post* looks comprehensively at establishing an effective regulatory framework, providing transparency, and appropriate government oversight and concludes that it is within Japan's power to successfully employ the best experiences of other countries that have made similar efforts to privatize. Again, we are submitting this White Paper to the Committee with a request that it be made part of the record.

The U.S. government agencies involved in this matter have been persistent in their efforts to persuade Japan's government to "do the right thing" with respect to GATS. "Doing the right thing", which means achieving a market regime consistent with GATS requirements, would also better ensure the soundness of Japan's insurance market and financial system. We are grateful for the efforts of the Office of the United States Trade Representative, which has been untiring in its efforts, the Departments of State, Treasury and Commerce, the U.S. Embassy in Tokyo, and others in the federal government—including numerous members of this Committee—for the continuing concern you have shown our industry regarding this issue.

This is not a partisan issue, or even a U.S.-national issue. It is a *fundamental* trade policy issue. At its core it asks the question whether one of the United States' best trading partners will live up to its international trade commitments. This is an issue that the whole world is watching given the high profile privatization in Japan has achieved. Several of its major trading partners have asked Japan to comply with its GATS obligations. The industry association of the European Union, Canada and others have taken positions similar to ours, as has the Life Insurance Association of Japan (LIAJ). Other countries, going through or considering similar privatization initiatives, are carefully watching what Japan will do and what the trade community will accept. We believe we all have a stake in the outcome.

We believe it is key that Japan make a commitment on this. Representatives of USTR have been negotiating on the issues in the context of the language of the annual Report to Leaders. The Report provides Japan with the opportunity to achieve a mutual understanding—the ball is certainly in their court to demonstrate their intentions.

We view the timing of the introduction of any further new or modified postal products and the requirement of an open, transparent process to evaluate the activities of the new Japan Post as *fundamental* issues. The timing of new products must be appropriate to avoid unfairness. Transparency in financial reporting and public disclosure by all of the postal businesses must also occur, since without a clear picture of the industry giant and its internal operations our industry, and our government will be greatly limited in efforts to articulate what is happening in the marketplace.

*Perhaps U.S. insurers would be less concerned had Japan not introduced a new postal life insurance product in 2004 over the strong objections of the U.S. government and in violation of existing bilateral commitments to the United States. That product competes directly with U.S. companies' products and has secured unusually impressive sales since its introduction.*

*We feel a sense of urgency in this regard since executives of Japan Post have recently stated that it must, in order to survive, soon begin selling the kinds of products our companies have developed. Indeed, there are very recent press reports that top Japanese government officials may have already made commitments on early "management freedom" to the leadership of Japan Post.*

**Mr. Chairman, we welcome competition, but it must be fairly premised.**

Our request to you Mr. Chairman, and to the rest of the Committee on Ways & Means, is to assist us and the rest of our government in making sure that Japan does not, by accident or by design, seriously harm what has become a real "American Success Story", and that it abide by its international trade commitments. We pledge to keep you informed to the best of our ability.

Mr. Chairman, let me again thank you and those members of the Committee on Ways & Means who have assisted us thus far in this very important effort. We look forward to your continued interest and involvement, and we thank you for permitting us to testify today.

**STATEMENT OF MICHAEL A. MUSSALLEM, CHAIRMAN AND  
CHIEF EXECUTIVE OFFICER, EDWARDS LIFESCIENCES  
CORP., IRVINE, CALIFORNIA, AND CHAIRMAN OF THE INTER-  
NATIONAL BOARD COMMITTEE, ADVANCED MEDICAL TECH-  
NOLOGY ASSOCIATION**

Mr. MUSSALLEM. Hello, I am Mike Mussallem. I am the Chairman and chief executive officer of Edwards Lifesciences, and today I am here as the Chairman of the International Committee of AdvaMed, our trade association.

By way of background, AdvaMed represents over 1,300 medical technology companies that manufacture medical devices, diagnostic products, and medical information systems. And our products save and improve lives and enhance economic productivity by allowing workers to recover from illnesses faster, remain longer in the work force, and live without costly long-term care. A recent study indicated that for every dollar that America invests in medical technology, the returns are between \$2 and \$3 in real health gains.

Now, to deliver these high-quality and innovative products, we invest heavily in R&D. As a matter of fact, we invest 11 percent of our sales in R&D, which is about 3 times the U.S. industry average. And within AdvaMed, our Members manufacture nearly 90 percent of the \$90 billion of U.S. health care technology and about half of the \$220 billion global market. In 2004, U.S. exports in medical devices and diagnostics totaled over \$24 billion. In terms of work force, the medical technology industry employs nearly 350,000 workers across the United States.

Now, regarding today's hearing, AdvaMed and its Members would like to thank the Committee for drawing attention to the U.S.-Japan trade relations. Japan is our industry's largest overseas market, and the obstacles that we face there are coming more onerous every year. And let me provide you a little background on that.

Japan's system for approving the use of new medical technologies is the slowest and the costliest in the world. As a result, the medical technologies that Japanese patients receive are several generations behind those available in the U.S. and Europe, and even developing countries like China and India and Thailand and Mexico.

Japan is compounding the problem with even more burdensome and costlier regulations. In addition to the customary regulatory expenses, Japan recently enacted new regulations that will cost our industry about \$1.5 billion over the next few years. And at the same time that it raises our regulatory costs, Japan is cutting reimbursement for medical technologies. Between April of 2002 and May of 2006, total revenues lost from recently enacted reimbursement cuts will be about \$3 billion.

In terms of how these payment reductions are made, Japan issues price cuts every 2 years, actually in two different ways: One is it surveys its hospitals and reduces reimbursement to reflect the pricing hospitals are paying for all medical technologies. At least this approach is based on conditions in Japan. Second, since 2002, Japan has also begun using a foreign average price, or FAP process, to cut prices for selected devices. Now, FAP aims to base reimbursements on average prices paid for medical technologies in the U.S., France, Germany, and the U.K. And under this model, they base technology prices not on the expensive Japanese market but

on the unrelated conditions in foreign markets. And we have a very strong objection to FAP. Japan's market is vastly different and it is much more expensive than the other four countries that they use to compute the FAP, and the products that we sell there are not the same products that we see in the U.S. and Europe, and the terms and conditions are different.

In addition, the three European countries impose relatively low price ceilings or price controls on the medical technologies, which further distorts the prices. So, from our perspective, Japan appears to be seeking ever lower prices for American medical technologies, in part to avoid correcting the massive inefficiencies in the health care system, such as long hospital stays. As you may know, Japanese patients stay in hospitals 5 times longer than other developed countries, which really drives up costs.

And while changes in other areas might have real impact on Japanese health care spending, the threatened cuts in our industry actually would have no perceptible effect of really impacting total health expenditures. Our medical devices account for only 8 percent of their total health spending, and the targeted products actually account for less than 1 percent.

And while we believe that payment reductions for our technologies will not help solve the underlying problem, it also seems inappropriate that virtually all of the technologies targeted for cuts are produced by non-Japanese companies. In general, we believe payment reductions to medical technology are counterproductive to Japan's goals, as studies show that investing in health care reduces long-term health care costs. And our products will actually become part of the solution as their population gets older.

We have recommendations to help address these issues. With respect to the regulatory environment, we ask the Japanese government to simplify and speed the approval processes while they continue to ensure that products are safe and effective. And regarding reimbursement, we seek a fair, transparent, and predictable system based on operating conditions and the costs of doing business in Japan.

As an industry, we seek to work with the Japanese Government on a system that would limit the size of the price reductions in any given year and allow us to build such cuts into our long-term planning.

Thank you again for inviting us to raise these issues. We hope that you will continue to recognize the important role that our industry plays in improving and extending patients' lives, and we hope you will work with us to ensure the continued access to foreign markets. As you may know, the engagement of the Congress and the administration is critical to maintaining our exports into this important market. So, thank you again.

[The prepared statement of Mr. Mussallem follows:]

**Statement of Michael A. Mussallem, Chief Executive Officer, Edwards Lifesciences Corporation, Irvine, CA, and Chairman of the International Board Committee, Advanced Medical Technology Association**

AdvaMed and its member companies would like to thank the Chairman, Ranking Member, and Members of the Committee for holding this timely and important hearing today. Japan is our industry's largest overseas market, second only to the United States. We applaud the Committee for recognizing Japan's continued impor-



tance in the global economy, world trade, and U.S. foreign trade. We also greatly appreciate the work Executive Branch agencies have done on our industry's behalf.

### **The Medical Technology Industry**

AdvaMed represents over 1300 of the world's leading medical technology innovators and manufacturers of medical devices, diagnostic products and medical information systems. AdvaMed is proud to represent an industry that brings new hope to patients around the world, and U.S. companies are still benchmark manufacturing leaders in terms of total production, innovation and highest quality products. Our member companies manufacture nearly 90% of the \$94 billion U.S. health care technology market, and nearly 50% of the \$220 billion of medical technology products that are purchased globally each year. In 2004, U.S. exports in medical devices and diagnostics totaled over \$24 billion. The medical technology industry directly employs about 350,000 workers in the U.S.

Our industry is fueled by intensive competition and the innovative energy, driving very rapid innovation cycles that in many cases can lead to new product iterations every 18 months. About 70% of AdvaMed's membership is comprised of small and medium sized enterprises. Accordingly, our industry is most successful in fair, transparent, global markets where products can be adopted in a timely fashion and on their merits.

Innovative medical technology saves and enhances peoples' lives. Our products enrich patients' productivity and quality of life, thereby improving living standards and benefiting society overall.

Medical technology also contributes substantially to economic growth. Our products increase productivity by allowing workers to recover from illness faster, remain longer in the workforce, and thrive without expensive long-term care. Studies show that funds invested in health care yield far greater benefits than costs to a nation's economy over the long term.

The use of medical technology will become even more important as a nation's population ages. According to the 2002 Commission on Global Aging, medical advances will bring "longer, healthier, more productive lives with declining rates of disability for the elderly." Innovative medical technologies offer an important solution for nations that face the challenges of balancing serious budget constraints and the demands of serving aging populations.

To deliver this value to patients, our industry invests heavily in research and development (R&D). Today, our industry leads global medical technology R&D, both in terms of innovation as well as investment. The level of R&D spending in the medical devices and diagnostic industry, as a percent of sales, more than doubled during the 1990s—increasing from 5.4% in 1990 to 8.4% in 1995 and over 11% last year. In absolute terms, R&D spending has increased 20% on a cumulative annual basis since 1990. Our industry's level of spending on R&D is more than three times the overall U.S. average.

### **Global Challenges**

Despite the great advances the medical technology industry has made in improving patient quality of life and delivering considerable value for its innovations, patient access to critical medical technology advances can be hindered by onerous government policies. Patients and health care systems experience much less benefit from our industry's R&D investment when regulatory procedures are complex, non-transparent, or overly burdensome—all of which can significantly delay patient access and drive up costs. In the future, patients will be further disadvantaged if reimbursement systems fail to provide appropriate payments for innovative products—which will subsequently affect the availability of R&D funds and the stream of new technologies.

The medical technology industry is facing these challenges around the world as governments enact more regulations. While we support those regulations that ensure product safety and efficacy, many others are being imposed without scientific justification, and in non-transparent processes, which only adds to costs and delays without improving patient outcomes.

As governments prioritize difficult budget decisions, they sometimes look to short-term decreases in health care expenditures without accurately assessing the long-term implications. In most cases, governments do not effectively measure the contributions medical technology makes in enhancing patient outcomes and productivity as well as expanding economic growth, which would more than offset the costs of providing these products. Instead, governments often inappropriately include reduced reimbursement rates as part of overall budget cuts.

### The Challenge in Japan

This is the situation we are facing in Japan, and it is getting more difficult every year. Japan's system for approving use of new medical technologies is the slowest and most costly in the developed world. Although Japan is one of the wealthiest countries in the world—the second largest economy in the world—its spending on health care is among the lowest of major developed countries. On a *per capita* basis, Japan's spending of 7.8% of GDP is lower than 17 other Organization of Economic Cooperation and Development (OECD) member countries.

Japan is compounding the problem by imposing more burdensome and costlier regulations, thereby penalizing the U.S. medical technology industry. Japan's latest regulations are expected to cost our industry over \$1.5 billion just to achieve compliance to 2010.<sup>1</sup>

At the same time, Japan has made significant reimbursement reductions for medical technologies that impact the medical device industry in many ways, including limiting the availability of funds that could be devoted to R&D of new and innovative products. Inventing products that save and enhance lives requires large investments. Deep cuts for medical technologies in Japan have put downward pressure on companies' ability to invest in R&D. For the period April 2002 to March 2006, the total revenue loss from these reimbursement reductions is expected to be about \$3 billion—a significant share of which would have gone toward R&D.<sup>2</sup>

Japan appears to be making these changes, in part, as a way to avoid correcting the existing inefficiencies in its health care delivery system. Yet, because of its country's practices, Japanese patients often must wait two, three, or even five years longer for access to technologies that are already available in most other countries. Japanese patients are being denied access to our most advanced medical technologies.

### An Inefficient Health Care System in Japan

Japan's hospitalization practices are the major contributor to high healthcare expenditures in Japan, with patients staying five to six times longer in hospitals than in other developed countries. For example, the average hospital length of stay in the U.S. is 6 days compared to 37 days in Japan, and these additional days clearly escalate the cost of care without significantly contributing to the quality of patient care. Japanese doctors own the hospitals in Japan, so there appears to be little incentive to diminish costs by better managing hospital stays.

The monetary cost of the inefficiencies of this system is huge. Japan's MHLW has estimated that excessively long hospital stays alone inflate annual costs by at least \$20 billion. This figure was found by comparing the average length of stay for Japan in total to a "best practice" length of stay in its most efficient district—leading to a reduction of stay length to 28 days. Using this same methodology, we estimate that Japan could save over \$68 billion by bringing its hospitalization lengths of stay down to the average in other developed countries (7.3 days) and \$71 billion if Japan reduced its hospitalization durations to the U.S. average of 6 days.

In addition, Japan has the highest ratio of beds to population of any of the 30 OECD nations and four times the number of hospital beds per person than in the U.S., which increases costs and reduces efficiency in several ways. First, Japan maintains many hospitals that would otherwise be closed. While we are sensitive to cultural differences between Japan and the U.S. or Europe, even the country's own Ministry of Health, Labor and Welfare (MHLW) has recognized that the current number of beds is excessive.

Second, Japan's diffuse hospital settings prevent the cost savings offered by specialized centers. A source of savings in specialized centers is the enhanced expertise doctors achieve when performing specific operations many times. The Japanese system limits the opportunities for Japan's health care professionals to develop optimal skills for performing complex medical procedures. Doctors who implant only a few devices each year would not receive as much training to perfect their skills as doctors practicing in specialized surgical hospitals, where a doctor might perform several implants (such as pacemakers) on a daily basis.

<sup>1</sup>Treasury's methodology was confirmed by the GAO in an April 2005 Report (GAO-05-351). The GAO concluded in the Highlights section of the report that "Treasury has generally complied with the reporting requirements for its exchange rate reports—" On page 13 of the report, GAO stated "Treasury did not find that Japan was manipulating its currency in 2003 and 2004. Treasury officials told us that they viewed Japan's interventions as a part of macroeconomic policy aimed at combating deflation in Japan and they expressed skepticism about the efficacy of intervention to affect the yen's value."

<sup>2</sup>An Assessment of the Impact of Japanese Foreign Exchange Intervention: 1991-2004, by Alain P. Chaboud and Owen F. Humpage, Board of Governors of the Federal Reserve System, International Finance Discussion Papers, Number 824, January 2005.

Unquestionably, this system substantially drives up costs for our industry. Since clinicians in Japan are often less familiar with the technical specifications and use of our products, service costs—including physician training and assistance during procedures—are much higher for industry. Medical technology products are often handled by two or more layers of distributors in Japan, each adding their own mark-up or margin. In comparison, the vast majority of medical technologies in the U.S. are sold directly without distributors.

#### **A Slow Regulatory Process for Medical Devices in Japan**

In addition to the overall inefficiencies of its health care system, Japan's new technology approval process remains the slowest and most costly in the developed world. Even after creating a new agency last year to process applications for medical technology products, Japan had a backlog in February of over 491 applications filed before April 2004. When new applications are included, the backlog is reportedly much longer. A problem for this new agency is the number of staff reviewing applications for approval of medical technology products—about 40 officials, compared to over 700 in the U.S. Due to the long approval process, the medical technologies patients receive in Japan are often several generations behind the products in the U.S., Europe, and even developing countries like China, India and Thailand. Lengthy approvals also translate to higher costs for the U.S. medical technology industry, which must maintain out-of-date product lines just for Japan.

Japan should be examining ways to streamline its regulatory system, achieving greater efficiencies and facilitating patient access to the most advanced technologies available. We have made such suggestions to the Regulatory Reform Council, established by Prime Minister Koizumi, on some changes. We also have been working with MHLW officials and are willing to continue doing so.

So far, however, instead of facilitating patient access to medical technology, Japan has been compounding the problem by imposing more burdensome and costlier regulations that discourage innovation. Its revised Pharmaceuticals Affair Law (PAL), which covers medical technology products, went into effect on April 1, 2005. Even our largest companies are experiencing difficulties meeting PAL's complicated provisions. Some of our smaller companies have indicated they may have to exit the Japanese market because of PAL requirements. The initial and on-going costs of \$1.5 billion through 2010 are monies that otherwise could have been invested in furthering innovation for patients who need it most.

#### **Continued Reduction in Reimbursements for Medical Devices in Japan**

At the same time our industry is facing these onerous and costly regulations, MHLW is threatening severe reimbursement rate cuts. In Japan, the government sets the maximum reimbursement rates, which usually act as ceiling prices for all medical technology products. These prices are reviewed and usually reduced every two years.

Before 2002, Japan adjusted prices according to a process it called “reasonable-zone” or “R-zone.” In brief, MHLW surveys its hospitals for prices paid to distributors, and allows for a reasonable margin (or “zone”) for discounts off of the government's reimbursement rate. While there are some difficulties with this system—as identified in bilateral Market-Oriented, Sector Specific (MOSS) negotiations between the U.S. and Japanese governments—our industry recognizes that it is at least based on factors in the Japanese market.

In 2002, however, Japan also adopted a system called Foreign Average Pricing (FAP). This system calls for the establishment and revision of reimbursement rates on the basis of prices paid for medical technology products in the U.S., France, Germany, and the United Kingdom (U.K). The prices of medical technology products in Japan are designed to be based not on that market's requirements, but on completely unrelated conditions in foreign markets.

The U.S. medical technology industry has several strong objections to this method of calculating reimbursement rates.

- As a methodology for setting reimbursement rates, it is not economically sound to compare prices in foreign markets that operate under vastly different conditions. Japan's regulatory system is far costlier to comply with than European or U.S. regulations. In addition, the overall cost of doing business in Japan is far higher than in the U.S. or Europe. Just in terms of basic cost of living, Tokyo is ranked the most expensive city in the world, with Osaka number 2. Tokyo is about twice as costly in general as New York City and about 2.5 times

as expensive as a mid-western city, like Minneapolis. No U.S. city is in the top 20 cities on this list.<sup>3</sup>

- Operating in Japan compounds costs by our industry compared to selling in other countries. For example, the added expenditures for product redesign, development, distribution, research and marketing all increase the cost of supplying Japanese patients by hundreds of millions of dollars each year.
- Conditions in the three European countries included in the FAP analysis are different from both the U.S. and Japan. The European Union member states use a product approval system that, in many cases, is more streamlined than the U.S. process. However, France, Germany and the U.K. also maintain pricing interventions that place a ceiling on medical technology pricing.
- Comparing prices even within markets—let alone across national boundaries—is difficult. Our member companies sell products under a variety of terms and conditions. In the U.S., our companies can often offer lower prices to buyers willing to commit to much larger volumes for longer periods of time, but Japan does not have such buyers and offers minimal channels for efficient selling and distribution of medical technologies. Additionally, Japan's FAP system is an attempt to compare prices for products that are not the same in Japan as they are in other countries. Due to Japan's regulatory delays, U.S. manufacturers must incur the cost of maintaining older or outmoded production lines for sale in Japan.
- Japan established its FAP system and continues its plans to cut reimbursement rates because of the "perception" that prices for certain medical technology products are much higher in Japan than in other countries. As previously noted, there are many reasons prices are higher in Japan than in other countries. In addition, Japanese doctors and others in Japan, often obtain this perception by comparing U.S. hospital purchase prices to the official Japanese reimbursement rates, which are usually higher than the prices medical technology products are sold in Japan.
- As previously mentioned, the net effect of Japan's reimbursement rate cuts could have a detrimental effect on the funds available for research and development (R&D) of innovative products that are intended to lessen the time, pain and expense of treatments for a wide range of illnesses.

Ironically, Japan's planned reimbursement decreases are likely to have no perceptible effect on moderating Japan's health care budgetary expenditures. While some of the other practices mentioned in this testimony are very inefficient and obvious drivers of inflation of Japan's health care costs, medical technology products account for only about 8% of Japan's total health care spending, and products targeted for price cuts represent less than 0.7% of all health care expenses. Virtually all technologies targeted for these cuts are made by non-Japanese companies.

Instead of trying to balance its budget on the backs of the medical technology industry, Japan should look to major reforms of its inefficient hospital system. Such reforms would provide huge savings and would be good for Japanese patients and for Japan's economy.

#### **U.S. Government Support**

The U.S. Government has provided our industry with tremendous support in trying to convey this message to the Japanese government. We have enjoyed bipartisan Congressional support, with these hearings serving as just the most recent manifestation of that support.

Our industry has also benefited from continuous support from the Executive Branch. We want to thank the Departments of Commerce, State and Treasury, the Office of the U.S. Trade Representative (USTR), and the U.S. Embassy in Tokyo for their hard work on our behalf. Since the mid-1980s, Executive Branch agencies have included regulatory and reimbursement issues in the MOSS negotiations. More recently, these issues have also been a topic for high-level USTR-Commerce negotiations with Japan under the Regulatory Reform Initiative.

We believe that U.S. government support has been a major reason that total U.S. medical technology exports have flourished world-wide for many years, exceeding imports. In fact, this past year was the first time that total U.S. imports of \$25.2 billion ever exceeded exports in the medical technology sector.

<sup>3</sup>The yen behavior in 2003 and 2004 is especially interesting because the Japanese Ministry of Finance reports that interventions by the Bank of Japan in 2000 amounted to 1,528.9 billion yen; 3,210.7 billion in 2001; 4,016.2 billion in 2002; 20,425 billion in 2003; and the final intervention was 14,831.4 billion in the first quarter of 2004. Thus, despite the largest intervention over this period, the yen went strongly in the opposite direction.

While U.S. exports of medical technology have enjoyed a surplus with Japan, we see disturbing signs that this too could change. During the 1980s and 1990s, our industry's exports rose steadily. Since Japan introduced its FAP system in 2002, U.S. exports have basically stagnated at essentially the same level of exports in 2004 as in 2001. At the same time, Japan's exports of medical technology products in 2004 rose by 10%, contributing modestly to Japan's burgeoning total trade surplus with the U.S. of \$75 billion—an increase of 14% last year. With added regulatory hurdles and reimbursement reductions, U.S. exports to Japan could deteriorate further.

The World Trade Organization (WTO) recognizes that standards and regulations can be non-tariff barriers (NTBs). While we are not alleging a WTO violation, we do believe that Japanese policies are essentially creating new NTBs for our industry to try to overcome.

### **Recommendations**

We have several recommendations to help ameliorate the situation in Japan and, at the same time, facilitate patient access to advanced medical technology products. AdvaMed members want to cooperate with the Government of Japan to find solutions that are mutually beneficial to patients, Japan, and our industry. We have met frequently with officials from MHLW and other government agencies, including at senior levels, to seek such solutions. We respectfully request that such solutions be based on actual operating conditions in Japan and not on circumstances in other countries.

In terms of the regulatory environment, AdvaMed members will continue our efforts to understand and comply with existing regulations. At the same time, we ask that MHLW seriously examine our suggestions to facilitate patient access to advanced technologies.

- **Regulatory Improvements.** Japan should urgently address the growing backlog of product applications and to reduce the review times of new product applications—particularly in light of Japan's User Fee system and its commitment to meet performance measures. One concrete step would be to quickly expand the number of experts employed in Japan to review product approval applications for product safety and efficacy, which would help reduce the considerable backlog. As part of this effort, the expertise and training of reviewers could be broadened to include necessary skill sets, such as a background in engineering and biostatistics. Another step would be for Japan to accept results of scientific studies conducted in the U.S. We have made recommendations of this nature to the Government of Japan, and we would hope they receive serious consideration.
- **Reimbursement Improvements.** We seek a fair, transparent and predictable system based on actual operating conditions in Japan. We believe such a system should reward innovation by providing higher payments for truly innovative products. If there is a clear demonstrable reason to reduce some product prices, we would welcome the opportunity to work with MHLW on a transparent system that would limit the size of reductions in any given year and would allow us to build such cuts into our long-term planning, instead of being unpredictable and dictated every two years.

### **Conclusion**

Thank you, Mr. Chairman, and the other members of this Committee for providing us the opportunity to submit the views of our industry in the context of a hearing on overall U.S.-Japan trade relations. We hope you and other members of Congress will continue to recognize the importance of the medical device industry, as well as access to foreign markets for the sustained growth of our industry and U.S. jobs. In our relationship with Japan, Congressional and Administration involvement is critical to maintaining our exports to this important market.

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Mr. SHAW. Thank you.  
Mr. McAdams.

**STATEMENT OF JIM McADAMS, PRESIDENT, NATIONAL  
CATTLEMEN'S BEEF ASSOCIATION**

Mr. MCADAMS. Thank you, Mr. Chairman. I am Jim McAdams. I am a cattle producer from Adkins, Texas, and I am President of the National Cattlemen's Beef Association. We represent our 25,000 Members, and through our affiliates we represent over 230,000 cattle and beef producers in the United States. We appreciate the Committee allowing us the opportunity to share our thoughts regarding beef trade with Japan.

Prior to the identification of a case of BSE in the United States, international trade had been a great benefit to U.S. beef producers. We were enjoying on average every year over a \$1 billion trade surplus. Japan was our largest export market. In 2003, we sold them \$1.7 billion worth of beef and beef products.

But after December 23, 2003, when the case of BSE was identified, we lost 90 percent of those export markets. It has been nearly 2 years now since we lost those markets, and with a lot of hard work, we have only been able to open up about one-third of them. Japan still is not open. They were our primary market, and the administration developed a strategy to get that market open. We supported that strategy, and we feel like the Administration has done everything they could to make that strategy work.

But next month, it will be a year ago since Japan and the United States announced that we had a framework for agreement allowing the resumption of beef trade. And in the over 11 months since that agreement was announced, we haven't shipped the first pound of beef to Japan. We were asked at that time to be patient and to allow Japan the time to work through their domestic process.

We have been patient, but the time for patience is gone. There is no more need for any words. We need to act. For us, this is a bigger issue than just opening the Japanese border for our beef. American agriculture has been the foundation of this country when we were founded and we needed to be able to sell our agricultural products, and that has not changed. Agriculture is more than a part of our heritage. It is a vital component of our future.

We in agriculture and in the beef industry realize that we have to be part of this international market if we are going to be able to grow our industry and have a prosperous industry. But when we see the chaos that has been created by the disruptions in trade, we are wondering should we even support additional trade agreements.

We are entering a critical timeline in the WTO negotiations, and the agriculture component has been an impediment to progress. We realize that. We see this Japanese beef issue as a litmus test as to if we can't resolve this Japanese issue, how can we have confidence in our ability to negotiate and enforce trade issues in the future?

So, where we are today is this: We either solve this problem quickly and correctly, or it just does not make sense for U.S. cattle and beef producers to be supporting any future trade negotiations. The producers of our industry have been patient, but while we have been patient, we have absorbed billions of dollars in losses. And we can no longer wait for a process that seems bent on delay.

We are anxious to work together to achieve our end goal, and that is reopening these markets, because we realize that the alternative is protectionist policies, it is trade wars, and it is chaos in commerce. But we cannot be satisfied with the status quo. We feel the United States has played by the rules. We have negotiated fairly. We have based our policies on sound science, and it is time for the Japanese to reciprocate. The Japanese Food Safety Commission has not worked to expedite this process. Instead, we feel they have delayed it. They have even stated, "What is the rush?" Instead of working with us to solve this, they have denigrated the safety of our product and the effectiveness of our firewalls.

We believe strongly that the time for the Japanese to open their markets to our beef is now. It is time for them to start working with us and not against us. And it is time for our government, all segments of our Government, to assure that this happens. We are asking this Committee to work with us to take whatever steps are necessary to get this market open.

We appreciate once again the time that you have given us, and I will be glad to answer your questions at the appropriate time.

[The prepared statement of Mr. McAdams follows:]

**Statement of Jim McAdams, President, National Cattleman's Beef Association**

Chairman Thomas, Ranking Member Rangel, and members of the Committee: On behalf of cattle producers nationwide, the National Cattlemen's Beef Association (NCBA) appreciates the opportunity to present our views on U.S. and Japan Economic and Trade relations. I am Jim McAdams, a cattle producer from Adkins, Texas. I am privileged to serve as President, representing more than 25,000 beef producers and more than 230,000 members through our state and breed affiliates. Today I would like to focus on Japan's sanitary and phytosanitary barriers to trade for agricultural imports, specifically the ban on U.S. beef and beef products.

Access to the Japanese market for U.S. beef and beef products has been restricted for nearly 21 months despite many proactive measures taken by the U.S. government and beef industry to demonstrate the safety of U.S. produced beef.

Beginning in 1989, the United States was the first country without Bovine Spongiform Encephalopathy (BSE) within its borders to begin a series of interlocking safeguards to prevent this disease from ever taking hold in the United States. The U.S. was also the first country without BSE to test cattle for the disease. Eight years ago in 1997, the U.S. instituted a ruminant-to-ruminant feed ban when it was determined that this was the vector that allowed for the spread of this disease between cattle. After the December 23, 2003 discovery of BSE in Washington state, the U.S. began an aggressive policy of specified risk material (SRM) removal to ensure additional levels of safety. Removal of SRMs combined with an effective feed ban, are the principal components to our system of interlocking firewalls.

The Japanese did not put comparable measures into place until they had identified their first case in 2001; to date, they have identified 20 positive cases of BSE in a cow herd that is only 3.6 percent the size of the United States cattle population.

Since June 2004, the U.S. Department of Agriculture's (USDA's) Enhanced BSE Surveillance Program has tested more than 471,691 cattle in highest risk category for BSE and has found only one confirmed case, evidence that U.S. firewalls are working and the prevalence of this disease in the U.S. is extremely low. Testing 268,500 animals can detect BSE at a rate of 1 in 10 million adult cattle at a 99 percent confidence level.

Nearly one year ago, October 23, 2004, the U.S. government and the government of Japan issued a joint press statement outlining the conditions and modalities by which the two countries would begin resuming two-way trade in beef and beef products. This agreement was subject to their respective regulatory approval processes and based on science.

We saw the implementation of this agreement as an interim step in resumption of trade with Japan and believed it would lead to science-based trade consistent

with the World Animal Health Organization's (OIE) guidelines in an expeditious manner.

Yet, today, 11 months after this framework agreement was announced by the two governments, the ban on U.S. beef and beef products remains in place, and U.S. cattle producers' patience with Japan's Food Safety Commission (FSC) has been exhausted.

Cattle producers consider October 2005 a significant milestone in the push for resumption of U.S. beef exports to Japan. The Administration has fully responded to all of the government of Japan's requests for information in a science-based manner. The United States has been extremely patient with Japan, giving them a generous amount of time to work through internal processes, but we have yet to see a timeline regarding re-opening of Japan's borders to U.S. beef. Quite simply, Japan has not followed through on what it committed to in October 2004.

A continued ban on U.S. beef is not based on science. In recent weeks, Japan's FSC has made erroneous claims regarding the safety of U.S. beef. These continued delay tactics represent nothing more than a trade barrier and these statements must be rebuked. We are extremely proud of all that has been done in the United States to keep beef safe from BSE. Extensive U.S. leadership regarding this disease is now leading toward the eventual eradication of BSE. We cannot accept the safety of U.S. beef to be questioned in such a way.

The National Cattlemen's Beef Association, on behalf of cattlemen nationwide, supports the recent measures taken by members in the U.S. House of Representatives and U.S. Senate to ensure fair treatment for our product in this trade agreement. And with no end in sight, we encourage our lawmakers to evaluate every measure possible to regain access to Japan for U.S. beef and beef products.

#### **Trade Benefits Beef Producers**

International trade is a key to economic growth and creates opportunities to help U.S. cattle producers grow demand for our product and enhance our profitability. With the vast majority of the world's population living outside our borders, we must look abroad to generate new markets and expand existing ones. Prior to the discovery of BSE in December 2003 in the United States, and the subsequent closure of over two-thirds of our export markets, the United States was the largest importer of beef in the world and one of the largest exporters. We exported our high value beef and beef products, and imported lower value products of which we had a deficit.

In 2003, the United States imported \$2.62 billion of beef and variety meats and exported a record \$3.86 billion in beef and beef variety meats. In that year, the average per pound value of U.S. beef exports was \$1.66 while the average per pound value of our imports was \$1.21. Overall, the United States enjoyed a record \$2.2 billion beef and beef product trade surplus in 2003. Such success in the export market is nearly unprecedented in any agriculture commodity when one considers that the U.S. beef industry also experienced record domestic prices in 2003.

Following the announcement on December 23, 2003, many countries shut their borders to our products, including our largest export market: Japan. In 2003, the United States exported \$1.4 billion worth of beef and beef variety meats to Japan.

Overall, the cumulative swing in the net balance of beef trade since then will result in a more than a \$7 billion loss to our industry by the end of this year. Japan and South Korea currently account for approximately 80 percent of our lost export markets that are worth \$175 per head to U.S. beef cattle producers. That's \$60 million per week in lost income.

#### **Science-based Protocol for Trade with Countries with BSE Necessary**

Prior to the discovery of BSE in Canada and the United States, countries did not want to trade with other countries known to have even one case of BSE within their borders. However, this practice did not follow OIE guidelines on how to trade products safely under those circumstances. In fact, the new BSE health code, published in August 2005 by the OIE, states that boneless skeletal beef from animals less than 30 months of age can be traded regardless of the BSE risk status of its country of origin. It is time for a new order in world beef trade. One of the lessons the United States learned is that we must treat others as we would like to be treated in similar situations. As such, NCBA calls for an international commission to establish a science-based protocol in which all countries are accountable in resuming trade.

If we would have had such a commission prior to December 23, 2003, we might have been able to prevent much of the economic losses that the cattle producers of this great nation have experienced since.

In no way does this proposal intend to suggest errors have been made or that these government to government negotiations to reopen our exports markets have



been mismanaged. We see this as a “next step” effort to further instill confidence and reliability in scientifically-sound regulations. In order to prevent any future collapse in the confidence and safety of beef, anywhere in the world, because of policy decisions based upon political perception rather than sound science.

On September 10, 2001 when Japan discovered its first case of BSE, Japanese consumers didn’t stop buying just Japanese beef; the undisputable fact is that they significantly curtailed buying *all* beef, regardless of its origin. (U.S. exports to Japan fell by roughly 40 percent in 2002, which played a part in the dismal U.S. cattle prices of that year.)

Japan’s decision to test 100 percent of the cattle slaughtered was not based upon science but rather an attempt to begin to reassemble the Japanese consumers’ shattered confidence in beef. Nearly four years later, on August 1, 2005, Japan finally began its return toward a science-based path as it repealed its 100 percent testing requirement. Japan now requires BSE tests for cattle 21 months of age and older. As a result of this change, it also requested as an interim step that U.S. beef exports to Japan come from cattle 20 months of age or younger.

While we realize that this is by no means a science-based criterion for beef trade, we also understand the necessity of rebuilding Japanese consumers’ confidence in beef. We are committed to this effort as long as Japan is committed to a path that will lead to trade in beef based upon scientifically-sound and internationally accepted regulations and protocols. However, the reopening of Japanese market to U.S. beef from cattle under 21 months must be a short-term interim step that allows us to resume commerce. Trade must then be expanded in an expeditious manner following OIE guidelines.

#### **No Japanese Beef Imports Until U.S. Exports to Japan Resumed**

While we believe any decision to prevent trade should have science-based reasons, NCBA cannot support the reopening of the U.S. market to imports of Japanese beef until Japan reopens its market to U.S. beef. In this particular case, it’s the principle of the thing. We’ll agree to take Japan’s half a semi-load of beef it ships us each year, at a value of \$45 per pound, *simultaneously and on the same terms* as our \$1.7 billion in exports to Japan, BUT NOT BEFORE. Nowhere in the framework agreement does it say we have to go first.

#### **Summary**

Several years ago, Europe decided to shut its doors to U.S. beef by manipulating and then flaunting international trade rules. If Japan, the world’s second largest economy, does the same, how can we view international trade positively? Rapid resolution of this Japanese trade issue is critical to moving forward in the reality of today’s international agricultural marketplace. If we don’t get positive resolution on this issue, the alternative is an ugly drawn out trade war that benefits no one and results in protectionist policies and chaos in commerce.

America’s cattlemen realize that our future depends upon how international trade is conducted, and re-opening this valuable market remains our highest trade priority. Given a fair chance, we are willing and able to compete with anyone in the world with the highest quality and safest beef. All we’re asking for is the opportunity to sell the same beef we feed our families every day to the world’s consumers.

We understand this is a government-to-government negotiation. All we’re asking from our government leaders is that they stand committed to resolving this issue based upon sound scientific principles. There is a difference between deciding to make a decision and actually doing something—we simply need to see some action.

The United States has played by the rules and honored its commitments, and now it is time for Japan to do the same and to lift its ban on U.S. beef.

## Attachment 1:

**U.S.—Japan Progress Report**  
**Action Taken to Resolve Japanese Import Ban on U.S. Beef**  
**NCBA Fact Sheet: Fall 2005**

What did the October 2004 Agreement between U.S. and Japan call for?	What Has Been Done and Where We are Now—
<p><i>“Specified risk materials (SRMs) must be removed from animals of all ages”</i></p>	<p>A Japanese government study-mission visited the U.S. and Canada in May 2005 to examine BSE preventative measures for Japanese exports. The group consisted of six officials from the Ministry of Health, Labor and Welfare, the Ministry of Agriculture, Forestry and Fisheries and the Foreign Ministry. The group found and reported <b>that both Canada and the United States have taken strict steps to remove specified risk materials from cows.</b></p> <p>BSE infectivity has only been found in nervous system tissues, and that prompted the removal of SRMs at packing plants to prevent any contamination. After the first U.S. case of BSE in December 2003, USDA and FDA took extra precautionary steps to prohibit from the food supply parts of the animal that could carry the BSE agent.</p> <p>Also, the U.S. Food and Drug Administration in August, 2005 is reportedly preparing to unveil stricter policies on cattle feed bans, especially in regard to specified risk materials.</p>
<p><i>“Animals must be verified at 20 months of age or younger”</i></p>	<p>As stated in a USDA press release dated October 2004, two methods will be used to verify that animals are 20 months or younger.(1) Production records that indicate birth dates. These include records for individual animals; records from insemination; group age verification plans; and records from already existing USDA-certified special programs. (2) The USDA physiological grading system. A special study is being conducted to examine the correlation between chronological age and physiological characteristics. This information then will be used to define the parameters of the USDA grading criteria that will be used in determining animal eligibility for export. Also, a new BSE health code, published in August 2005 by the OIE, states that boneless skeletal beef from animals less than <b>30 months</b> of age can be traded regardless of the BSE risk status of its country of origin.</p>
<p><i>“BSE testing requirements finalized” “BSE testing requirements finalized” (cont.)</i></p>	<p>Many believed the United States could speed the process of resuming beef trade with Japan if the USDA would perform 100% testing of cattle for BSE. <b>On the contrary, this request was never made by the Japanese government, and Japan and the U.S. never agreed to 100% percent testing as terms of agreement.</b></p> <p>As of September 20, 2005, USDA’s Enhanced BSE Surveillance Program has tested <b>471,691 targeted animals at highest risk for BSE and has found only one confirmed case, evidence that our firewalls are working and the prevalence of this disease in the U.S. is extremely low.</b> Testing 268,500 animals can detect BSE at a rate of 1 in 10 million adult cattle at a 99 percent confidence level.</p> <p>Also, on August 1, 2005, <b>the Japanese government dropped its policy of 100 testing for BSE.</b> It found testing cattle under 21 months of age unnecessary for detecting BSE.</p>

What did the October 2004 Agreement between U.S. and Japan call for?	What Has Been Done and Where We are Now—
<p><i>“Japan’s domestic approval process to include deliberation by the Food Safety Commission (FSC)”</i></p>	<p>In September 2005, Japan’s FSC had its sixth meeting since May to discuss resumption of U.S. beef trade with Japan. The FSC was required by the Japanese government to speed up its process by increasing the size of the committee and its staff and holding meetings more frequently.</p> <p>On May 3, 2005, The FSC reported to hopefully conclude its discussion on the safety of beef by May 6th and immediately submit its recommendations to the government.</p> <p>In July 2005, then Agriculture, Forestry and Fisheries Minister Yoshinobu Shimamura prodded the panel to reach a speedy decision on the future of Japan’s ban on U.S. beef imports.</p>
<p><i>“Other international experts including the World Organization for Animal Health (OIE) and the World Health Organization (WHO) invited to participate in consultations with Japanese and U.S. government officials”</i></p>	<p>In May 2005, the World Organization for Animal Health (OIE) changed its recommendations for standards on trade status in regards to BSE. Risk profiles of countries that have experienced BSE in their national herds will now be based on what steps the country is taking to manage the disease. They also expanded the list of tradable, non-risk products to include boneless beef.</p> <p>Also in May 2005, OIE Director General Bernard Vallat says in an interview with Japanese press that <b>Japan’s ban on U.S. beef does not comply with the OIE standards, is against international law and is excessive.</b></p>
<p><i>“Both the United States and Japan to have food safety systems in place that are sufficiently robust such that a few additional BSE cases will not result in market closures and disruption of beef trade patterns without scientific foundations”</i></p>	<p>In June, both Japanese Prime Minister Junichiro Koizumi and Japanese Chief Cabinet Secretary Hiroyuki Hosoda said the confirmation of a second case of BSE in the United States <b>“will not directly affect”</b> deliberations on reopening Japan’s market to U.S. beef. But still, the Food Safety Commission continued to request more information in July 2005 from the USDA regarding the second American case of BSE so it can make a risk assessment on U.S. beef.</p> <p>After the second BSE case in the U.S., consumer confidence in U.S. beef is at an all-time high. The United States has worked for more than 15 years to set up extensive science-based regulations and firewalls to prevent BSE in this country. That’s why consumer confidence in U.S. beef is now at an all-time high, and all U.S. beef is safe from BSE.</p>

Mr. SHAW. Thank you.  
Mr. Mohatarem.

**STATEMENT OF G. MUSTAFA MOHATAREM, PH.D., CHIEF  
ECONOMIST, GENERAL MOTORS, DETROIT, MICHIGAN**

Mr. MOHATAREM. Chairman Shaw, Congressman Levin, thank you for providing me the opportunity to testify this afternoon.

2005 is shaping up to be another banner year for auto sales in the U.S. Calendar year-to-date sales have been running at a pace just over 17 million, a level that was considered unattainable a few years ago. But despite these strong sales, U.S. auto manufacturers and suppliers are struggling to turn a profit. Autoworkers have

been laid off, credit ratings for the auto companies have been downgraded, and many suppliers are facing bankruptcy.

Now, there are many reasons for our current challenges, but the legacy of Japan's mercantilist trade policies and the impact of Japan's sustained currency manipulation stand out among the primary causes.

With the progressive lowering of tariffs and other barriers to trade, exchange rates have taken on a larger component of competitive advantage. Indeed, Japan is demonstrating that elimination of tariffs and removal of nontariff barriers are meaningless if a country is allowed to offset these actions by artificially depreciating its currency.

No industry better exemplifies the effects of Japan's mercantilist post-war trade policy than the U.S. automotive industry. Last year, the U.S.-Japan automotive trade deficit reached \$44 billion, representing over two-thirds of our total U.S.-Japan deficit, and this is not a new development. This has been going on for almost 25 years.

In 1995, the U.S. government negotiated an agreement, a 5-year agreement with Japan that was designed to address many of the barriers we had identified. It was a good agreement, and it immediately resulted in an increase in not just our exports, but the exports of our suppliers to Japan. But just as we had finished making significant investments to take advantage of this agreement, the Japanese government began to intervene in currency markets to deliberately weaken the yen. The impact of this was to make U.S. exports to Japan prohibitively costly. In pursuing this weak yen policy, Japan effectively nullified the value and commercial significance of the 1995 U.S.-Japan Auto Agreement.

Now, the IMF clearly states that Members should avoid manipulating exchange rates in order to gain an unfair competitive advantage over other Members and defines such manipulation as protracted large-scale intervention in one direction in exchange markets. Since 2000, Japan has intervened over 400 times, spending over \$420 billion. As a result, Japan has seen a massive increase in its reserves, growing from \$345 billion in July of 2000 to over \$840 billion.

Now, we heard from the earlier panel that Japan has not intervened since the first quarter of 2004. That is true. But it is important to keep in mind that Japan spent \$150 billion in that one quarter alone and announced that they had budgeted another \$1 trillion to intervene in currency markets. With an intervention of that magnitude and a commitment to continue intervening, is it any surprise they have not needed to intervene further?

Now, this intervention, the cheap currency translates directly into competitiveness. We estimate that in the last year alone, the cheap yen resulted in a subsidy to Japanese manufacturers of approximately \$3,000 on a small car going up to \$12,000 on a large luxury car. For those who question whether this matters, all you have to look at is the first-half results announced by the Japanese auto companies. Collectively, they reported \$1 billion in additional earnings as a result of the weak yen.

It is precisely for this reason that the WTO, the IMF, and the Omnibus Trade Act address the issue of currency manipulation, yet Japan has been able to do that without any consequences.

On behalf of General Motors, I urge the Committee to give greater attention to our ongoing trade and currency problems in Japan and to see how directly these issues are related to the competitive problems American manufacturers face. There are responsible actions that Congress and the Administration can take. You can insist that these unfair currency practices cease, and if Japan or another trading partner continues, they must understand there will be consequences. The Congress and the administration should make clear they will make full use of U.S. and international trade laws to discipline unfair currency manipulation. The bottom line is in a world where we have much more open trade, currency valuation makes a tremendous difference, and when we allow a country like Japan to manipulate its currency to the advantage of their manufacturers, it comes as the detriment of our manufacturers, us and our employees.

Thank you again for the opportunity.

[The prepared statement of Mr. Mohatarem follows:]

**Statement of Mustafa Mohatarem, Ph.D., Chief Economist, General Motors, Detroit, MI Chairman Thomas, Ranking Member Rangel, Members of the Ways and Means Committee: Thank you for providing me with the opportunity to provide testimony at the hearing this morning.**

General Motors Corporation, founded in 1908, is the world's largest automaker and has been the global industry sales leader since 1931. GM has employees in all 50 states for total U.S. employment of 166,000 people. GM's worldwide employment is approximately 317,000. Last year GM spent over \$6.5 billion in pension payments to 456,000 retirees and surviving spouses, and provided health care benefits of over \$5.2 billion to more than 1.1 million retirees, workers, and their families. GM has manufacturing operations in 32 countries and its vehicles are sold in virtually every country. In 2004, GM sold nearly 9 million cars and trucks globally.

2005 is shaping up to be another banner year for auto sales in the United States. Calendar year-to-date sales have been running at a pace just over 17 million units. Annual auto sales have hovered at or exceeded 17 million units—a level that was considered unattainable as recently as the early 1990s—for seven straight years.

Given the strength of auto sales, one would think that U.S. auto manufacturers, auto suppliers and their workers would be celebrating. But we are not. Despite the strong sales, U.S. auto manufacturers and suppliers are struggling to turn a profit, autoworkers have been laid off, credit ratings for U.S. auto companies have been downgraded and many suppliers are faced with bankruptcy.

While there are many reasons for the current challenges facing American-owned auto manufacturers, the legacy of Japan's unfair and mercantilist trade policies and the impact of Japan's sustained currency manipulation stand out among the primary causes. With the progressive lowering of tariffs and other barriers to trade, exchange rates have taken on a larger component of competitive advantage. Indeed, Japan has demonstrated that elimination of tariffs and the removal of non-tariff barriers are meaningless if a country is allowed to offset these actions by artificially depreciating its currency. Thus, for example, the artificially weak yen has provided Japanese auto companies a cost advantage ranging from \$3,000 on a small car to \$12,000 on a luxury sport utility. This subsidy has both facilitated the expansion of Japanese companies in the U.S. and succeeded in keeping American-built automobiles out of Japan.

The world's acceptance of Japan's postwar export-based economic growth model has long been debated here in Congress and elsewhere. However, it is frustrating, really unbelievable, to many of us in this business and the American manufacturing sector that the Japanese government's extraordinary \$420 billion currency manipulation program has gone unquestioned and unchallenged, while China has become the sole focus of attention as *the* threat to American competitiveness.

Let me assure you—when it comes to working to secure the health and viability of American auto jobs and the future well being of this industry, there is nothing more important to consider than the U.S.-Japan relationship.

#### **U.S.—Japan Automotive Trade**

No industry better exemplifies the effects of Japan's imbalanced, mercantilist postwar trade policy than the automotive sector. Last year, the U.S.-Japan bilateral automotive trade deficit reached \$44.2 billion, making it the largest sectoral trade deficit the United States maintains with any country. In 2004, automotive trade represented over two-thirds of the total U.S.-Japan deficit. And this is not a new development. This has been the case for more than twenty-five years, confirming the deep historical and structural nature of the chronic trade imbalance between our two countries.

A quick glance at the trade numbers confirms this pattern. In 2004, Japan exported to the United States over 1.7 million passenger vehicles and a substantial amount of auto parts worth a total of \$46 billion. During the same time, Japan imported just 15,000 passenger vehicles and auto parts from the United States worth a total of \$1.8 billion. The market share of Japanese nameplate brands reached over 30% of the total U.S. light vehicle market in 2004—including nearly 40% of passenger cars. In contrast, sales of U.S. nameplates in Japan reached only 2% of the total market.

It didn't have to be this way. The reality is that Japan built and grew its economy based on exports, and has fueled that export machine by restricting demand in its domestic market. It is a mercantilist model that others have sought to follow, and it has succeeded, in large part, at the expense of its trade partners. In an effort to address the obvious problems in automotive trade, in 1995, the United States and Japan signed a five-year agreement intended to address the huge structural imbalance in our automotive trade by improving the access of U.S. automakers to the Japan market. It was a good agreement, and resulted initially in a modest increase in sales for U.S. auto and auto parts companies in Japan.

It was a good agreement that made a serious effort to address the very broad range of non-tariff barriers that had successfully maintained Japan as a closed market, even after Japan reduced its vehicle tariffs to zero. These non-tariff barriers included the interlinking collusive business practices such as the 'keiretsu' relationships between Japanese auto manufacturers and their family of suppliers, and the restricted distribution arrangements between Japanese manufacturers and their dealers that prevented Japanese dealers from establishing contractual relationships with U.S. and other foreign auto companies.

Additionally, Japan's regulatory system that governs certification to safety and emission standards was, by any objective standard, clearly designed for the convenience of Japanese automakers and to make it expensive, difficult, and very time consuming to sell imported cars in Japan.

In the 1995 Auto Agreement, the United States set out a specific course of action that included a detailed set of measures that the Japanese government and industry agreed to take to remove the labyrinth of non-tariff barriers that had been used to successfully keep the market closed. Among the major commitments made by Japan in the 1995 Agreement were:

#### **1995 U.S.—Japan Auto Agreement**

The Japanese government agreed to:

- “Demonstrate the commitment of the Japanese vehicle manufacturer to support open and competitive distribution systems for vehicles in Japan”;
- “Eliminate concerns that Japanese vehicle dealers may have about the consequences associated with carrying competing foreign motor vehicles”; and
- Confirmed that the government “supports open and competitive distribution systems for motor vehicles in Japan.”
- “The Government of Japan will provide guidance to auto parts distributors that “they refrain from any form of discrimination when handling foreign made auto parts;
- Deregulation of Disassembling Repair Requirements (Critical Parts Requirements);
- Deregulation of Certified and Designated Garages;
- Deregulation of Modification Inspection Requirements;
- Notification of Regulatory Changes; and
- The Government of Japan agreed to 23 specific commitments intended to ease the burden, cost and overall disproportionate process required of foreign automakers to achieve certification of vehicles for sale in Japan.

Many of these measures and commitments contained in the 1995 U.S.-Japan Auto Agreement were potentially important positive developments. If fully tested and implemented, they could perhaps have made a significant difference in improving sales opportunities for U.S. auto and auto parts companies in the Japanese market. However, just as the U.S. companies began to undertake the extensive capital investments to test these commitments, the Japanese government moved in a major new policy direction that totally changed the terms of trade.

In 1996, it began to use massive resources to intervene in currency markets to deliberately manipulate the value of the yen in order to weaken its value to promote exports. The impact of this was to make U.S. exports to Japan significantly, and for many, prohibitively costly. In pursuing this weak yen policy throughout the late 1990s, Japan effectively vitiated the value and commercial significance of the 1995 U.S.-Japan Auto Agreement. As a result, to this day, we have no way of knowing whether Japan's commitments made in 1995 to remove its web of non-tariff barriers restricting access to its auto and auto parts markets were met.

#### *Currency Manipulation*

Japan's weak yen policy has given its exporters a huge subsidy and competitive advantage in the U.S. market, causing significant harm to U.S. manufacturers. One clear sign that a country is manipulating its currency is a substantial increase in its foreign currency reserves, which occurs as it buys and holds dollars. Japan has seen a massive increase in its foreign currency reserves since 2001, growing from \$344.8 billion in July 2000 to \$840 billion in July 2005.

In a January 2005 Working Paper, the U.S. Federal Reserve reported that "Since the early 1990s, the monetary authorities of the major industrialized countries, with one notable exception, have greatly curtailed their foreign-exchange interventions. That exception has been Japan, where the Ministry of Finance has continued to intervene frequently—and at times massively—in foreign exchange markets."

There are several international agreements that preclude or limit the use of currency intervention for trade-distorting purposes. These agreements seem to put Japan's currency intervention actions on the level of a non-tariff barrier. Of particular interest are the rules governing the IMF and the original GATT. Section IV of the IMF charter states without reservation, that "members should avoid manipulating exchange rates in order to gain an unfair competitive advantage over other members" and defines such manipulation as "protracted, large-scale intervention in one direction in exchange market."

Perhaps more relevant, GATT Article XV (Exchange Arrangements) states that contracting parties shall not, by exchange action, frustrate the intent of the Agreement. The intent of the Agreement, as stated in the preamble, is the objective of "entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade." Japan is clearly violating GATT Article XV by manipulating its currency to keep it artificially weak. Japan is in effect providing a substantial subsidy to its exporting industries. These practices are clearly inconsistent with the intent of the IMF and GATT, and likely violate both the IMF and the GATT Agreements, causing major distortions to international trade.

As a result of Japan's massive and disruptive currency interventions, the value of the yen fell from 101 yen/dollar in January 2000 to 136 yen/dollar in 2002. Market forces, helped by Bush Administration officials' statements, had pushed the yen to slightly more reasonable levels of 105 yen/dollar in early 2005. However, due in part to ongoing "jawboning" and verbal intervention by high-ranking Japanese officials, the yen is currently in the 111 yen/dollar range. The damage caused to key sectors of the U.S. economy has been deep and in many cases permanent.

Japan's artificially weak currency provides a significant per-vehicle cost advantage that amounts to an outright annual subsidy of between \$3,000 for small car to \$12,000 for a luxury sedan or SUV for every vehicle exported to the United States. Cars produced here by Japanese companies also benefit heavily from this subsidy because of their high use of imported parts and components. Japanese automakers have used this cost advantage to:

- Dramatically increase investment in technology and production worldwide;
- Minimize, and in some cases reduce, prices on new models;
- Dramatically increase spending on advertising; Offset tariffs, taxes and other fees; Increase incentives to boost market share; and
- Enhance spending on research and development.

For those who may question whether the exchange rate policies of our trading partners are important factors affecting U.S. competitiveness, half-year earnings statements just released by Japan's automakers answer that conclusively. Toyota, Nissan, Honda, Subaru, and Japan's other auto companies announced last week

that they earned nearly \$1 billion in unanticipated windfall profits in the first half of fiscal year 2005. These were due exclusively to the artificial weakness of the yen.

Most Japanese automakers set a projected exchange rate of 105 yen/dollar as their benchmark at the beginning of the 2005 fiscal year. But, because Japanese government policies resulted in a yen/dollar exchange rate much weaker than that, Japanese automakers' total profits increased by 112 billion yen—over \$1 billion—above what they projected. Much of that profit increase came as a result of sales in the United States. According to the Nikkei news service, the breakdown of these additional weak currency-driven profits include 50 billion yen / \$452 million for Toyota, 28 billion yen / \$253 million for Nissan, and 14.2 billion yen / \$127 million for Honda.

With no sign that the Japanese government will change its exchange rate policy to allow the yen to rise to its true market level (90 to 100 yen per dollar is the commonly accepted range), the full-year windfall provided by the Japanese government's currency policy could likely be a check for \$2 billion written to Japan's automakers.

Is it any surprise then that the relative competitive performance of the Japanese and U.S. auto companies is so dramatically different? Armed with a significant per-vehicle subsidy, the Japanese companies have embarked on a period of rapidly escalating profits, which they have directed toward increasing market share in the United States.

Intervention on the scale that Japan has engaged in is no different from other forms of subsidies that governments offer. That is why the WTO has explicit provisions against currency manipulation. And that is why the Omnibus Trade Act of 1988 required the U.S. Treasury to monitor currency manipulation by other countries and to take appropriate measures to prevent other countries from manipulating their currencies to gain unfair competitive advantage for their products.

#### **Conclusion**

Automotive trade between the United States and Japan has been chronically and structurally unbalanced for decades. It has consistently made up the vast majority of the United States' total deficit with Japan. Contrary to claims that the opening of Japanese auto plants in the United States would cause Japanese auto exports to decline, Japan's automakers have sharply increased their exports to the United States. Even a hard-fought and sound 1995 U.S.-Japan Auto Agreement has been rendered useless because of reckless Japanese currency policies. Over the last five years, subsidized by an artificially weak yen funded by \$420 billion in Japanese government currency interventions, Japan's automakers have exported an annual average of 1.8 million cars and trucks into the United States, 13% higher than the average from 1996–2000.

On behalf of General Motors, I urge the Committee to give greater attention to our ongoing trade and currency problems with Japan—and to see how directly these issues are related to America's slipping industrial competitiveness. There are responsible actions the Congress and the Administration can take to respond. You can insist that these unfair competitive currency practices cease. And if Japan or another trading partner continues, they must understand there will be consequences. The Congress and the Administration should make clear it will make full use of U.S. and international trade laws to discipline unfair currency manipulation. And the United States will refuse to consider any further overtures, such as Free Trade Agreements or tariff reductions to countries like Japan that are engaged in such practices, until such time as those governments commit publicly to cease engaging in currency manipulation and intervention in the future.

Mr. SHAW. Thank you, sir.  
Ms. Howard.

#### **STATEMENT OF DEBORAH HOWARD, PRESIDENT, JAPAN MARKET RESOURCE NETWORK, TOKYO, JAPAN, ON BEHALF OF AMERICAN CHAMBER OF COMMERCE IN JAPAN, TOKYO, JAPAN**

Ms. HOWARD. Mr. Chairman, Congressman Levin, thank you for the opportunity to appear before you today on behalf of the American Chamber of Commerce in Japan, or ACCJ. My name is Debbie Howard, and I am the founder and President of a market



research firm based in Tokyo that has been in business for 17 years. I also currently serve as the elected President of the ACCJ. I would like to discuss some key structural challenges confronting Japan and what we believe must be done to ensure Japan's sustained economic growth.

The first challenge is Japan's rapidly aging population, the most extreme of all industrialized nations. Japan's birth rate is also flattening, and the downward trend shows no sign of stopping. Japan will likely increase consumption taxes in 2007 and implement other tax reforms to help cover the anticipated costs, but these measures are unlikely to be adequate.

The second major challenge confronting Japan is its unprecedented fiscal crisis. Japan's public debt exceeds 163 percent of GDP, over 2 times that of the U.S. Japan has basically reached its limit on borrowing and must look to other solutions to deal with its aging demographics. Considering these challenges, Prime Minister Koizumi has decided to introduce private sector-driven reforms that will enhance efficiency in the overall economy of Japan.

The centerpiece of Prime Minister Koizumi's reforms is the privatization of Japan Post. This Committee has been involved in postal reform from the very beginning and has issued a very strong joint letter to Japan calling for equal treatment between private companies and the privileged, government-run postal companies, as well as for a standstill on new product offerings until such equal treatment is achieved. Even after the legislation passes in October, though, this Committee's continued engagement will be essential to obtain commitments from Japan to ensure equivalent conditions of competition and transparency of the process by which the postal entities will be allowed to expand the range of their businesses. This is critical to the future viability of many U.S. financial institutions that generate tens of billions of dollars annually in Japan. They will also ensure Japan's compliance with its national treatment obligations under the GATS.

Japan has also begun to consider broad reform of its health care system. It is important that health care reform incorporate market-based measures that make efficient use of limited resources and enable innovative companies, including U.S. companies, to provide cost-effective solutions that improve patient access to the most advanced treatments, as well as improve diagnostics and patient quality of life. In addition to hastening approval times for pharmaceuticals and medical devices, ACCJ Members would very much like to see private companies permitted to own or manage medical institutions on a for-profit basis.

It is also important for Japan to continue to strengthen its corporate governance. Progress has slowed dramatically in this area. Rather than protecting the interest of Japanese management, the government should be focusing on improving corporate governance through active shareholder participation and through the introduction of modern merger techniques that create a market for corporate control and facilitate corporate restructuring and investment.

The U.S. government has for many years been encouraging Japan to take measures to improve the transparency of its policy-making process. Progress has been made with the establishment of

public comment procedures and no action letter systems, as well as improved access to advisory groups. On the downside, however, government agencies often provide unreasonably short comment periods and ignore comments submitted during the public comment process. Most agencies also remain reluctant to respond to no action letter requests, and the quality of access to advisory groups varies depending on the agencies and officials involved.

In conclusion, Mr. Chairman, U.S. business interests in Japan have become much more complicated. In addition to the priority areas I have outlined today, the ACCJ is seeking policy improvements in areas as wide-reaching as labor mobility, personal information protection, taxation, competition policy, and even Narita airport management. While we have come a long way, there is still much work to be done, and it is critical that Japan implement further reforms in a manner that creates a level playingfield.

In terms of trade policy, it is essential that the U.S. Government remain engaged multilaterally in the WTO, APEC, and other forums, and bilaterally in the Economic Partnership for Growth and other processes, to ensure that reform in Japan stays on track and that Japan lives up to its trade commitments.

On behalf of the Members of the ACCJ, I would like to thank you again and the Members of your Committee for this opportunity to present our views.

[The prepared statement of Ms. Howard follows:]

**Statement of Deborah Howard, President, Japan Market Resource Network, Tokyo, Japan on behalf of American Chamber of Commerce in Japan, Tokyo, Japan**

Mr. Chairman and members of the Committee, thank you for the opportunity to appear before you today on behalf of the American Chamber of Commerce in Japan, or ACCJ, at this important hearing on U.S.-Japan economic relations. My name is Debbie Howard. I am the founder and president of a market research firm based in Tokyo that has been in business for 17 years. I also serve as the elected President of the ACCJ. The ACCJ's mission is to promote commerce between the United States and Japan, promote the interests of U.S. companies and members, and improve the international business environment in Japan. Established in 1948, the ACCJ has grown into one of the most influential business organizations in Japan, with 3,000 individual members and 1,400 companies, ranging from Fortune 500s to entrepreneurial ventures like mine.

We are delighted that the Committee is carefully examining the U.S.-Japan economic relationship and appreciate the strong leadership demonstrated by this Committee on this very important issue. Japan has the world's second largest economy—three times larger than that of China and larger than those of the U.K., France, and Italy combined. Our two economies are inextricably intertwined. As a result, Americans have a huge stake in Japan's continued economic growth and in strengthened economic ties between the two countries. For example, Japan is the largest overseas market for America's farmers, and is the United States' largest overseas export market overall, purchasing \$54 billion in American goods in 2004, up from \$52 billion the year before. Japanese companies also employ approximately one million Americans at home. In addition, Japan is by far the largest holder of U.S. Treasury securities. Japan is also an important global partner in many other ways, for example, by committing funds and troops to Iraq and actively contributing to international relief efforts such as tsunami recovery and aid to Africa. The United States and Japan also have shared interests in strengthening the global trading system and in particular in working together to constructively respond to the challenges and opportunities presented by China's rapid growth and emergence as a major trading nation and in ensuring that China lives up to its commitments under the WTO agreements.

In the next few minutes, I would like to briefly discuss some key structural challenges currently confronting Japan and what must be done to ensure sustained economic growth in Japan. A robust Japanese economic and financial system governed

by market-based principles and transparent rules is a crucial building block for continued growth and prosperity in the United States and must be a key factor when considering U.S. trade policy for Asia and indeed the world.

### **Structural Challenges**

The first challenge is that Japan's population is rapidly aging and is in fact shrinking.

Japan's population will peak in 2006 at 127.7 million and by 2050 decline to just over 100.6 million. In 2000, the ratio of productive to dependent members of society stood at four to one. By 2050, that ratio will drop to one to 1.5.

Japan's birthrate has plummeted from 3.65 children per woman in 1950 to less than 1.29 today, and the downward trend shows no signs of stopping. These demographic trends are straining Japan's social safety net systems to the breaking point and the government is scrambling to figure out how to respond. In 2004 government expenditures for

pensions, medical expenses, and nursing care totaled 86 trillion yen or \$825 billion. By 2025, that total is expected to jump to 152 trillion yen or \$1.5 trillion. Japan will likely substantially increase consumption taxes in 2007 to help cover some of the costs, but measures currently being contemplated are unlikely to adequately cover the anticipated expenses.

This brings me to a second major challenge confronting Japan—that is, its government's unprecedented fiscal crisis. In the decade following the collapse of its asset bubble in the early 1990s, Japan attempted to spend its way out of a prolonged economic slump with public works spending. The result is a public debt that exceeds 163 percent of GDP, compared to U.S. public debt of 63.5 percent of GDP. The Government of Japan has basically reached its limit on borrowing and must look to other solutions to deal with its aging demographics.

Accordingly, the Government of Japan must take decisive, private-sector-driven measures to enhance efficiency in its economy overall and to create a new social safety net system able to cope with an older society. In the recent election, the Prime Minister ran on a platform of reform; his basic position was that slimming the bureaucracy and bringing vitality to the private sector was the only way to create sustainable economic growth and reform of Japan's healthcare, pension, and other social safety net systems in the face of Japan's falling birthrate and declining population. Indeed, the Japanese public's strong support for Prime Minister Koizumi in the election is seen by many as a clear signal that the people of Japan understand the need for reform and are ready to move forward.

### **Postal Reform**

The centerpiece of Prime Minister Koizumi's revitalized reform platform is the privatization of Japan's postal operation, Japan Post. I would like to note that this Committee has been involved in postal reform from the beginning and, among other things, has issued a very strong joint letter to the Government of Japan calling for equal treatment between private companies and the privileged government-run postal companies and for a standstill on new product offerings until such equal treatment is achieved. We very much appreciate the Committee's involvement and credit much of the progress made on this issue to your active oversight.

During the election, the Prime Minister's message was that smaller government through postal privatization is the only way to overcome the challenges now confronting Japan. He has called Japan Post privatization Japan's most important reform since the Meiji Era. It is hard to disagree—indeed, Japan Post privatization is the ACCJ's top advocacy priority. In addition to delivering the mail, Japan Post operates the largest bank and life insurance company in the world. Japan Post accounts for approximately 40 percent of Japan's life insurance assets and 30 percent of the country's individual savings deposits. A quarter of Japanese households' total financial assets are held by Japan Post, and a quarter of all Japanese government bonds are owned by Japan Post.

The postal entities compete directly with the private sector, yet receive government privileges, including tax exemptions, government guarantees of their products, and separate, more lenient regulatory supervision, all of which unfairly disadvantages their private competitors. More importantly, the exemption of these mammoth institutions from the Financial Services Agency's comprehensive, rules-based system of financial regulation undermines the ability of the Government of Japan to provide a sound regulatory environment essential to the future growth of Japan's financial sector.

The Prime Minister has pledged to reform and privatize Japan Post by 2007. When his postal privatization legislation was rejected early last month, Mr. Koizumi dissolved the Diet, calling a snap election in which postal privatization was the key

issue—almost the only issue. Now armed with a more than two-thirds majority in the lower house, the Prime Minister has re-introduced the legislation and hopes to have it enacted into law by mid October.

It has been the longstanding position of the U.S. government, as expressed in the National Trade Estimate and other documents, that Japan Post should not introduce any new products or services until equivalent conditions of competition with private sector competitors are established. This is consistent with language in the Japan Post legislation, which provides that “measures shall be implemented to ensure equivalent conditions of competition between [the privatized postal companies] and other companies engaged in like business operations.”

Despite this language, it is vital that we obtain specific commitments from the Government of Japan to faithfully implement this language and prohibit product expansion until a level playing field is established and to ensure transparency of the process by which the postal entities will be allowed to expand the range of their businesses. These dual commitments are essential to the future viability of many U.S. financial institutions who generate tens of billions of dollars annually in Japan, and to the sound regulation of the world’s second largest financial sector. They will also ensure Japan’s compliance with its national treatment obligations under the GATS. After the legislation passes, this Committee’s continued engagement will be essential to ensure full implementation of the promised measures to ensure equivalent conditions of competition.

#### **Healthcare Reform**

Japan has recently begun to consider broad reform of its healthcare system recognizing that the current system is financially unsustainable given the rapid aging of Japanese society and low birth rate. Consistent with the Prime Minister’s theme of “letting the private sector do what it can do,” it is essential that these reforms incorporate market-based measures that make more efficient use of limited resources and enable innovative companies—including U.S. companies—to provide cost-effective solutions. Under the current rules, for example, private companies are not permitted to own or manage medical institutions on a for-profit basis. This restriction is a substantial trade barrier to U.S. companies and denies Japanese consumers of potential efficiency gains that for-profit management could bring. It is also essential that healthcare reform include wide-reaching measures applying market-based pricing premiums for pharmaceuticals and medical devices that reward and stimulate advances in drug research and medical technology and which accurately reflect the value of innovative products. The current system, which is more a political negotiation than a market pricing mechanism, stifles innovation and denies Japanese consumers access to the most advanced treatment.

#### **Corporate Governance**

Continued measures to strengthen sound corporate governance are essential to improving corporate performance in Japan. Such measures would ensure that management works to maximize shareholder value through increased productivity and economically sound business decisions. Keys to improving corporate governance include the active shareholder participation as well as the introduction of modern merger techniques that create a market for corporate control and facilitate corporate restructuring and investment.

Unfortunately, a growing fear of hostile foreign takeovers sparked by a recent series of domestic events quite unrelated to foreign investors has slowed progress in this area substantially, leading to the recent amendment of the Japanese corporate code allowing a range of new takeover defenses and to a delay in the adoption of rules allowing cross-border triangular mergers that companies overseas could use to acquire companies in Japan. Rather than protecting the parochial interests of Japanese management, the Government of Japan should be focusing on enhancing corporate governance in Japanese companies and creating a regulatory framework that emphasizes shareholder value and efficient capital markets. Such measures would promote Japanese consumer welfare; create a better business environment for all companies, domestic and foreign; ensure Japan’s continued economic growth; and enhance Japan’s ability to contribute as a global citizen to the international economy.

#### **Transparency**

For many years, the United States Government and the ACCJ have been encouraging the Government of Japan to take measures to improve the transparency of its policymaking process. Much progress has been made. For example, public comment procedures and no action letter systems have been established in most areas of government, and our member companies have improved access to the advisory

council deliberative process, which is central to the legislative and regulatory drafting process in Japan.

The fact remains, however, that Government agencies often provide unreasonably short comment periods and ignore comments submitted during the public comment process, and most agencies remain reluctant to respond to no action letter requests. Further, while we are grateful for improved access to the advisory council process, the quality of that access varies widely depending on the agencies and officials involved.

A case in point is Article 821, a recently enacted amendment to Japan's Corporation Law, which may force foreign companies operating branches in Japan whose sole business is in Japan to transform their branches into Japanese corporations, resulting in millions in additional expenses to those companies. Even though the provision was aimed at foreign companies, it was drafted without sufficient consultation with the foreign business community, and the public comment procedure was effectively circumvented, because the version adopted was completely different from that submitted for public comment. Most firms became aware of the new amended Article 821 only after it had passed the Diet's lower house. Unfortunately, we were unable to get the Article amended prior to its passage into law and had to settle for legislative history aimed at narrowing its application and a supplemental resolution promising to consider revising the provision as necessary.

Article 821 casts into doubt the legal and corporate structure by which foreign companies have operated as good corporate citizens in Japan for more than 50 years, and it must be amended before its scheduled implementation date next year. The ACCJ will be working to achieve such an amendment during the upcoming legislative session this fall.

Although we applaud the significant progress on transparency to date, much work remains to be and we look forward to the Committee's continued support on this front.

### **Conclusion**

Over the past 60 years, the United States and Japan have forged a remarkably close bilateral relationship that continues to yield tremendous benefits to both sides—economically, politically, and culturally. This relationship is not always easy, but it is always worth it. Access to Japan's markets for U.S. goods and services has improved substantially over time, but there is still work to be done, and meaningful progress on the issues I've just outlined will help continue moving the ball forward. In terms of trade policy, it is essential that the U.S. Government remain engaged multilaterally in the WTO, APEC, and other forums and bilaterally in the Economic Partnership for Growth, U.S.-Japan Insurance Talks, and other processes to ensure that reform in Japan stays on track and Japan lives up to its trade commitments. Accordingly, the ACCJ firmly supports the U.S. Government's efforts to make meaningful progress under the Doha Development Agenda. History shows that government-to-government engagement on regulatory issues has had a substantial impact on the course of reform in Japan—indeed, this Committee has played a vital role. Continued active involvement by the U.S. government remains key. Also, we believe that careful investment in the U.S.-Japan relationship will enhance our ability to leverage our relationship with Japan to collaboratively address issues related to China's integration into the global economy to the great benefit of both the United States and Japan.

In closing, I would like to point out that the business environment in Japan has changed for the better in many important ways over the past six to seven years. It is much more open to imports. Foreign direct investment has grown substantially, and the Japanese government is more open and receptive to ideas from the ACCJ and foreign business community. In short, it is easier to do business in Japan now.

At the same time, U.S. business interests in Japan have become much more complicated. In addition to the large priority areas I have outlined today, we are seeking policy improvements in areas such as labor mobility, personal information protection, taxation, competition policy, and even Narita airport management.

Fortunately, and most important, Prime Minister Koizumi's landslide victory indicates that a consensus has emerged among the Japanese people and its leaders that even more reform is necessary for Japan to meet the challenges of the future. The ACCJ stands ready to engage both the U.S. and Japanese governments in finding the right solutions.

On behalf of the members of the ACCJ, I would like to thank you and the members of your committee for this opportunity to present our views. We look forward to working with this Committee to improve economic relations with Japan.

Mr. SHAW. Thank you.

Mr. Levin.

Mr. LEVIN. Thank you very much, Mr. Chairman, and thank you for your testimony.

I think a lot of our colleagues are not here—I just was shown on the BlackBerry there was another session called. The Secretary of Defense is having a briefing right now, as I understand it, and so we regret that so many of our colleagues went there. They will fill us in on what was said there. It was a secret briefing, so they will tell us directly. We will fill them in on what you have had to say.

Let me just ask, in view of your important testimony, Governor Keating, you have talked about the challenge of their reform and what it could mean for American industry. Mr. McAdams, you discussed so thoroughly, as did the Governor, the challenge relating to agriculture. You kind of lauded our government or said they were doing—they were working on it. But here it is almost a year later, and nothing has happened.

Dr. Mohatarem, you have spelled out so clearly the problems with the currency, and it was not so long ago that they were rigging their currency, or whatever word one wants to choose, very harmfully to the U.S.

So, tell us—now we have votes—what do you want us to do that has not been done? Take each of your fields. If postal reform, jawboning has not worked very well. I remember the Motorola case—and I will be very brief—where the Japanese said to Motorola you can sell this in northern Japan, but not in Tokyo. And the company was willing to stand up and say, no way, we are not going to settle for that, or settle for a lot of jawboning.

So, in a word, tell us what you expect of this government, and what happens if it is not working well? Take each of the three cases as examples.

Mr. KEATING. Mr. Levin, as I mentioned in my formal remarks and in my summary remarks, this is a very fragile time because, for our industry, this is huge. Japan is the second-largest life insurance market in the world. Kampo is the largest life insurance company in the world, and for Japan to honor its GATS commitment and permit all of this to be on a level playingfield and compete is good for Japan, as well as good for the American people.

We have seen our market share advance, unlike some of these other representatives at the witness table. We are happy with that. We have also seen, as a result of some very good work on the part of the Trade Rep, Department of Commerce, Department of State, that this legislation—and as I mentioned, I spoke to a number of Members of the Diet as well as ministerial officials—has the elements in it that we want, namely, we hope—because it has not been introduced yet—the FSA regulation, taxation, no full faith and credit, and product holder protection fund. What it does not have is transparency. That worries us. And the devil is in the details.

So, right now we are cautiously optimistic with a small “c” and as this process is completed, hopefully that will be a capital “C.” But they are in violation of the GATS agreement right now, and they did last year introduce a product that is a very significant

product and a competitive product to the United States companies that are there.

So, we are concerned, we are alarmed, but we have not panicked yet. If this hearing were 6 months from now, perhaps our reaction would be different.

Ms. HOWARD. And may I add one point to that? This privatization will probably take place over the course of about 10 years, so if we do not get it right, it is really quite a long period of time where our industries are going to be suffering. And we are really on the case watching the details. I think we are all very concerned about that.

Mr. LEVIN. Now, Mr. Chairman, if we want to give the others a brief—do you want to have time for your questions, too? However you want to handle it. Should we just ask each of the others to give a very brief answer?

Mr. SHAW. I think that is good.

Mr. LEVIN. Take beef and then currency.

Mr. SHAW. I am going to ask this panel if they would answer written questions that we will be submitting to you. And I also would like to say that I along with Mr. Cardin and the rest of the Trade Subcommittee are looking forward to following up on this. We are not going to just drop it. We are going to watch it very closely, and some of you may be invited back to testify. And I would hope that you would keep us advised, Governor Keating, you with what is going on with regard to the transparency, and keep this Committee advised as to exactly what is happening. Too often we come and we visit a subject, and then go on and do something else and don't come back to it. And I think that the Japanese really have to know that it is in their best interest to move forward and cooperate and allow our business to compete just as we allow their businesses to compete.

What was your suggestion?

Mr. LEVIN. Just quickly if we could have a quick response on the beef issue and currency. What next? What do you expect?

Mr. MCADAMS. Well, from the beef standpoint, there is a strong inclination on our part, our hearts are saying, we are not being treated fairly and we need to retaliate. But when we think with our heads, we look at what has happened with our beef trade to Europe. For all practical purposes, we have none. They have manipulated and flaunted the international rules to the point that we don't have access to that market.

So, whatever we do, we want to see a positive result quickly, and I am going to use a cowboy analogy, because I don't know how to give you a straight answer other than this. What I do know is when you are training a horse, what you never want to do is use one ounce of pressure less than needed. What you want to do is just use only one ounce of pressure more than is necessary. And so I am dependent on you in Congress, and we are willing to work with you to figure out what that is. But that is where I see we are right now.

Mr. SHAW. I think even somebody from Michigan could figure that out.

[Laughter.]

Mr. LEVIN. Or Florida.

Mr. MOHATAREM. Congressman, the 1988 Trade Act clearly lays out a procedure for the Treasury to identify countries that might be manipulating the currency. The IMF has a process and the World Bank has a process. But we have to be willing to step up and ask that that process be utilized.

One thing we have to remember is that with Japan, as you have dealt with them for a long time, being identified as a currency manipulator I frankly believe would be more than sufficient to get them to stop because that is the one thing they do not want. Yet we have been very reluctant, and as the Director of the IMF noted in a Washington Post article today, we have been very reluctant to go to the IMF and to make that request.

So, I think that is where it has to start, that we have to be willing to say this is inappropriate, this is unacceptable, and that we will use our laws and our international agreements.

Mr. LEVIN. Amen. Thank you.

Mr. SHAW. Mr. Mussalleem, let me ask you one question with regard to medical devices and the extensive process that you have to go through. Have we had any instances where a device has been approved by the FDA that has not met the standards required of the Japanese?

Mr. MUSSALLEM. Thank you for that question, Mr. Chairman. This happens routinely. As a matter of fact, I can just speak of our own company. We have several heart valves that are approved in this country that are not approved yet in Japan, and——

Mr. SHAW. Is that because of red tape or have they been turned down?

Mr. MUSSALLEM. It is generally because of red tape.

Mr. SHAW. So, there are Japanese people who are dying because these life-saving devices are just not approved.

Mr. MUSSALLEM. That is absolutely true.

Mr. SHAW. Answer specifically, though, what I asked. Has any device been actually turned down by the Japanese after going through their extensive process that was approved here that you can recall?

Mr. MUSSALLEM. Well, what happens along the way is they do get turned down, and then we resubmit data, and ultimately these generally get approved. So, what we find in general is that product lines get approved in Japan, but somewhere 3 to 5 years after they are approved in this country, often. So, we are oftentimes even producing products uniquely for Japan because they are out of date by the standards that would be employed in the rest of the world.

Mr. SHAW. Somewhere along the line we have got to in our country, as well as other countries, countries that have a vigorous process, up to the standard of our own, allow companies to have an abbreviated process once it has been approved and whatever the gold standard is with the other country, because it is crazy to make you guys go through it all, and it just runs the cost of health care up. We are going to have to adjourn this hearing right now because we are out of time. There are a number of questions, including a couple that I know the Chairman wanted to submit, that we would be submitting to you, and we will keep the record open for that purpose. Thank you very much.

[Whereupon, at 5:29 p.m., the hearing was adjourned.]



[Questions submitted from Chairman Thomas and Representative Thompson to Ms. Wendy Cutler, Ms. A. Ellen Terpstra, and Dr. Mustafa Mohatarem, and their responses follow:]

QUESTION SUBMITTED BY CHAIRMAN THOMAS TO MS. WENDY CUTLER

**Question: Thank you for testifying before the Committee on Ways and Means during the September 28, 2005, hearing on U.S.-Japan Economic and Trade Relations. In addition to your testimony before the Committee, please submit written responses to the following questions:**

**The United States was ultimately successful in the World Trade Organization apples case, but that case does not appear to have broader application to sanitary and phytosanitary barriers on other products. Is there a potential and appropriate broad-based WTO case that could be brought against the Japanese for its sanitary and phytosanitary barriers to trade, and what cases would have the broadest results in opening the Japanese market for many U.S. goods?**

Answer: WTO dispute settlement cases generally need to address specific measures of a WTO Member. On an ongoing basis, the United States monitors Japan's compliance with WTO obligations and is prepared to take WTO dispute cases as appropriate. The United States has taken two dispute cases against Japan for its phytosanitary measures and we won them both: (1) a dispute on Japan's varietal testing requirements for fruit in the late nineties, which opened Japan's market to tomatoes and resolved barriers related to fumigation of fruit, and (2) a dispute with Japan for its fire blight measures on imported U.S. apples that we expect will result in a resumption of apple shipments to the Japanese market later this year.

In response to U.S. concerns, we recently obtained Japan's commitment to take the necessary steps to reform its phytosanitary measures so that these decisions are science-based and more predictable. Under the auspices of the U.S.-Japan Regulatory Reform and Competition Policy Initiative, Japan has committed to conduct import risk assessments for quarantine pests in accordance with the relevant International Plant Protection Convention standard using science to determine if these pests should be subject to quarantine measures. In concrete terms, Japan has removed three citrus pests from its fumigation target list, thereby eliminating over \$1 million in annual fumigation costs on imports of U.S. citrus. In another step in the right direction, Japan also has agreed to assess 11 more pests, including pests found in lettuce, to determine if fumigation requirements for them are necessary. We believe our work under the Regulatory Reform Initiative is a positive and constructive path to addressing systemic phytosanitary regulatory impediments in Japan. Nevertheless, we will continue to monitor Japan's actions and take appropriate and necessary steps to ensure Japan meets its international obligations.

**Question: Please provide an update on the status of specific agriculture barriers in Japan including whether Japanese government officials have provided U.S. officials with adequate scientific information and risk assessments to justify the barriers as well as whether the laws, regulations, and legal guidance on the standard and the appropriate controls, if any, are available. In each instance that the information has not been made available by the Japanese government, what is the U.S. Government's strategy for obtaining the information to determine whether the standards and controls are appropriate and WTO compatible? Please identify the timeline for actions needed by U.S. and Japanese officials in this regard.**

Answer: Clearly the most critical barrier that Japan maintains is its import prohibition on U.S. beef. We have repeatedly and consistently engaged Japan at all levels on this issue. This Administration has transmitted a huge amount of scientific information to the Japanese government on the safety of U.S. beef. By any reasonable measure, Japan has had ample time to reach a conclusion to this issue. We will continue to press hard on Japan until it does the right thing in line with science and fully reopens its market to U.S. beef.

In addition to beef, as noted in the previous question, USTR and USDA have been working with the Japanese government to eliminate unjustified phytosanitary restrictions by bringing Japan's phytosanitary regime in line with international standards. Further, USTR and USDA are working to resolve sanitary and phytosanitary issues on U.S. cherries, chipping potatoes, and poultry. If USDA is unable to resolve issues at a technical level, USTR can engage the Japanese government bilaterally and through the World Trade Organization, as appropriate.

**Question Submitted by Chairman Thomas to Ms. A. Ellen Terpstra**

**Question: Thank you for testifying before the Committee on Ways and Means during the September 28, 2005, hearing on U.S.-Japan Economic and Trade Relations. In addition to your testimony before the Committee, please submit written responses to the following questions:**

1. The United States was ultimately successful in the World Trade Organization apples case, but that case does not appear to have broader application to sanitary and phytosanitary barriers on other products. Is there a potential and appropriate broad-based WTO case that could be brought against the Japanese for its sanitary and phytosanitary barriers to trade, and what cases would have the broadest results in opening the Japanese market for many U.S. goods?
2. Please provide an update on the status of specific agriculture barriers in Japan including whether Japanese government officials have provided U.S. officials with adequate scientific information and risk assessments to justify the barriers as well as whether the laws, regulations, and legal guidance on the standard and the appropriate controls, if any, are available. In each instance that the information has not been made available by the Japanese government, what is the U.S. Government's strategy for obtaining the information to determine whether the standards and controls are appropriate and WTO compatible? Please identify the timeline for actions needed by U.S. and Japanese officials in this regard.

Answer:

Dear Mr. Chairman:

Thank you for your letter of October 4, 2005, regarding the Committee hearing on U.S.-Japan Economic and Trade Relations of September 28, 2005, and requesting additional information in connection with my testimony.

As you know there have been some key developments since the hearing was held. Most notable, of course, was the reopening of the Japanese market to U.S. beef products on December 11, 2005. Resumption of beef trade with Japan is, indeed good news for American producers and Japanese consumers, and an important step toward normalized trade, based on scientifically sound, internationally recognized standards. While we are currently addressing issues of compliance with Japan's import requirements, we believe that the measures Secretary Johanns recently announced will prove satisfactory to the Japanese officials.

You asked if there was a broad-based World Trade Organization (WTO) case that could be taken against the Japanese on sanitary and phytosanitary (SPS) barriers to trade. We have successfully brought two SPS cases against Japan in the plant health area. One involved Japan's measures concerning codling moth and the other involved a pathogen known as fireblight. In each case, the United States successfully challenged scientifically unjustifiable measures that improperly restricted market access for U.S. apples and certain other fruits. The balance of rights and obligations under the SPS agreement is to permit WTO Members to adopt SPS measures necessary for the protection of human, animal and plant life or health without unnecessarily restricting trade with other Members. Consequently, the SPS agreement requires risk assessments associated with particular products coming from particular countries and sufficient scientific evidence to support the measures applied as a result of such risk assessments. Therefore, the SPS agreement contemplates examination of individual measures as applied to particular goods from Members, among whom different risks to the importing country may exist because of differing occurrences of diseases, pests, and other health risks. Some of Japan's measures applied with respect to U.S. goods or goods from other trading partners may be scientifically justifiable. Others may not be. The United States has been more aggressive with Japan than with any other country in the WTO in terms of bringing two formal WTO disputes to challenge scientifically unjustified SPS measures.

Regarding your request for an update on the status of specific agriculture barriers, please see the enclosed list which provides information on the status of key trade issues. In addition, we are seeing progress in other areas. Japan publishes its quarantine laws, maintains a website in English, and provides timely WTQ notifications on a number of issues. We fully expect these practices to continue. We also have an ongoing dialog with Japan on many levels, including through the U.S. Embassy in Tokyo, which has been vital in our information sharing and collecting.

Progress on all of these issues has also been advanced by the timely intervention from many Members of Congress, including yourself and other members of the Committee on Ways and Means. We must continue to work together to resolve issues with Japan since it represents an extremely important market for U.S. farmers and ranchers (at \$8.14 billion, our number three market in calendar year 2004). We

highly value our commercial relationship with Japan and want it to contribute to strengthening our overall bilateral relationship.

Thank you again for the opportunity to testify before the Committee and respond to your follow-up questions related to that hearing.

Sincerely,

A. ELLEN TERPSTRA  
*Administrator*

**Japan Key Trade Issues January 2006**

ISSUE	STATUS	NEXT STEPS
Aflatoxin	Currently, all U.S. corn bound for food processing in Japan are subject to "test and hold" inspections at import arrival because of a single finding of a U.S. corn sample that had an aflatoxin level exceeding Japan's established maximum level. Japan is our top market for corn..	USDA continues to work with Japan's Ministry of Health, Labor and Welfare (MHLW) to alleviate any delays and increased costs due to Japan's requirements for aflatoxin inspection for U.S. corn shipments.
Bt10	Syngenta's Bt10 corn was released in limited quantities and was not commercially approved at the time of its release. However, in March 2005, U.S. regulatory agencies determined that there were no food, feed, or environmental safety issues associated with Bt10 and that Bt10 is legal to be in food and feed in the United States. Currently, FDA is responding to Syngenta's formal request for a food safety consultation of Bt10..	USDA will continue to work with grain traders and Japan's Ministry of Agriculture, Forestry and Fisheries (MAFF) to ensure that Japan's proposed guidelines and procedures for Bt10 testing will not cause unnecessary and costly trade disruptions for corn shipments.
Cherries	USDA is currently working with Japan to develop a systems approach alternative to costly methyl bromide fumigation for U.S. cherries. Japan is reviewing data collected from studies on the presence of codling moth in Pacific Northwest cherry orchards..	Studies will be conducted in California orchards in 2006.
Chipping potatoes	Japan is in the final stages of granting market access for U.S. chipping potatoes. In July 2005, Japanese officials completed inspections of U.S. potato fields. The Japanese Ministry of Agriculture, Forestry and Fisheries (MAFF) is currently soliciting public comment on revised regulations to allow market access for U.S. chipping potatoes..	Japan is expected to open the market for chipping potatoes in early 2006, pending successful revision to their regulations and visits to supplying States in the United States.

ISSUE	STATUS	NEXT STEPS
New Maximum Residue Levels (MRL) system	Japan is revising its MRL regulations to improve its system to limit the distribution of foods that contain agricultural chemicals above established tolerances. In this action Japan is proposing to adopt numerous new MRLs involving over 700 pesticides, veterinary drugs, and feed additives..	USDA's foreign Agricultural Service is working with the U.S. agricultural industry, the U.S. Environmental Protection Agency, and Japan's Ministry of Health, Labor and Welfare (MHLW) to avoid proposed MRLs which could create trade disruptions.
Heat-treated poultry	Japan conducted inspections of a sampling of U.S. poultry plants in March 2005. Japan provided an audit report of these inspections, and USDA and the U.S. poultry industry are currently preparing for a follow-up audit. Most recently, USDA and USTR officials, during trade discussions held in Seattle on December 7, 2005, raised this issue with senior Japanese officials, and pressed for a timely resolution..	USDA is working with Japan to implement protocols for heat-treated poultry products to avoid trade disruptions caused by detections of avian influenza in the United States. When fully implemented, the protocols are expected to eliminate avian influenza related trade disruptions to U.S. heat-treated poultry product exports.

QUESTION SUBMITTED BY CHAIRMAN THOMAS TO DR. MUSTAFA MOHATAREM:

**Question: Thank you for testifying before the Committee on Ways and Means during the September 28, 2005, hearing on U.S.-Japan Economic and Trade Relations. In addition to your testimony before the Committee, please submit written responses to the following question:**

**Please outline in detail any specific legal or regulatory requirements placed upon U.S. automobiles when sold in Japan that are not in place for autos produced in Japan. Identify any known justification by Japanese officials for these requirements and the steps taken by U.S. auto firms to contest the requirements. In each case explain the rationale as to why the requirement is not WTO compatible and the evidence that might be used to support any U.S. claim against Japan.**

Answer:

Dear Chairman Thomas:

Thank you for giving me the opportunity to testify before the Committee on Ways and Means on the challenges American auto manufacturers face in competing with Japanese manufacturers—in the United States and around the world.

In your letter of October 4, 2005, you requested information on any specific legal and regulatory requirements that impede the sale of U.S.-made vehicles in Japan. As I noted in my testimony, American automakers are unable to sell vehicles in substantial volume in the Japanese market as a result of the persistent policy of the Japanese government to intervene in currency markets to weaken the value of the yen relative to the U.S. dollar. As a result, U.S. auto manufacturers are relegated to the position of niche, low-volume players in Japan. Our low volumes place us at a distinct disadvantage when complying with local regulatory requirements as compared to Japanese manufacturers who can spread the regulatory costs over a much higher volume.

The problem is that Japan has promulgated several safety and emission regulations that are not harmonized with either the U.S. or European regulatory systems. Examples include pedestrian head protection, driver visibility requirements, an advanced OBD system, enhanced emission standards for NOx and particulate matter, and a new fuel economy standard. These and other regulations that are specific to Japan are burdensome to importers because the costs that American manufacturers incur to make the engineering and design changes necessary to comply are prohibitive when sales volume per model are in the hundreds of units. Not surprisingly,

Japanese manufacturers are able to spread these costs over a huge volume base in their home market.

In short, a weak yen that is the direct result of currency intervention by the Bank of Japan prevents us from profitably selling high volumes of products in Japan. The low volumes, in turn, lead to much higher per unit costs of complying with Japan's unique regulatory standards. Thus, even though Japanese manufacturers must comply with the same requirements, the compliance burden is much greater on importers.

The key to opening the Japanese market for American products thus lies in persuading the Japanese government to cease its policy of currency manipulation. While elimination of regulatory burdens will help, a market determined yen dollar exchange rate is essential to the success of American auto manufacturers, in Japan and in the U.S.

Sincerely,

G. MUSTAFA MOHATAREM

QUESTION SUBMITTED BY REPRESENTATIVE THOMPSON TO Ms. WENDY CUTLER

**Question: Wine**

**Japan is the second largest export market for American wine. However, it has one of the higher tariffs for wine in Asia, with a 15.3% tariff rate for bottled wines. This tariff rate exceeds China's tariff rate, which is 14%, or Taiwan's rate, which is 10%. How does a developed country like Japan justify such a high rate, especially when the purchasing power for the average Japanese is approximately 36 times greater than that of the average Chinese?**

Answer: Japan's agricultural tariffs generally are significantly higher than other countries' tariffs. In fact, Japan's average agricultural tariff is 51 percent, compared to the United States' average agricultural tariff of 12 percent. During the Uruguay round of negotiations, Japan did reduce its bound tariff on wine from 55 percent to 15 percent. Significant improvement in market access for U.S. food and agricultural exports is a top priority for the agriculture negotiations in the WTO. In the Doha Development Agenda, the United States is seeking a significant cut in Japan's food and agricultural tariffs, including for exports of U.S. wine.

**Question: Timber**

**In the 1990 U.S.-Japan Wood Products Agreement, Japan committed to take the necessary steps to reduce overall tariff rates on wood products. This doesn't appear to be the case, with Japan's tariff rates on timber products as high as 10%. By contrast, both China and Indonesia charge zero rate of duty on logs and lumber. What steps is the USTR taking at the Doha round to get Japan on board in support of U.S. trade liberalization objectives?**

Answer: In the industrial goods market access negotiations in the Doha round—where forest products are covered—the United States is pressing for a robust tariff-cutting formula that reduces tariffs on a line-by-line basis with no flexibility from application of this formula for developed countries, including Japan.

**Question: Medical Devices**

In 2002, Japan implemented a new "foreign reference pricing" system for medical devices. The pricing system links prices in Japan to those prevailing in the United States, France, Germany and the United Kingdom. Is it appropriate for Japan to base prices for medical devices on comparisons with overseas markets?

Answer: We continue to press Japan's Ministry of Health, Labor and Welfare to implement reimbursement pricing policies that reward U.S. companies for developing innovative, life-enhancing medical technology. We will keep urging that Ministry to ensure its policies do not unfairly discriminate against American medical devices and that reimbursement levels are determined in a way that is transparent, predictable, and fair. Over the years, we have had a long and cooperative relationship with the U.S. medical device industry on reimbursement pricing issues in Japan. We share U.S. industry's concerns about the Foreign Average Price rule for medical devices and we are prepared to ratchet up our approach to the Japanese government on this matter as necessary.

**Question: Rice**

**In June, the Japanese government announced a new policy to sell large stockpiles of imported rice at discounted prices for the production of rice/flour premixes called "cake mixes." Does this new policy violate Japan's WTO obligation not to treat imported rice differently than domestic rice? If so, shouldn't Japan offer the same discounted price to all other end users, including retailers, foodservice and other industrial buyers? What**

**plans, if any, does the administration have for addressing this discriminatory policy and preventing it from being implemented?**

Answer: On June 29, 2005, Japan's Ministry of Agriculture, Fisheries, and Forestry announced new guidelines for the sale of imported rice from government held stocks. While we strongly support the release of government held stocks of imported rice into commercial markets in Japan, we are very concerned about the restrictions that these new guidelines impose on these sales.

These guidelines establish complex rules that base the volume of imported rice cake mix that each company is eligible to purchase on the amount of imported rice cake mix it has historically imported. The guidelines also create incentives for processors to reduce their purchases of imported rice by linking increases in the quantity of imported rice that processors are permitted to purchase from government stocks to reductions in the quantity of imported rice cake mix. Further, the guidelines impose penalties that reduce the amount of imported rice stocks a processor may purchase if it fails to reduce its imports of imported rice cake mix by the amount claimed.

USTR and USDA are currently evaluating whether the new guidelines raise WTO concerns and are working closely with U.S. industry to resolve this issue.

[Submissions for the record follow:]

**Statement of The American Farm Bureau Federation**

The American Farm Bureau Federation is pleased to submit for the record our views on the economic effects of the closure of the Japanese market to U.S.-produced beef.

The discovery of a BSE-infected cow in Washington state in December 2003 resulted in serious disruptions in beef and cattle trade between the U.S. and other beef producing and consuming countries. Following the identification of the BSE-infected animal, more than 60 countries banned the importation of U.S. beef. Since that time, the U.S. has resumed trade at levels that account for roughly one-third of the pre-BSE volume. However, two of the traditionally largest export markets, Japan and South Korea, still remain closed to U.S. beef. Losses to the U.S. cattle and beef industry resulting from the discovery of BSE conservatively total \$4 billion.

In 2003, the U.S. exported 2.5 billion pounds of beef and beef variety meats valued at \$3.8 billion. Japan and South Korea alone accounted for 1.2 billion pounds of beef and beef variety meats totaling \$2.2 billion in value. The domestic discovery of a BSE-infected cow resulted in market closures and a reduction of U.S. beef exports in 2004 to less than 500 million pounds. A primary consequence of the reduced market access for U.S. beef is that other world beef exporters were able to gain global market share that they will not easily relinquish once the U.S. regains access to traditional trading markets. Although the U.S. is slowly regaining access to previous export markets, it will likely be several years before U.S. beef is traded at volumes attained prior to the discovery of BSE.

More specific to the Japanese beef market, the U.S. and Japan reached an agreement in October 2004 to facilitate the resumption of U.S. beef exports to Japan. Japan's Food Safety Commission (FSC), which makes the final determination on resuming imports of U.S. beef, has been reviewing the safety of U.S. beef since the agreement was signed. Despite aggressive negotiations on the part of the U.S. government and extensive scientific information that has been provided by the U.S. Department of Agriculture, academia and the beef industry, the time for a final report from the FSC is uncertain. Without a decision from the FSC, trade remains halted and the financial losses to U.S. beef producers continue to mount.

The U.S. has provided all the data necessary to demonstrate that U.S. beef can be safely imported and enjoyed by Japanese consumers. Furthermore, we have advanced our part of the October 2004 agreement which entailed amending our regulations to permit the limited import of certain types of low-risk Japanese beef. Given the overwhelming amount of scientific evidence that shows U.S. beef is safe and the efforts that have been made to share that information with Japan, the American Farm Bureau Federation strongly believes Japan should move as quickly as possible to reopen their market to imports of U.S. beef. Thank you.

**Statement of The Automotive Trade Policy Council**

2005 is shaping up to be another strong year for auto sales in the United States. Based on vehicle sales thus far, U.S. car and light truck sales should reach just over 17 million units. Annual U.S. auto sales have hovered at or exceeded 17 million

units—a level that was considered unattainable as recently as the 1990s—for seven straight years.

Given the strength of auto sales, one would think that U.S. auto manufacturers, auto suppliers and their workers would be in a strong economic position. However, this is not the case. Despite the strong sales, U.S. auto manufacturers and suppliers are struggling to turn a profit, autoworkers have been laid off, credit ratings for U.S. auto companies have been downgraded and many suppliers are faced with bankruptcy—including the largest auto supplier in the world, which filed Chapter 11 last week.

While there are many reasons for the current challenges facing American owned auto manufacturers, the long history of Japan's unfair and mercantilist trade policies and the most recent impact of Japan's currency manipulation stand out as among the primary causes. While the world's acceptance of Japanese postwar export-based economic growth model has been a long debate here in Congress and elsewhere, it is frustrating, if almost unbelievable, to many of us in this business that the Japanese government's extraordinary \$400 billion currency manipulation program has gone unquestioned and unchallenged—by the press, academics, and to a large degree Congress and the Administration—while China has become the sole focus of the attention as the challenge to American competitiveness.

#### **U.S.—Japan Automotive Trade**

No industry exemplifies the imbalanced, mercantilist history of Japan's postwar trade policy more than the automotive sector. Last year, the U.S.-Japan bilateral automotive trade deficit reached \$43.7 billion, making it the largest trade deficit in any sector the U.S. maintains with any country in the world. In 2004, automotive trade represented over two-thirds of the total U.S.-Japan deficit. And this is not a new development: it has been the case for more than twenty years, confirming the deep historical and structural nature of the chronic trade imbalance.

A quick glance at the trade numbers confirms this unbalanced pattern: in 2004, Japan exported to the U.S. over 1.7 million passenger vehicles, as well as auto parts, worth a total of \$46 billion. During the same time, Japan imported just 15,000 passenger vehicles as well as auto parts from the U.S., worth a total of \$1.8 billion.

The market share of Japanese nameplate brands reached over 30% of the total U.S. light vehicle market in 2004—including nearly 40% of passenger cars. In contrast, sales of all foreign nameplates (worldwide) in Japan reached only 4.5% of the total market or 272, 880 import sales.

Japan's motor vehicle manufacturing industry, led by Toyota, Honda and Nissan, produced over 10 million vehicles in 2004. In the same year, just about 6 million motor vehicles were sold in Japan. Buffeted by a persistently stagnant economy, sales of domestically produced passenger cars have basically been flat for a decade or more. Domestic manufacturers dominate the market with Toyota, Honda, Nissan, Mitsubishi, Mazda, Fuji Heavy, Suzuki, Daihatsu, and Isuzu accounting for nearly 95% of Japan's market in 2004. U.S. nameplates continue to represent less than three percent of Japan's total market.

The reality is that Japan has built and grown its economy based on exports, and has fueled that export machine by restricting and controlling its domestic market. It is a mercantilist model that others have sought to follow, and it has succeeded in large part, at the expense of its trade partners. A major factor in the past years that has compounded and sustained this imbalanced trade relationship has been the Japanese government's policy of maintaining an artificially weak value of the yen against the dollar. This policy has been fueled by massive interventions—over \$400 billion—by the Japanese government in currency markets since 2000 [see attachment 1]. This artificially weak yen has provided a subsidy amounting to thousands of dollars per vehicle for every car exported to the United States [see attachment 2]. It has given a significant competitive cost advantage to Japanese vehicle makers, who have used this windfall to increase investments in technology and plants worldwide, offer higher sales incentives, broaden and deepen advertisement campaigns, and enhance research and development.

In 1995, the U.S. and Japan signed a five-year agreement intended to address the huge structural imbalance in our automotive trade by improving the access of U.S. automakers to the Japan market. It was a good agreement, and resulted in modest positive progress for U.S. companies selling into the Japanese market. But in 2000 the Japanese government engaged in a renewed policy of major currency manipulation that negated or reversed much of those gains. At the same time, pushed by a weakened yen which made its exports more cost competitive,

Japan's automotive imports to the U.S. renewed a substantial upward trend, continuing to rise every year, while ATPC member companies' combined market share in Japan remains below 3%, unchanged from the 1995 level.

Japan's history of discouraging direct foreign investment and the close business relationships (*keiretsu* ties) between Japanese firms traditionally made it difficult for outsiders to participate in the market. This is now changing. In the last few years, foreign auto companies have acquired controlling interest in a number of Japanese auto companies. This change, however, is still too recent to determine whether it will have a lasting effect on opening access to the Japanese auto market.

Today's auto industry is a global one that is intensely competitive. ATPC and its member companies believe that it is critically important that the U.S. continue to press countries such as Japan to eliminate artificial trade barriers, such as currency manipulation, that provide them an unfair competitive advantage.

### **The Economic Impact of the U.S. Auto Industry**

The U.S. automakers—DaimlerChrysler Corporation, Ford Motor Company, and General Motors Corporation—are a critical component of the manufacturing and industrial base of the United States. Our companies have been instrumental in the growth and prosperity of the American economy in the 20th century and continue to serve as an engine of economic growth.

Our companies face unprecedented competitive challenges from auto producers around the globe. We are meeting these challenges by investing billions of dollars in the United States in new products, facilities, advanced technologies, and education and training. The following are highlights of the vital role DaimlerChrysler, Ford, and General Motors play in our economy, our communities, and the major challenges we face.

The auto industry is essential to the health of the American economy, accounting for 4% of U.S. GDP and 11% of manufacturing shipments. DaimlerChrysler, Ford, and General Motors comprise the majority of that contribution. They:

- Manufacture 74% of all the cars and trucks made in America
- Employ nearly 400,000 workers across the United States
- Have 176 major automotive facilities in 34 states
- Purchase 80% of all U.S. auto parts—totaling \$155 billion
- Are among the largest purchasers of U.S. semiconductors and electronics, rubber, aluminum, iron, and steel
- Invested over \$176 billion in the U.S. auto industry since 1980—85% of the total investment made by all automakers
- Spend over \$16 billion annually on research and development—significantly more than any other industry sector
- Provide health care benefits to over 2 million U.S. employees, retirees, and their families at an annual cost of \$9.3 billion (2004)
- Pay over \$11 billion in pension payments each year to over 800,000 retirees and surviving spouses, providing economic stimulus in every state in the United States

### **Specific Areas of Concern**

**Traffic:** *Japan has a 0% tariff rate on motor vehicles. The fact that Japan maintains a 0% motor vehicle tariff, yet is among the most difficult and unwelcoming markets in the industrialized world for imports is the classic example of how powerful non-tariff barriers can be in severely limiting trade.*

- **Financial Services:** Credit companies cannot act as insurance agents in offering credit products that incorporate insurance features. The credit industry continues to be subject to “administrative (METI) guidance” rather than specific, well-documented and transparent rules and regulations.
- **Standards:** In the 2003 Annual Trade Report, USTR states “Further opening of the Japanese auto and auto parts markets remains an important objective of the United States. Access to Japan's automotive market continues to be impeded by a variety of overly restrictive regulations, a lack of transparency in rule making, and lackluster enforcement of antitrust laws. While there has been a trend toward closer integration and important technological advancements in the global automotive industry over the past several years, the effect these changes will have on market access and competition in this sector remain unclear.”

Japan has made attempts to improve the transparency of its standards regime over the years, however some serious problems still remain. Certification of import autos remains costly & difficult. Two systems are allowed, with limited vehicles (PHP type) and expensive and extensive testing required (TDS type). In both cases, imports need to meet unique standards. This means that imported vehicles must



undergo expensive modification to meet unique standards; limited imports under PHP prevent free importation of vehicles; long delay in approval process for TDS type inspections. Also, unique homologation requirements are discriminatory to imported vehicles. Currently, for example, three areas are of concern in ongoing standards issues impacting U.S. imports including: driver visibility, pedestrian protection, and VIN stamping.

- **Trade-Distorting Taxes:** A tax system with a number of different automobile-related taxes, including a consumption tax, an annual engine-displacement based tax that ranges from 7,200 to 111,000 yen, and an acquisition tax of 3% to 5% based on vehicle size and use, which has the cumulative effect of impacting imported motor vehicles more than domestic vehicles, unfairly discriminating in final sale prices.
- **Structurally Closed Market:** The results of this unusually imbalanced trade model are seen most clearly in the Japan experience. Japan's pursuit of aggressive worldwide market expansion for its auto exports from a protected domestic automotive market base has resulted in the most vivid example in the WTO history of severe distortion of the principles and expectations of the founding Charter of the General Agreement on Tariffs and Trade.

### Currency Manipulation

Currency manipulation is a policy used by the governments and central banks of some of America's largest trading partners to artificially set the value of their currency to gain an unfair competitive advantage for their exports. The IMF defines currency manipulation as "protracted large-scale intervention in one direction in the exchange market." Japan's interventions in currency markets—over 150 times in five years in the amount of \$400 billion—without question meets that definition. Countries that manipulate their currencies effectively protect jobs in their home country at the expense of jobs and economic growth in their trading partners' markets. Japan, in particular, has been using currency manipulation to avoid making much-needed domestic economic reforms.

In effect, Japan's weak yen policy has given its exporters a huge subsidy and competitive advantage in the U.S. market, causing significant harm to U.S. manufacturers. One clear sign that a country is manipulating its currency is a substantial increase in its foreign currency reserves, which occurs as it buys and holds dollars. Japan has seen a massive increase in its foreign currency reserves since 2001—in fact, Japan holds more forex reserves than any other nation, including China—growing from \$344.8 billion in July 2000 to \$840 billion in July 2005 [see attachment 3].

In a January 2005 Working Paper, the U.S. Federal Reserve reported that "Since the early 1990s, the monetary authorities of the major industrialized countries, with one notable exception, have greatly curtailed their foreign-exchange interventions. That exception has been Japan, where the Ministry of Finance has continued to intervene frequently—and at times massively—in foreign exchange markets."

There are differences in how countries manipulate their currency to gain unfair trade advantages for their export industries. The intent, however, is always the same—to artificially weaken their currency to provide their industries with a cost advantage. Japan has regularly and actively intervened in global exchange markets, purchasing massive amounts of dollars in order to "push down" the value of their own currency to give their exports a price advantage. Japan also manipulates its currency by less transparent actions, such as encouraging domestic pension funds and large corporations to sell yen and buy dollars at strategic times. Since 2000, Japan has intervened over 150 times in global currency markets, spending over \$400 billion in the process. In 2004, Japan spent over \$139 billion, all in the first quarter.

As a result of Japan's massive and disruptive currency interventions, the value of the yen fell from 101 yen/dollar in January 2000 to 136 yen/dollar in 2002. Market forces, helped by Bush Administration officials' statements, have pushed the yen to slightly more reasonable levels of 105 yen/dollar in early 2005 [see attachment 4]. However, due in part to ongoing "jawboning" and verbal intervention by high-ranking Japanese officials, the yen is currently in the 111 yen/dollar range. The damage caused to key sectors of the U.S. economy have been deep and in many cases permanent.

Japan's artificially weak currency provides a significant per-vehicle cost advantage that amounts to an outright subsidy of thousands of dollars for every car exported to the United States. Cars produced here also benefit heavily from this subsidy because of their high use of imported parts and components. Japanese automakers have used this cost advantage to:

- Minimize price increases on new models and in some cases reduce prices on new models;
- Dramatically increase spending on advertising;
- Offset tariffs, taxes and other fees; Increase incentives to boost market share; and
- Enhance spending on research and development.

For those who may question whether exchange rate policies of our trading partners are important factors affecting U.S. competitiveness, half-year earnings statements just released by Japan's automakers this month answer that conclusively. Toyota, Nissan, Honda, Subaru, and others announced last week that they earned nearly \$1 billion in windfall profits in the first half of their fiscal year due to the artificial weakness of the yen.

Most Japanese automakers set a projected exchange rate of 105 yen/dollar as their benchmark at the beginning of the 2005 fiscal year. But, because Japanese government policies resulted in a yen/dollar exchange rate much weaker than that, Japanese automakers' total profits increased by 112 billion yen—over \$1 billion—above what they projected. Much of that increase came as a result of sales in the United States. According to the Nikkei news service, the breakdown of these additional weak currency-driven profits include 50 billion yen / \$452 million for Toyota, 28 billion yen / \$253 million for Nissan, and 14.2 billion yen / \$127 million for Honda.

With no sign that the government will change its exchange rate policy to allow the yen to rise to its true market level (90 to 100 yen per dollar is the commonly accepted range), the full-year windfall could be a check for \$2 billion to Japan's automakers.

There are several international agreements that preclude or limit the use of currency intervention for trade-distorted purposes. These agreements seem to put Japan's actions on currency intervention on the level of a NTB. Of particular interest are the rules governing the IMF and the original GATT. Section IV of the IMF charter states without reservation, that "members should avoid manipulating exchange rates in order to gain an unfair competitive advantage over other members" and defines such manipulation as "protracted, large-scale movement in one direction in exchange market."

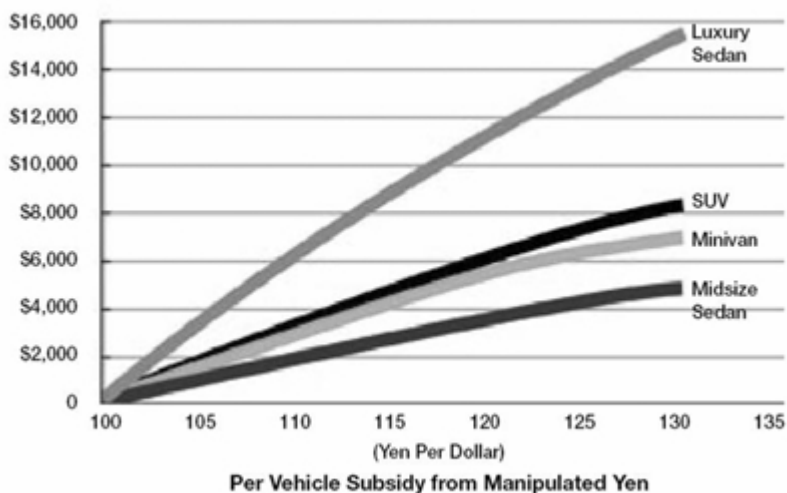
Perhaps more relevant, GATT Article XV (Exchange Arrangements) states that contracting parties shall not, by exchange action, frustrate the intent of the Agreement not by trade action, the intent of the provisions of the Articles of Agreement of the IMF. The intent of the Agreement, as stated in the preamble, is the objective of "entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade."

Japan is clearly violating GATT Article XV by manipulating its currency to keep it artificially weak. Japan is in effect providing a substantial subsidy to its exporting. These practices are clearly inconsistent, and likely violate both the IMF and the GATT Agreements, cause major distortions to international trade and should validly be questioned and challenged as part of an Automotive NTB Vertical Initiative in the NAMA as the largest single non-tariff barrier that Japan maintains with the U.S. in automotive trade. (Also GATT XXVI  $\leq$  Nullification and Impairment).

### **Conclusion**

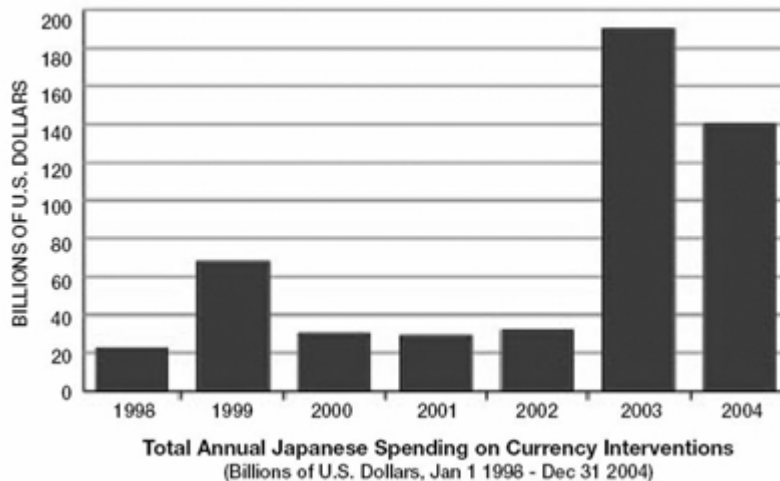
Automotive trade between the United States and Japan has been chronically and structurally unbalanced for decades. Over the past twenty years, automotive trade has represented 66% of our total deficit with Japan. Contrary to claims that the opening of Japanese auto plants in the U.S. would cause Japanese auto exports to decline, Japan's automakers have sharply increased their exports to the United States. Over the last five years, subsidized by an artificially weak yen funded by \$450 billion in Japanese government currency interventions, Japan's automakers have exported an annual average of 1.8 million cars and trucks into the United States, 13% higher than the average from 1996–2000. Japan's auto trade with the U.S. is a one-way street that, if left unchecked, will continue to see our largest single-sector trade deficit grow even more imbalanced. Japan's government needs to take the steps necessary—steps it pledged originally in the 1995 Auto Agreement but which have never been truly tested in a market environment due to the widespread use of currency manipulation—to reduce friction in automotive trade.

**2) The Weak Yen Provides Japanese Automakers With a Significant Cost Advantages in the U.S. Market**



Source: ATPC Member analysis

1) **Japan's Currency Manipulations Have Been Massive**



Source: Bank of Japan

**Statement of Joseph Damond, PhRMA**

*Recognizing the Value of Pharmaceutical Innovation: Putting Patients First*

Mr. Chairman, Members of the Committee, Ladies and Gentlemen:

On behalf of PhRMA, I want to express our appreciation for the opportunity to present written testimony to the Committee. PhRMA represents America's leading life sciences companies. Our business is pioneering new ways to save lives, cure dis-

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Mr. Chairman, Members of the Committee, Ladies and Gentlemen:

On behalf of PhRMA, I want to express our appreciation for the opportunity to present written testimony to the Committee. PhRMA represents America's leading life sciences companies. Our business is pioneering new ways to save lives, cure disease, and promote a healthier aging process. We are businesses, but our broader mission is to enable patients around the world to live longer, healthier, and more productive lives. In 2005, America's pharmaceutical and biotechnology companies will invest over \$38.5 billion in advanced scientific research to develop new medicines. The fruits of our efforts are new and more effective innovative medical treatments for use around the world, bringing life, cures, and hope to patients and their families where currently there is none.

Japan is the world's second-largest pharmaceutical market. America's pharmaceutical companies have been doing business in Japan for decades. On an annual basis, sales of U.S. medicines currently total about \$14 billion, and represent about 25 % of the Japanese market. We are proud of our leadership in supplying Japanese patients with breakthrough medicines.

Japan's health care system has long been admired for its achievements in delivering universal access to quality health care services at a reasonable cost. However, more than any other industrialized nation, Japan now faces a difficult demographic and economic challenge as it rapidly transitions to an "aging" society. Bridging this transition—while continuing to provide Japanese patients with quality health care and access to the latest medical discoveries—will require changes in the way that health care services are financed and delivered.

PhRMA has been pleased to work with the Japanese Government and the Ministry of Health Labor and Welfare (MHLW) to explore constructive ways to support life sciences discovery and expand access to innovative medicines. Our paper—*Putting Patients First: A Program for 21st Century Health Care Reform in Japan*—represented a comprehensive effort to show that competition and choice are fully compatible with the NHI system's core principles of equity and universality. Working within the NHI system, PhRMA sought to show that a virtuous cycle of reform—one that links private sector incentives to advance medical progress with regulatory efficiencies in the delivery and financing of essential health care services—is in the interests of Japan as a nation and Japanese patients, who like patients everywhere want access to the latest advances in medical science. We welcome many of the MHLW's policy proposals in its bold 2002 Vision: "Towards Reinforcing the Global Competitiveness of the Pharmaceutical Industry, Mainstay of the 'Century of Life.'"

Over the past four years, PhRMA has been privileged to work with the Commerce Department and the Office of the U.S. Trade Representative on the Bush Administration's Regulatory Reform and Competition Initiative. This initiative, which was launched by President Bush and Prime Minister Koizumi in 2001, built on the Clinton Administration's Enhanced De-Regulation Initiative and the Reagan Administration's Market-Oriented Sector Specific Initiatives. It seeks to promote economic growth and open markets to American products by focusing on sectoral and cross-sectoral regulatory barriers. Our industry views the 1998 Birmingham Agreement as a major breakthrough. In the Birmingham Agreement, Japan committed to "recognize the value of innovation of pharmaceuticals and medical devices, so as not to impede the introduction of innovative products which bring more effective and more cost-effective treatments to patients. It committed to ensure transparency in the consideration of health care policies" and to allow foreign pharmaceutical manufacturers "meaningful opportunities to state their views in the relevant Councils . . ."

The Birmingham Agreement has transformed our industry's relationship with MHLW. Japan's commitment to improved transparency has proven invaluable, as it has allowed PhRMA companies to participate directly in MHLW's biennial price revision process and in the consideration by the Ministry of potential changes to the NHI drug pricing rules. In 1999, the Ministry created a new MHLW Study Group to facilitate more effective consultation with PhRMA, the Japanese Federation of Pharmaceutical Manufacturers (FPMAJ), and the European Federation of Pharmaceutical Industry Associations (EFPIA) prior to meetings of the Ministry's chief advisory council—the Chuikyo. Such transparency would have been unthinkable a decade ago when we were often on the outside looking in, when key rule and policy changes were discussed behind closed doors with Japanese stakeholders. We believe MHLW has taken its transparency commitments seriously. For its part, PhRMA has worked hard to come forward with thoughtful, constructive policy proposals, as in "Putting Patients First." We believe the Ministry appreciates its dialogue with U.S.

in Japanese competitiveness in the life sciences and an increasing drug lag. Recent studies confirm that many of the world's leading medicines still are not available to Japanese patients. The decline in Japan's life sciences sector, moreover, is accelerating. Many of Japan's leading pharmaceutical companies are now shifting their most advanced biomedical research and development to U.S. laboratories and introducing their best and most innovative drug discoveries in the U.S. market before bringing them to Japan.

Above all, I want to express PhRMA's appreciation to our U.S. negotiating team—the Department of Commerce, Office of the U.S. Trade Representative, State Department, and U.S. Embassy in Tokyo. Our negotiators secured the Birmingham commitments for our industry. However difficult the situation in Japan, we know it would be a lot worse if they had not negotiated forcefully on our behalf and worked tirelessly to hold Japan to its commitments on transparency and recognition of the value of innovation.

We are deeply concerned about certain near-term and long-term developments in Japan.

#### **Near-Term Developments**

In the near-term, policy proposals from MHLW threaten to roll-back some of the gains achieved through the bilateral dialogue. Of particular concern in the near-term are: (1) calls to abolish, reduce or restrict the application of the Foreign Price Adjustment for Pharmaceuticals (FPA-P); (2) suggestions that downward pharmaceutical price revisions be conducted annually—a major change from current biennial price reviews; and (3) increasing regulatory delays at the Pharmaceuticals and Medical Devices Agency (PMDA). Foreign Price Adjustment

The proposed changes to the FPA-P would accelerate the downward spiral in Japanese prices for leading innovative medicines. While PhRMA does not support foreign reference pricing as a general principle, the peculiarities and distortions of Japan's NHI pricing system mean that the FPA-P has become an important corrective mechanism for ensuring that Japanese prices are at least somewhat aligned with prices in the U.S. and Europe. If FPA-P is to be revised, it should only be in the context of overall reforms to the NHI system which address other underlying distortions, *e.g.* the practice of basing the prices of innovative new drugs on older, and less effective “comparators” that do not reflect the latest advances in biomedical science.

The proposed changes to the FPA-P would further erode Japan's recognition of the value of life sciences innovation and worsen the drug lag. If the rule is altered or eliminated, the Japanese pharmaceutical market is likely to become even more isolated and anachronistic, as NHI reimbursement prices grow increasingly out of line with those in other advanced industrial economies, *i.e.* the United States, Germany, France, and the U.K. Ultimately, the proposed changes to the FPA-P would hurt Japanese patients, who would experience even longer delays in access to advanced medicines.

#### **Annual Price Revisions**

Currently, NHI price revisions are instituted every two years based on a survey of drug prices. We understand that MHLW is considering changing from a biennial to an annual process. Again, while there may be legitimate reasons for the price revision process, such a change to annual revisions should only take place as part of a comprehensive reform of the current NHI pricing system, which addresses a host of rules and practices, such as the comparator system and various repricing rules, *e.g.* market expansion, that artificially depress the prices of breakthrough U.S. medicines. Otherwise, changing to an annual price revision process will only accelerate the downward spiral in Japanese new drug prices, and worsen the current delays in bringing the most innovative global medicines to Japanese patients.

#### **Regulatory—PMDA**

In the Birmingham Agreement, Japan committed to “[s]horten the approval processing period for new drug applications to 12 months by April 2000, with steady and continuous improvement between now and then, and to further speed the introduction of innovative new pharmaceuticals, significantly shorten approval times, particularly for priority drugs.” In addition, Japan committed to “[e]xpand acceptance of foreign clinical test data for pharmaceuticals.” Since 1998, PhRMA has worked closely with MHLW on the establishment of a new and independent regulatory agency—the PMDA—modelled on the U.S. Food and Drug Agency and the European Medicines Evaluation Agency (EMA). As part of this process, we worked closely with MHLW on a new system of user fees and benchmarks for speeding up the traditionally slow and cumbersome Japanese new drug evaluation process to the time frames achieved by FDA and EMA.

While we welcomed the creation of the PMDA, we are deeply concerned by the increasing delays in the new drug approval process; and increasing indications that the agency is experiencing serious difficulties in assembling the trained personnel, expertise, and resources to carry out its mission. Such delays carry a serious human cost. America's biopharmaceutical companies are leaders in developing innovative treatments for crippling and life-threatening diseases. With each new breakthrough medicine we produce, we offer new hope to countless people. However, such advances cannot help patients if they remain tied up in endless and regulatory processes. We are also concerned by the increasingly dire shortage of Japanese capacity for advanced clinical trials. Absent such capacity, it is vital the MHLW further expand the acceptance of foreign clinical data. In short, we urge an intensive effort by MHLW and PMDA to address the growing delays in the new drug approval process.

*Long-term Developments: Comprehensive Health Care Reform*

We understand that the Prime Minister has directed the Council on Economic and Fiscal Policy (CEFP) to begin developing proposals to reform Japan's social security and health care systems. Mr. Chairman, as the Ways and Means Committee knows, it is exceedingly difficult to successfully foster far-reaching reform legislation. We applaud the Prime Minister Koizumi's bold leadership in seeking to grapple decisively with the long-term challenges facing Japanese society. The task, though difficult, offers great potential benefits for Japan's economy and for U.S. health care companies.

However, we need your immediate help to ensure that the US industry is brought into the CEFP's process of developing health care reform proposals in a meaningful and timely way. Specifically, in the Birmingham Agreement, Japan committed to provide meaningful opportunities for US companies to state their concerns in the "relevant Councils" on an equal basis with Japanese stakeholders. The GOJ's broad Birmingham commitment clearly covers the CEFP.

Accordingly, we seek your support in urging GOJ to bring us into the CEFP process, so that we have a meaningful opportunity to share our ideas and views, consistent with the Birmingham Agreement. For our part, we pledge to approach our dialogue with the CEFP in a constructive and positive spirit, and to bring our best ideas, information, and experts to the table. We have much to contribute to the upcoming dialogue over reforming Japan's health care system, and are important stakeholders in the outcome. As always, our objective will be to ensure that Japanese patients continue to benefit from improved access to the latest advances in medical treatment and to life-saving cures for disease and disability.

*Conclusion*

Mr. Chairman, we applaud the Committee's leadership in scheduling this hearing. U.S.-Japan trade relations have changed dramatically in the past decade. Much progress has been achieved. Many challenges remain. We look forward to working with the Committee to continue to improve recognition of the value of pharmaceutical innovation in Japan; to ensure the continued transparency of Japan's pricing and health care policy processes; to speed the approval of innovative new medicines; and to lock in the benefits of the Birmingham Agreement for Japanese patients and global life sciences innovation. Thank you.

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**Statement of Todd Gillenwater, California Healthcare Institute, La Jolla, California**

The California Healthcare Institute (CHI) appreciates the opportunity to present its views for this important hearing.

CHI represents more than 250 of California's leading biotechnology, pharmaceutical, and medical device companies as well as our state's premier academic and non-profit research institutions. California medical device and diagnostics companies lead the world in life sciences R&D, accounting for nearly one-third of all medical technology innovators in the United States. Medical device and diagnostics firms in the state employ over 75,000 workers, account for over \$4.5 billion in exports, and, in 2003, received nearly 20 percent of the total life sciences venture capital dollars invested in the U.S.

The research these firms conduct holds tremendous promise for patients and their families. Already, advanced technologies such as replacement heart valves, implantable defibrillators, and coronary stents have helped reduce deaths from heart disease and stroke by more than half over the past 30 years. Medical tech-

nology products also contribute to our nation's economic health, increasing productivity by allowing workers to recover from illness faster, remain longer in the workforce, and thrive without expensive long-term care.

Important as these contributions have been, experience elsewhere is that patient access to critical medical technology advances can be hindered by onerous government policies.

**This is increasingly the situation in Japan.**

#### **Experiences and Challenges in Japan**

Japan's system for approving new medical technologies is the slowest and most costly in the industrialized world. During the past decade, the Japanese regulatory process has grown progressively more complicated and burdensome. At the same time, Japan has significantly cut payments for medical technologies. The effect of lower margins has been to reduce the capital available for research and the development of new and innovative products.

Even after creating a new agency last year to process applications for medical technology products, Japan had a backlog in February of over 491 applications filed before April 2004. When new applications are included, the backlog is reportedly much longer. Due to the long approval process, the medical technologies Japanese patients receive may be generations behind state-of-the-art products in the U.S., Europe, and even in developing countries like China, India and Thailand. Prolonged regulatory processes translate to higher costs for the U.S. medical technology industry, which must maintain out-of-date product lines for Japan.

Likewise, Japan's revised Pharmaceuticals Affair Law (PAL), which covers medical technology products and went into effect on April 1, 2005, has caused difficulties for medical technology companies. While larger firms may be able to absorb higher costs associated with compliance, some smaller firms, with limited resources, have indicated they may have to exit the Japanese market altogether because of PAL requirements.

At the same time industry is facing these burdensome and costly regulations, Japan's Ministry of Health, Labor and Welfare (MHLW) is threatening severe reimbursement rate cuts.

Before 2002, Japan adjusted prices according to a process it called "reasonable-zone" or "R-zone." In brief, MHLW surveys hospitals for prices paid to distributors, and allows for a reasonable margin (or "zone") for discounts from the government's reimbursement rate. While there are some difficulties with this system—as identified in bilateral Market-Oriented, Sector Specific (MOSS) negotiations between the U.S. and Japanese governments—industry has recognized that it has been based on factors within the Japanese market.

In 2002, however, Japan adopted a system of Foreign Average Pricing (FAP). This system calls for the establishment and revision of reimbursement rates on the basis of prices paid for medical technology products in the U.S., France, Germany, and the United Kingdom (U.K). *The result is that prices of medical technology products in Japan are designed to be based not on that market's requirements, but on completely unrelated conditions in foreign markets.*

As a methodology for setting reimbursement rates, it is economically unsound to compare prices in foreign markets that operate under vastly different conditions. For instance, Japan's regulatory system is far costlier to comply with than European or U.S. regulations. In addition, the overall cost of doing business in Japan is far higher than in most of the developed world.

Furthermore, comparing prices within national markets—let alone across international boundaries—is difficult. Medical technology companies sell products under a variety of terms and conditions. In the U.S., firms can often offer lower prices to buyers willing to commit to larger volumes for longer periods of time, but Japan does not have such buyers and offers minimal channels for efficient selling and distribution of medical technologies. Additionally, Japan's FAP system is an attempt to compare prices for products that are not the same in Japan as they are in other countries. As noted above, due to Japan's regulatory delays, U.S. manufacturers must incur the cost of maintaining older or outmoded production lines for sale in Japan alone.

#### **Conclusion**

Together, reimbursement reductions and regulatory hurdles in Japan have had a damaging effect on the ability of California's medical technology industry to expand further in that important market. In fact, since Japan introduced its FAP system in 2002, total U.S. medical technology exports have stagnated. Meanwhile, Japan's exports of medical technology products in 2004 rose by 10 percent, contributing modestly to Japan's burgeoning total trade surplus with the U.S. of \$75 billion—an increase of 14 percent last year.

Congressional and Administration attention and involvement, as exemplified by this hearing, is critical to maintaining and expanding access for the U.S. medical device and diagnostics industry to the Japanese market.

CHI again appreciates the importance of these proceedings and thanks the Chairman and the other members of the Committee for providing the opportunity to submit the views of the California medical technology industry in the context of a hearing on overall U.S.-Japan trade relations.

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**Statement of International Roundtable for Trade and Competition Policy,  
Inc., Miami, Florida**

*Developing Competition in the Japanese Postal System*

We are pleased that the House Ways and Means committee is looking at the issue of Japan's economy in general, and in particular at the issue of postal privatization. The International Roundtable for Trade and Competition Policy, Inc a 501(c)(6) organization is a privately funded non-government organization (the "Roundtable") that looks particularly at the link between internal market and regulatory issues and their impact on international trade and economic development. The Roundtable looks at these issues across all markets, but has a strong focus on markets that are in the process of undergoing privatization or market liberalization.

We are firm advocates of pro-competitive privatization and liberalization processes. We see great opportunities for the Japanese postal privatization in this regard. We believe that if the postal liberalization truly unleashes the forces of competition, this could lead to greater efficiency in the postal system in Japan, and also more opportunities for new entrants in this and related sectors, wherever they are from. The results have the promise to be good for Japanese consumers as well as competitive companies. However, if the liberalization does not succeed in unleashing pro-competitive forces, then it poses the danger of merely converting public monopoly with regulation to private monopoly without regulation. This would have a negative impact on competition, and on consumers. The decision to privatize, alone, does not guarantee competitive markets. The end result depends on the quality and design of the regulatory framework.

*Postal Privatization*

Perhaps the most important argument in favor of postal privatization is often lost when the issue is discussed, and critically when the regulatory framework is decided upon and implemented. While the argument that the postal company will become more efficient, with resulting benefits for investors is often raised, the impact on consumers of privatization is often ignored. This is a pity as the benefits to consumers are the most valuable benefits for society as a whole provided that the privatization is accompanied by competition as well as liberalization.

The benefits of privatization are that public sector postal monopolies tend not to be as efficient as private entities. It is to be hoped that privatization will lead to more efficiencies, because managers will be able to keep costs down and quality up. Managers will be able to ensure workers maximize output and minimize waste. These are things that are not easily done in a public sector context. But these greater efficiencies do not just arise because of the fact of privatization. They arise because of the restraints that competition imposes on managers to discipline and also get the most out of their workforce. Postal prices have generally risen in countries where the postal service is a government owned monopoly. This is in contrast to other sectors where prices in communications and transportation have fallen.

*Key Areas That Need to be Addressed*

There are a number of key areas that need to be addressed. These can be regarded as benchmarks to assess whether the regulatory design is indeed pro-competitive or not. We will examine these in turn.

*Reserved Sector*

While the postal law covers the fact of privatization, there will be implementing regulations under the postal privatization that will address more specific aspects of the privatization. A key area here is how the reserved sector will be treated. Too large a reservation could have a very negative impact on competition in the market. Typically postal companies reserve as part of their postal monopoly all goods up to a certain weight limit. This weight limit varies considerably around the world (among postal agencies). Recent European directives set the reservation at 100g, de-



clining to 30g over time. Clearly a reservation that is significantly more than this could have adverse competitive impacts.

There is a market impact of such reservations. These reservations can lead to the following anti-competitive effects:

1. Where there is competition between the postal company and other providers of non-postal services. The reservation prevents the non-postal service providers from functioning in the market at all.

2. The fact that there is a reservation enables the postal company to lower its costs in the non-reserved sector. This can distort the market for provision of services in the non-reserved sector.

As a result, we believe that the appropriate weight limit for the reserved sector should be a maximum of 100g progressively reduced over time.

It should be the goal of the reservation not to lead to potential anti-competitive harms in sectors that can be impacted by the postal sector, but are not postal in and of themselves. The larger the reservation, the greater the pool funds that could be available to the Post Office to anti-competitively cross-subsidize in certain areas outside of the postal sector. Given the development of the internet, and other methods of information delivery (see post), Post Offices are feeling more and more pressure to diversify into other businesses. Nothing should prevent them from doing so. However, they should not be given governmental aids or benefits to succeed.

#### *Quality and Access Issues*

##### *Universal Service Issues*

Japanese Cabinet Decision on Basic Policy on Postal Privatization (Sept 10, 2004) (the "Cabinet Decision") states that "Preferential measures shall be established if necessary to maintain universal service". While universal service is a laudable goal, this statement presents a number of problems as our studies of the universal service obligation ("USO") in a number of different areas demonstrates. These studies show that the universal service commitment may actually lead to cost advantages for the incumbent that is subject to the USO. This is because the universal USO means that the Post Office has a built-in infrastructure that can be used to lower costs for the provision of certain services outside the reserved sector. For example, the Post Office can use its infrastructure to lower the costs associated with sending packages through express mail, if it has an express mail arm. Instead of having to pay costs of C for utilization of infrastructure which the private competitor must build out, the Postal Company must pay only C-X (the cost of elements that are needed but have already been built out under the USO). This reduction of costs means that the Postal Company is at a cost advantage over the private competitor. The USO therefore becomes more like a State Aid to use the language of European competition law. Applying the concepts that are applicable under European State Aid law, the USO becomes a governmental benefit that alters the cost base of the postal company.

##### *European State Aids Law and Its Application*

Neither Japan nor the United States has a set of disciplines like European state aids law. However, analysis of how these rules are applied and the jurisprudence that has developed under them prove instructive in understanding how a regulatory system could be crafted in Japan to avoid potential anti-competitive harms. We therefore look at European rules and their interpretation to assist us in ensuring that the laws and regulations are properly crafted to move the Japanese postal economy to a more competitive one.

Under European terms, the aid is an "economic advantage which it would not have obtained under normal market conditions." Under European law there is an exemption for services of general economic interest. However, European courts have interpreted how the state aids rules apply in *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH* [2003] ECR I-nyr. In the case, the court ruled that in order for a benefit to be classifiable as a state aid, it must be capable of being regarded as an "advantage" conferred on the recipient undertaking which that undertaking would not have obtained under normal market conditions. Four conditions (the so-called Altmark conditions) would have to apply in order for a state financial measure to escape classification as a state aid if it is for services to a recipient to discharge public service obligations. First, the recipient undertaking must actually have public service obligations to discharge and those obligations must be clearly defined. Second, the parameters on the basis of which compensation is calculated must be established in advance in an objective and transparent manner. Third the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the public service obligation, taking into account the relevant receipts and a reasonable profit. Fourth,

where the undertaking is not chosen in a public procurement, the level of compensation must be determined by a comparison with an analysis of the costs which a typical transport undertaking would incur (taking into account the receipts and a reasonable profit from discharging the obligations).

In other words any USO that exceeds this level would be a state aid under the Altmark test. This would mean that any USO Fund which is based on a tax that competitors of the postal company would pay would almost automatically violate the Altmark principles because a fixed tax rate would be contingent on the variable of the revenues of the companies from which it is accrued, and that would have nothing to do with the actual cost of providing the universal service. We understand in Japan the proceeds of privatization will be used to set up a Universal Service Fund. While this is a marginally better situation than taxing potential competitors, it could still have market distorting consequences unless it is carefully and rigidly accounted for. The precise amount must also be calibrated to the actual level of USO, so that it cannot be used for other purposes.

The allocation of such funds would, under European law, also constitute special and exclusive rights under Article 87 of the Treaty on European Union ("TEU"). In ascertaining whether the services are in the general economic interest, it is necessary to ask whether the service has special characteristics that distinguish it from other economic activities, and the transfer of funds must be shown to be connected to that specific characteristic. One of the relevant factors is a financial advantage beyond the cost of covering the USO being given to one of the undertakings. Hence in order for a USO fund not to be caught under these provisions, it would need to be clearly defined.

Even if a political decision is taken to impose a Universal Service Obligation and obtain monies for that obligation from other parties, this has to be carefully handled in order to make sure that the incumbent company does not hide behind the USO as a way to engage in more anti-competitive practices. This has been dealt with in numerous ways across multiple network industry sectors. In general a number of themes emerge:

1. The USO has certain benefits and certain costs. The costs and the benefits must be weighed against each other. The historical USO in the case of the Post Office will be an advantage as it has enabled the Post Office to build out the necessary infrastructure in rural and remote areas in Japan.

2. The Universal Service Obligation should be supported by those who benefit from it. Clearly people in the rural areas themselves benefit from the Universal Service Fund. Clearly, people in rural areas cannot be expected to support the Universal Service fund entirely on their own. The obligation should therefore rest with taxpayers, but should be made explicit, so that the people make a decision as to whether they are prepared to pay the cost of the universal service benefit..

3. Universal Service Fund obligations should not be imposed generally on competitors or potential entrants to market. This is because this damages competitive markets. These public sector restraints are effectively state aids to the Post Office which may be used to help it compete against other new entrants in sectors that are broadly competitive.

#### *New Communications Economy*

In order to properly understand postal privatization in the context of a modern internet economy, one must fully understand where postal fits into the broader area of information delivery. In the past, postal delivery was the only means of keeping different communities connected. There was a real national security dimension to the work of the postal service. It was also the only way of sending documents for business purposes, and so there was also an economic security dimension to its work also. In the 21<sup>st</sup> century, the way information is delivered to consumers is undergoing a rapid and total change. People are organizing themselves around information and content, and less on materials and delivery. In this age, downward pressure on delivery costs brought about by the costless delivery of information over the internet and e-mail is very high. This has caused a shift to the actual content—a complete reversal from a world where “medium is the message”. It is hard to explain the full impact of this information revolution. Suffice it to say that costs reductions brought about by the printing press were of the order of 1,000. Costs reductions brought about as a result of the invention of the microprocessor has dropped 10 millionfold. The printing press led to the industrial revolution as the microprocessor has led to the information revolution.

In many ways, there is a new communications economy which applies to the way that all manner of products are transported across borders. In this new communications economy, the activities of a telecommunications provider, carrying information across the e-mail, or a mail carrier carrying the same information in documentary

form, or an express delivery provider carrying the same document must be weighed. Since these different platforms in some senses compete against each other, it is important that nothing is done that damages one or the other in the government's regulatory supervision of any one of these sectors. In order to ensure the most efficient and effective delivery channel, it is important that the channels are allowed to be as strong competitors as possible. Economists have described the theory that underpins such competition the theory of monopolistic competition. Under this theory, individual platforms (which may dominate very narrow market segments, but are not monopolies in the antitrust or economic sense) can compete better against each other and promote overall consumer welfare in an economic sense.

All of this has important consequences for postal companies. In the case of Japan Post, it is necessary to ensure that the regulations which are under the Postal Law ensure that Japan maximizes this new communications economy, so that all the different information delivery platforms can function as competitively as possible. Regulations in the postal sector could have important impacts in these related sectors.

#### *Public Goods Theory*

The original motivation for a letter mail monopoly was that communications were a vital part of ensuring national identity. The Postal service satisfied the public goods theory, because consumers that benefited from the service did not deprive others of its benefits or limit supply. Because the postal service had a role to play beyond pure commerce (see above), it was deemed that any possibility of market failure should be dealt with by some form of government action. Under ordinary public goods theory, there is an incentive for a monopoly to be declared because of the market failure brought about as a result of the fact that we are dealing with public goods. Market failure occurs because the marginal cost curve of these kinds of public goods decreases to zero (instead of being a U-shaped curve as is the case with other goods). This occurs because they generally have very high fixed costs, such as infrastructure and so forth that means that the average cost curve declines. This means that as more and more services are provided, costs decline to zero as does price. This prevents the service provider from functioning and hence explains the request for state subvention or in extreme cases, state-mandated monopoly.

However, with the advent of things like e-mail, the internet and telecommunications services, the arguments favoring public goods models are less and less persuasive. There is no longer a compelling public interest in ensuring that people have access to postal service because of the many other ways that information is transmitted. Furthermore, even if those arguments held up, there would be no reason not to permit competition, rather competition with regulated rates would be the norm in cases that are supposedly natural monopolies.

Conventional public goods analysis is frequently given as the reason supporting a natural monopoly. In this world, competition is shunned for fear that it will give rise to duplicated networks and less rather than more efficiency. In this context, it is important to note that legislated monopolies were created before the development of public goods theories. In other words, much of the economics to justify natural monopoly theory occurred well after the political forces that gave rise to natural monopoly did. The reality is that natural monopoly theories never did hold much weight. Viewing the competitive process as a dynamic one, we can see that few industries could say that the free market, applying a natural monopoly would allow consolidation to monopoly without the potential for new entrants or future competition acting as a restraint. Even if there are still adherents to the concept of natural monopoly, the number of industries that do not now have substantial infrastructural bypass capabilities is small and declining. One can look at the impact of wireless technology on the wired market and the arguments for natural monopoly there that were based on the high fixed costs of building the network. In the case of postal, this is even further removed from the realm of natural monopoly because of the ways that competing methods of getting information to people do not rely on or in any sense interconnect with the Postal Service's network.

A major issue is the notion of whether in a dynamic competitive environment, there is such a thing as excessive competition. "Ruinous" or "excessive" competition frequently harms high cost producers and benefits consumers. Consumers are only harmed if the low cost producers are actually producing below cost, and hence setting up the conditions for monopoly later. The whole concept of public goods theory rests on the presumption that in certain cases monopoly is the preferred market condition, because competition would invariably be excessive and lead to duplication. However, there is no reason in a public goods context why free competition as opposed to a legislatively granted monopoly might not lead to a large provider, and there is no inconsistency with normal competitive conditions that this should occur.

It certainly does not mean that certain industries are prone to natural monopoly, or that the market fails in certain cases.

Even during the high water mark of public goods theory or public utility theory, economists did point out that state privileges granted to state monopolies led to corruption and higher prices. In most network industries that had previously been thought to be natural monopolies, such as the electric utilities industry, competition has been an important element in keeping downward pressure on price.

#### *Network Industries and Natural Monopolies*

While the notion of natural monopoly in general has broken down, even if one accepts the notion of natural monopoly, postal services are the least likely entities to qualify for such treatment. In electricity, telecom or gas facilities, one can see the very high fixed capital costs of building out complex wire or pipe networks. We do not see such high fixed costs for postal services. However, this is not to assume that these energy and communications industries are natural monopolies. In the case of telecom, as has been noted above the advent of wireless telephony has rendered some of the difficulties in building infrastructure less critical in this sector. In the case of Postal the higher fixed costs are represented by requiring a postal office in multiple jurisdictions. However data shows that labor is a substantial component of these costs, perhaps as high as 80% in the case of the US.

The notion that the Postal service is somehow to be equated with very intensive capital cost industries such as electricity, telecommunications and gas is therefore misleading. The industry is closer to trucking or airlines, where a large percentage of the costs is actually labor cost, as well as any legacy labor costs. Neither of these industries sink much capital into a network. In the comparable industries of airlines and trucking, deregulation has taken place and has led to dramatic changes in pricing and cost structures. The Postal service does have to contend with inflated labor costs (at least in the US) and a large amount of political power derived from the size of the labor force.

Future mail delivery is a platform that admittedly now competes with other ways of sending out information, or, for example, paying bills. There are advantages to conventional "snail mail", above e-mail such as privacy and identity theft concerns. It is possible that in the future that postal bill paying might be competitive with e-bill paying. The important thing in terms of delivery of benefits to consumers is that these platforms are able to compete well against each other, following the theory of monopolistic competition, set out above.

#### *Ensuring Pro-Competitive Market in Postal and Related Areas*

The Japan Postal Privatization bill does contemplate a separation between the various lines of business of Japan Post. This is very important, and it is good that separation of these revenue streams is in the bill. It will be important to ensure no possibility of cross subsidization, so in implementing regulations, it would be important to see safeguards against this. This includes both De jure and de facto separation, including having separate price caps, if price caps are contemplated. Rigid accounting separation between these entities would also be required. However the separation currently contemplated is what one would expect from a Postal company that is also one of the world's largest banks and insurance companies. The separation currently referred to in the Postal Law is a separation of the postal from the financial services and savings branches. While this is good, it does not necessarily address the possibility that the postal monopoly can be used, especially if accompanied by anti-competitive universal service obligations and an overly broad reserved sector, to anti-competitively cross-subsidize into related areas, such as new businesses that the Postal company is active in.

The threat of anti-competitive cross-subsidization is a very real one, and can only be addressed by:

1. Developing rigid accounting separation of the different aspects of the Postal company's business.

2. Developing an appropriate cost methodology that builds in elements of cost that Japan Post has as a result of its historic government ownership and statutorily endowed privileges. This can include including an element of costs to account for parking privileges, favorable customs treatment, favorable tax treatment and so forth. This ensures that when evaluating whether an attempt to enter into a new business line is below cost, we are using an appropriate measure of cost.

3. Recognizing the government owned legacy, and result of the statutory monopoly. Since governments are not profit maximizers, and the statutory monopoly confers quasi-governmental status even after the privatization, we must recognize, as European competition law does, that there should be no need to recoup lost profit in the future in order to make out a below cost pricing case.

*Japan Postal Privatization Commission*

The Postal Bill contemplates a Postal Privatization Commission, which would be a body that oversees and guides the privatization process. This group does not currently have within its number representatives of the Competition Agency. This would be very important to ensure pro-competitive concerns are addressed in the privatization process itself. Too often "competition" issues are raised by other ministries without paying due regard to what the competitive process actually entails. Indeed there is great danger in confusing the terms "competition" with "competitiveness". While having a competitive market will doubtless, all other things being equal, lead to greater economic competitiveness for the country as a whole, adopting a regulatory design designed to make specific companies more competitive probably will not. Competition agencies are in the best position to evaluate and filter what are truly "competition" considerations.

There are also special exemptions that are contemplated in the privatization during the preparatory period for Japan Post. These include the ability of Japan Post to provide financing for international cargo transport. There are provisions that provide that this must be approved by the privatization commission, and that this activity must not unfairly harm those who provide like activities. This is a step in the right direction, but again these issues need to be evaluated properly and underlying regulations need to be carefully drafted. This applies with equal particularity to the privatization of the financial and insurance arms of Japan Post.

*Conclusion**Competition Red Flags*

There are certain competition red flags which denote specific areas of competition policy where policymakers should be concerned to ensure pro-competitive regulatory solutions. The key areas where the regulatory design for Japanese postal privatization should be watched are as follows:

1. Use of the USO as a shield for anti-competitive practices. Frequently, as noted above, the USO is so used. Particularly attention should be paid to ensure that any universal service fund is limited to the specific regulatory purpose for which it was intended.

2. A rigorous accounting separation mechanism among the various businesses is required to ensure that any anti-competitive cross-subsidization is limited. In considering the costs for provision of a service, we recommend using a hypothetical private firm, and adding to that cost base the benefits accrued from being government owned, including all exemptions from taxes, licenses or any other regulatory process that private firms would have to engage in. All these costs should be added to the hypothetical benchmark. If the postal company is charging below these costs in any of the related businesses, then a case should be made for anti-competitive cross-subsidization.

3. Particular attention should be paid to the size of the reserved sector.

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**Statement of Timothy MacCarthy, Association of International Automobile Manufacturers, Inc., Arlington, Virginia**

This statement for the record with respect to the above-captioned hearing is submitted for the Committee's consideration. The Association of International Automobile Manufacturers, Inc. (AIAM) is concerned that some of the testimony received by the Committee concerning the yen/dollar exchange rate relationship misrepresented the situation existing today in U.S.-Japan automotive trade. Contrary to some of these assertions, the evidence demonstrates that the yen/dollar rate has had no short-term impact on U.S.-Japan automotive trade and does not constitute a subsidy. The current yen/dollar relationship arises from the overall strength of the U.S. economy and the resulting flow of investment dollars into the U.S. from foreign countries. Significantly, only one witness testifying at the hearing expressed concerns about the yen/dollar relationship.

AIAM is a trade association representing 14 international motor vehicle manufacturers who have invested over \$27 billion to manufacture approximately 30 percent of all passenger cars and light trucks produced in the United States. AIAM members directly employ over 93,000 Americans, and generate an additional 500,000 U.S. jobs in dealerships and supplier industries nationwide. AIAM members include Aston Martin, Ferrari, Honda, Hyundai, Isuzu, Kia, Maserati, Mitsubishi, Nissan, Peugeot, Renault, Subaru, Suzuki and Toyota. AIAM also represents original equipment suppliers and other automotive-related trade associations.

## THE FACTS

### U.S. Government Finding

Two recent U.S. government reports directly contradict the assertion that “Japan’s sustained currency manipulation” and the resulting “artificially weak yen” provide a subsidy to Japanese automobile manufacturers. As noted during the Hearing by Treasury Deputy Assistant Secretary for Africa, Middle East and Asia, David Loevinger, the Treasury report on *International Economic and Exchange Rate Policies* released in May 2005 stated that Japan was not a currency manipulator.[1] Mr. Loevinger further said that in response to a U.S. request, Japan had not intervened since March of 2004, and that Japan has consistently supported the positions taken by the United States in the Group of Seven.

A second U.S. Government study, a Federal Reserve Staff Study of January 2005, concluded that interventions by the Japanese Government since 2002 have little or no impact on the yen/dollar rate.[2] Based on the findings of these two eminent studies, it seems clear—contrary to the claims heard by the Committee—that there has been no subsidy.

Indeed there is further concrete evidence that such a subsidy does not exist. For example, if the Japanese Government were providing a subsidy to its auto manufacturers, evidence of such action should appear in the annual financial statements of these corporations. However, an examination of the statements of Honda, Nissan, and Toyota—the three largest Japanese automakers—shows a mixed result. During the period since 2000, only Toyota reported that the impact of exchange rates on its operations was consistently positive before reversing in FY2005 (-140 billion yen). Honda and Nissan reported that with the exception of 2002, when the yen was the weakest, and, despite consistently increasing annual net profits, they lost money on currency each year. This data does not support the assertion that a large subsidy has been granted to the Japanese auto companies.

We also note that the Committee heard testimony suggesting that for the first six months of the current fiscal year, Toyota, Honda and Nissan earned additional profits in excess of \$1 billion due to a weaker than anticipated yen value. This assertion is not supported by the facts, since none of the Japanese auto makers have issued their financial reports for the first six months of their fiscal years. Beyond this fact, it is also true that even if these companies have earned these additional profits, such profits can be considered as evidence of conservative financial practices, rather than a subsidy.

### U.S.—Japan Vehicle Trade

The assertion that the yen has weakened and caused U.S. imports of Japanese vehicles to increase and the bilateral motor vehicle trade deficit to worsen is not supported by the facts.

#### U.S. TRADE DATA

Factor	2000	2001	2002	2003	2004
<b>Y/D Rate</b>	107.8	121.57	125.22	115.94	108.15
<b>1US Imports of Japanese Vehicles (\$s billions)</b>	32.1	31.1	35.0	32.2	32.2
<b>U.S./ Japan Motor Vehicle Trade Deficit (\$s billions)</b>	31.3	30.5	34.6	31.7	31.7
<b>US Imports of Japanese Vehicles (Millions of Units)</b>	1.82	1.79	2.05	1.77	1.72
<b>Value per Unit (\$s)</b>	17,637	17,374	17,073	18,192	18,720

Sources: Trade data from the Office of Automotive and Aerospace Industries in the U.S. Department of Commerce. The currency data is from the Federal Reserve System. The unit values are calculated.

This data gives the appearance that exchange rates may have had some effect on U.S.-Japan trade flows over this period, but the impact has been mixed, not long-lasting and remarkably small. When the yen weakened through 2002, U.S. imports

of Japanese vehicles increased. However, when the yen strengthened strongly in 2003, U.S. imports fell and then stabilized in 2004, despite a further strengthening of the yen. The fact that the changes in trade over this period have been so small merely demonstrates that consumer demand is the real driver in the market. AIAM member companies do not respond to short term movements in exchange rates, but do respond to changes in consumer demand.

#### Exchange Rates and the U.S. Light Vehicle Market

Developments in the U.S. light vehicle market show that the yen/dollar rate *cannot* be a subsidy.

#### U.S Light Vehicle Sales (millions of units)

SALES	2000	2001	2002	2003	2004
<b>Total U.S. Market</b>	17.332	17.118	16.808	16.622	16.648
<b>Big 3</b>	11.341	10.806	10.345	9.999	9.864
<b>Total Japanese</b>	4.431	4.577	4.706	4.796	5.154
<b>Japanese From NAFTA</b>	2.825	2.939	2.953	3.077	3.522
<b>Japanese From Imports</b>	1.606	1.638	1.753	1.719	1.632
<b>1y/d rate</b>	107.8	121.57	125.22	115.94	108.15

Source: Office of Automotive and Aerospace Industries, U.S. Department of Commerce

Over the period 2000–2004, the Detroit Three (DaimlerChrysler Corporation, Ford Motor Company and General Motors Corporation) lost 1.477 million units of sales while Japanese automakers gained only 723 thousand units, or about half of what the Detroit Three lost (the market decline of about 648 thousand units cost them most of the remainder). Of this gain by the Japanese automakers, 697 thousand units have come from the member countries of the North American Free Trade Agreement (NAFTA)—the U.S., Canada and Mexico. Another way to look at this is that over 94 percent of the increase in Japanese light vehicle sales in the United States has come from plants located in the NAFTA countries where the yen/dollar exchange rate has no effect.

#### Foreign Currency Behavior Against the U.S. Dollar

Did the yen behave in a different fashion against the U.S. dollar than other currencies? Federal Reserve data provides an overall picture of what has actually happened between the U.S. dollar and our major trading partners.

#### Currencies per U.S. Dollar

Currency	2000	2001	2002	2003	2004	%Change in \$ +/-
<b>Australia*</b>	0.5815	0.5169	0.5437	0.6524	0.7365	– 26.65
<b>Canada</b>	1.4855	1.5487	1.5704	1.4008	1.3017	– 12.37
<b>Euro*</b>	0.9232	0.8952	0.9454	1.1321	1.2438	– 34.72
<b>Japan</b>	107.8	121.57	125.22	115.94	108.15	+0.32
<b>Korea</b>	1130.90	1292.01	1250.31	1192.08	1145.24	+1.23
<b>All Major Currencies**</b>	98.34	104.26	105.98	93.04	85.42	– 13.14

\* U.S.\$s per currency unit // \*\* This is an index where March 1973 equals 100

The assertion that interventions by the Japanese government have caused aberrant exchange rate behavior and a subsidy to their exporters is not supported by the data. During the most recent five year period, the U.S. dollar initially strength-

ened slightly against the yen and the won, and fell against the others. Beginning in 2001, the dollar fell against all these currencies (it fell 11.04% against the yen). Interestingly, the Bank of Japan made its largest interventions during this period in 2003 with the intention of maintaining a weak yen. [3] The yen, however, continued its steady rise against the dollar. This outcome clearly does not support the allegation.

#### **Direct Government Expenditures in Foreign Exchange Markets Do Not Work**

The principal reason governments cannot permanently affect exchange rates without altering basic economic fundamentals is that governments simply do not have enough currency to significantly move the markets. For example, in the 1<sup>st</sup> quarter of 2004 Japan purchased nearly \$140 billion in an attempt to reduce the value of the yen. However, even this action failed to change the yen's value because it was miniscule in relation to the size of the yen/dollar market. The Bank of International Settlements estimates that *every day* approximately \$230 billion are exchanged for yen. This translates to a market during the quarter of about \$22 trillion or \$84 trillion for the year. It is clear therefore that even \$140 billion, while large, has little chance to influence such a massive market.

#### **The Impact of "Verbal Intervention"**

Although Japan's Ministry of Finance (MOF) has not intervened in the markets since the 1<sup>st</sup> quarter of 2004, allegations have been made that Japan and Korea are now using "verbal intervention" to drive down the value of the yen or prevent it from strengthening further. However, many governments make comments about the value of their currencies in the market, the United States among them. It is a policy tool which governments sometimes use. Sometimes it works for a little while, more often it does not. In the case of Japan, it seems unlikely that, following the failure of monetary intervention, a few well-chosen words regarding the need for currency stability and orderly adjustment would have anything more than a temporary effect.

The job of central bankers is to seek stability, not disrupt it. There is nothing to suggest that Japanese bankers are doing otherwise or acting differently than the many other national economic managers and leaders around the world.

#### **CONCLUSIONS**

- It is clear from the facts that Japanese governmental intervention in exchange rate markets did not have a significant impact on exchange rates and did not constitute a subsidy.
- Even if intervention had more than a temporary effect, such intervention would make no difference in the competitive relationship between automobile companies in a global market. Currently, about 70 percent of all cars and light trucks sold by Japanese automakers in the United States are built in the NAFTA countries. Over 94 percent of the increase in Japanese light vehicle sales in the United States since 2000 has come from local manufacturing in NAFTA countries. Local content rates for these vehicles average 70 percent and many exceed 90 percent. The yen/dollar rate has no effect on these vehicles.
- Private foreign trade and investment flows have a far greater impact on currency values than government intervention. The size of the yen/dollar market is simply too large to enable government attempts at intervention to have any more than a temporary effect.
- While exchange rates impact trade over the long run and are used to make business decisions, they are not the sole basis for those decisions, nor are they the most important factor in those decisions. Building and offering the right products that fit the needs and desires of consumers is the goal of AIAM member companies and is the basis on which the business decisions of these companies are made.

