Interview: Commerce Undersecretary

Lionel Olmer: economic supremacy is the issue in U.S.-Japan frictions

by Richard Katz

In an exclusive 2½-hour interview with *Executive Intelligence Review,* Lionel Olmer, Undersecretary of Commerce for International Trade, explained the *domestic* economic strategy lying behind the recent escalation in Washington's economic pressure on Japan.

Olmer hopes to preserve the remnants of America's technological, economic, and political supremacy—not through direct promotion of this country's own industrial-technological progress, but by using the threat of trade friction to prevent Japan, or any other nation, from challenging what remains of American economic advantage.

Olmer, who spent much of his career in U.S. Naval Intelligence and later became staff director for the Foreign Intelligence Advisory Board under Henry Kissinger, believes, as he told Congress Nov. 3, "Technological leadership and economic leadership generally can translate into political, diplomatic, and military leadership." *EIR* asked Olmer whether this issue, rather than simply fair access, was at the root of U.S.-Japan trade frictions, and whether Washington policies were designed to prevent Japan from overtaking the United States in economic and technological leadership. "I wish I could say they are designed with that in mind," Olmer answered, "I am urging that we think along those kinds of lines. I think we are doing that intuitively."

U.S. post-industrialism

EIR has repeatedly shown that the cause of America's decline is a long-term policy of shifting this country to a "post-industrial" services economy, a shift so escalated by Paul Volcker's high interest rates that the nation's largest employer is no longer General Motors; it is now MacDonald's hamburgers. Japan, on the other hand, has used a system of close government-business cooperation, low interest rates and special low-interest credits for new technologies, and tax credits for productivity-enhancing investments to achieve its unparalleled record of growth in productivity, living standards and industrial growth.

Olmer said that he believes the shift to a post-industrial services economy in the United States "is in large part inevitable." He added, "I believe it is very important for the United States to maintain an industrial base of production. Technological innovation can only come from a domestically generated base."

EIR asked why the United States doesn't simply end its industrial decline by adopting a policy like that which has worked so well in Japan. Olmer replied, "It's not in our nature to applaud central government planning." Asked about providing directed low-interest credits to expand productivity, he countered, "We don't favor that." Asked about changing Federal Reserve policy to lower interest rates generally, his only answers were, "We're attempting to reduce the budget," and "What would that do to inflation?"

Olmer's attitude is seen throughout the Commerce Department. Its policy is to reduce alleged "overcapacity" in steel. The December 1981 Commerce report on auto states that the production, employment, and profit levels of peak year 1978 will *not* be achieved again, even with full economic recovery and even if Japan restrained auto exports.

Olmer told *EIR* he disagrees with the "limits-to-growth" arguments of the Club of Rome. "I recall reading how the computer program generated so much false data that the conclusions of the Club of Rome were quite false. I don't accept the Malthusian view of history. I don't think we're in an era of limited resources or limited growth." Yet, in practice, his economic prescriptions parallel those of the Club of Rome, i.e., an overall shift to a services economy but retention of some manufacturing, particularly in the electronics-computer sphere. However, Olmer does not intend to allow the presumed outcome of U.S. industrial decline, the surpassing of America by Japan in technological leadership and per capita GNP perhaps by the year 2000.

In 1975, the Council on Foreign Relations began a study called the 1980s Project. The leaders of the Project, such as Cyrus Vance, Zbigniew Brzezinski, and Michael Blumenthal, went on to run the Carter administration. One volume in the published study, *Alternatives to Monetary Disorder,* by a British adviser to the

International Monetary Fund, Fred Hirsch, suggests that a major cause of international economic turmoil in the 1980s is friction between "liberal" economies based on the ideas of Adam Smith, such as the United States and Britain, and those based on the ideas of Alexander Hamilton such as Japan, West Germany, and Gaullist France, particularly if the latter ally with the developing countries. The remedy Hirsch proposes the United States and Britain take is as follows: *"A degree of controlled disintegration in the world economy is a legitimate objective for the 1980s and may be the most realistic one for a moderate international economic order."* Carter appointee Paul Volcker publicly endorsed this statement shortly before his appointment as Federal Reserve Chairman. Lionel Olmer is carrying it out.

Olmer's strategy

As the "idea man" on international economics, Olmer has emerged as the leading architect of American foreign trade policy, surpassing even U.S. Trade Representative William Brock, nominally his superior.

Beginning last fall, Olmer helped engineer a major change in the focus of American economic policy toward Japan. Previously, Washington, along with businesses and labor unions, focused primarily on the effects (real and imagined) of Japan's *exports,* such as steel, auto and semiconductors. Olmer shifted focus to Japanese *imports* and used that issue to demand that Japan dismantle—"fundamentally restructure," as he puts it in public speeches—its entire economic system, ostensibly because it inherently discriminates against imports." Even in those instances where the intent is not principally to impede imports," Olmer told a New York audience April 12, "structural biases in the Japanese economy produce that effect."

At the heart of Japan's successful economic structure is close cooperation among banking, industry, and government, including what Olmer attacked as "the Japanese practice of targeting future growth industries." Using administrative guidance, the Ministry of International Trade and Industry (MITI) helped propel Japan not just to higher growth, but to successively higher technological levels. Japan quickly moved from textiles and toys to steel and chemicals, to autos and machinery, and is now moving to computers and industrial robots.

Japan's big business is organized along *keiretsu* lines. In huge business groups such as Mitsui, Mitsubishi, and Sumitomo, industries from almost every sector are grouped together around a bank and trading company. In cooperation with the *keiretsu* system, the governmental Bank of Japan functions much like the U.S. National Bank set up by founding father Alexander Hamilton, which did so much to lay the basis of American economic success. In fact, the founders of modern Japan in the 1868 Meiji Revolution learned their economics by studying the writings of Hamilton and by working with Hamiltonian economists associated with Abraham Lincoln.

The scrap-and-build system

The result can be seen in the difference between Japanese and American investment programs in steel. In steel, as elsewhere, the Japanese apply the "scrap-and-build" system. Even if a plant is only 10-to-15 years old, and even if the full debt is not paid off, if it is technologically obsolete, Japanese managers can get loans and tax incentives to scrap the old plant and build a new, modern one.

As a Japanese business consultant told *EIR,* "We know that the new plant will not only have higher operating profits, but will produce enough profits to pay for amortizing the old scrapped plant." The result is that Japanese steel firms can make steel at half the cost of U.S. plants, using almost 30 percent less iron ore and coking coal per ton of steel and 30 percent less labor time.

EIR asked a banker from Morgan Guaranty if he would make a loan to a U.S. steelmaker for a similar scrap-and-build program. "No," he quickly answered.

One reason why Japanese industry can afford to think about profits in the long term, rather than quarter to quarter, is that in the Japanese *keiretsu* system, stockholders do not hold shares for quick profits or dividends, or buy and sell quickly. There are relatively few major shareholders, mainly among other *keiretsu* members, who hold the shares indefinitely for long-term capital gain. Foreigners have difficulty taking over such firms, because the major shareholders do not wish to sell out; foreign minority shareholding, however, is becoming increasingly common.

Olmer's April 12 speech was a call to dismantle this system. Among other things, Olmer demanded "encouragement of foreign acquisition of Japanese companies" and "anti-trust restraint of the *keiretsu* industrial and trade system." Without these measures, he warned, "a deepening cycle of U.S.-Japan trade frictions will be difficult to avoid."

The "friction" threat is being implemented through the congressional-administration commitment to legislation enforcing "reciprocity" in trade. Some congressional sources expect a bill to be on the President's desk by summer.

The impetus for the "trade reciprocity" bills began following Olmer's Dec. 1 testimony to the Senate Finance Committee, in which he claimed that the reason for 1981's record $18 billion trade deficit with Japan "was not lack of competitiveness . . . not the strong U.S. dollar or high U.S. interest rates. . . . The fundamental reason for Japan's surplus is a profound inequality in our access to the Japanese economy." This he blamed on Japan's business structure.

The reciprocity effort

During the early spring, Sen. John Danforth (R-Mo.) introduced S.2094, the most prominent of a number of "reciprocity bills' with wide support in Congress. Among other measures the bill would add absence of "Substantially Equivalent Competitive Opportunities" as a criterion for retaliatory action by the President under Section 301 of the 1974 Trade Act. This section allows the President to restrict imports of goods, or place extra tariffs on them, or impose fees or restrictions on services from other countries, if the United States determines that the foreign country acted in an "unreasonable" or "discriminatory" manner. Retaliation need not be confined to the offending sector. Under the Danforth bill, which the administration is jointly revising with the Senate, if it is determined, for example, that Japan does not offer the United States the same market access for cigarettes that we offer for Japanese goods, then the President can restrict Japanese goods ranging from autos to computers.

The Danforth legislation would also add services and investment to 301 coverage, and Olmer told *EIR* that in practice the reciprocity legislation would tend to affect services more than goods trade. "Services are not covered by the GATT [General Agreement on Trade and Tariffs] International Agreements. Also, we feel we have a wide-open market in the services sector. Increasingly, the volume of trade reflects the growing importance of that sector."

Olmer denied that the administration would invoke retaliatory import restrictions. The real effect of the reciprocity legislation, he said, would be to give the administration leverage with other countries. "We are working bilaterally with a great deal of vigor to convince them that they should remove these impediments to our imports." In reality, with world trade falling, the potential for 1930s-style trade war is dangerously high.

At May 6 Senate hearings, many of the constituency groups one would expect to support the bill, if it were truly aimed at protecting American industry, opposed this reciprocity provision, including the American Association of Exporters and Importers, the American Chamber of Commerce in Japan, the Computer and Business Equipment Manufacturers Association, and the Legislative Representative of the AFL-CIO. Earlier, the American Farm Bureau announced opposition.

The following is excerpted from an interview with Lionel Olmer conducted by Richard Katz May 7.

Katz: In your Nov. 3 testimony to Congress, you argued that technological and economic leadership translates into political and strategic leadership. Is the root of U.S.-Japan friction not so much the issue of fair access, but a political issue of relative economic power if Japan does surpass the U.S.?

Olmer: I don't think it is yet, but I think it could become that. It is a perception I have which, quite frankly, I'm trying to share with others and gain agreement.

World leadership has traditionally been thought of in strategic terms, i.e. military, diplomatic, and political; much less so economic. In the last 10 years there has been an awakening to the importance of international economics, the effects of world trade, of capital flows, of investment flows, and so forth on the ability of nations to conduct their affairs.

That realization has not yet taken hold in Japan. It has only been a couple of years that Japan has become an industrial giant. It has yet to overtake the U.S. in terms of per capital GNP, if in fact it will. Some say it may by the year 2000.

Yet, the Japanese still view themselves as vulnerable, an island nation beset by hostile forces, natural and otherwise. That island mentality makes them resistant to change, and to foreign encroachment in markets, ownership of property, and also prevents them from further assumption of larger responsibilities as a world leader.

Katz: The U.S. has political leadership now primarily because of its economic supremacy, but people talk of Japan surpassing us economically 20 to 30 years from now in absolute GNP. Do you think the United States should design policies to prevent Japan from surpassing us?

Olmer: I think that will not happen for a variety of reasons, predominantly market forces. The U.S. market, which is still the largest, most open in the world, will of itself not let that happen. I think we are going to witness a resurgence of American industrial power that will prevent an accession to dominance that some predict for Japan.

The U.S. is looked to throughout the world for a variety of responsibilities, not just the nuclear umbrella. Look at the Falkland Islands, the Middle East. Whether any individual effort on our part actually works or not is irrelevant to this point. The point is that other nations look to us as basically the fairest, the most likely to achieve success over difficult questions.

The Japanese are not ready for that. I asked a Japanese diplomat if they were ready for the political and security leadership they would have to exert on assumption of technological leadership that I think would flow from present trends. He said no.

Katz: In what specific way are Washington's economic policies toward Japan designed to prevent our loss of political leadership due to loss of economic supremacy?

Olmer: I wish I could say they are designed with that in mind. However, as they actually come out, I don't think they are. I am urging that we think along those kinds of lines. I think we are doing that, intuitively, in our quest for equivalent access to each other's markets and technology. Maybe I don't give sufficient credit. Maybe it's more than intuitive. Maybe others have recognized it and haven't articulated it in quite the same way.

I've started to list the bilateral technology exchange agreements between American and Japanese corporations. It's astonishing. It's done purely as a commercial matter. I think in significant measure they are made by American companies with shorter-term objectives than the Japanese, who have longer-range objectives in mind.

I doubt we will need to come to the point where we view that free flow of technology as potentially damaging to either our national security or our position and responsibility as the major Western industrial power. But I think one thing our government can say is: look, if you want free access to U.S. technology, as you have had, then you have to give free access to American companies.

Katz: At the reciprocity hearings, the emphasis was not on trade in goods, but on services and investment. I think the stress on services is because people think we are becoming a services economy. Investment is something altogether different. Do you think the stress on investment reflects the worry of Japan overtaking us and the political ramifications?

Olmer: No question. It's what I had in mind. You're right, investment is different from services, entirely different. Now, the Japanese equate investment with "takeover." I try to tell them, we're not trying to implant in Tokyo what you see here: takeovers, mergers, proxy fights. I am saying there ought to be an easier way for foreign companies to go about acquiring an equity interest in Japanese companies, or in establishing new manufacturing facilities of their own. What's happened so far is tokenism, but they're not going to be able to hold it back. I think they will find the experiences worthwhile and not as painful as they think. I want U.S. companies to have access to the Japanese workforce, Japanese capital, and ultimately to the Japanese marketplace.

Katz: You have repeatedly said Japan's government should encourage foreign aquisition of Japanese companies. Yet, Sumitomo does not sell itself to Mitsubishi; why should they sell themselves to a foreigner? Mergers and acquisitions are not common in Japan.

Olmer: Firstly, there are cases of Japanese firms buying other Japanese firms. Secondly, what the Japanese government must make clear is that if an American company wants to buy an existing Japanese company, and the latter agrees, that the government will facilitate this, and not put impediments in the way. Japan should open up its business structure to Americans, who either want to invest in existing companies or build their own facilities.

Katz: Americans setting up their own facilities is different than buying existing Japanese companies.

Olmer: Sure it's different, but it's controlled by the same agency of government which has traditionally kept foreigners out, foreign capital out, and Japanese yen in. It's part of the structure that has to be changed. I'm not saying that we send in some upwardly mobile capitalist freebooter with a fistful of money to buy up every company in sight. I'm not suggesting this be the common pattern, but just that it be made possible.

Katz: There are two issues here. One is the relative strengths of the U.S. and Japan as economic powers. The other is the growing tendency here toward multinational companies—that are not really American in any sense. Is one of your objectives that this multinational phenomenon would become part of the Japanese business and political structure?

Olmer: That's not an objective of mine. I don't think in those terms, but I see it as an ultimate consequence of them opening up.

Katz: You have said repeatedly that the cause of the U.S. trade deficit with Japan is not high interest rates here, nor currency rates, nor lack of competiveness or productivity, but the greatest cause is Japan's closed market. I've tried to get some figures from the Commerce Department backing that up; I've had a rough time. On what basis do you say that?

Olmer: I say it because the evidence demonstrates that large trade deficits existed when all of those conditions were absent: when the yen was 360 to the dollar; when our interest rates were less than theirs; when there was a strong international economy—we still ran a deficit.

Katz: But not of $18 billion.

Olmer: No, no. I was going to go on. I cannot deny that I said the greatest cause of the deficit was lack of access. I would probably want to qualify it by saying: sure, those other factors are causes. Clearly, perhaps the most immediate means of eliminating the deficit—and that is not our objective, we are not seeking bilateral balances—but the greatest thing affecting the deficit would be a weakening of the dollar and a strengthening of the yen.

Katz: Are you now saying the currency rate is more important than market access?

Olmer: No, only in immediate terms. But to do something in the long run there has to be a perception and a reality that the Japanese marketplace is open.

Katz: Prior to the Khomeini oil shock and our high

interest rates, Japan's surplus with us was at most $7-$8 billion. Now, it has more than doubled. Just to be clear, do you believe their market became twice as closed in those three years? Or in the deficit growth from 1980's $12 billion, to $18 billion in 1981, it became that much more closed in one year?
Olmer: No. You can't make those one-for-one trade-offs. Nothing I said should imply a correlation between any single year's deficit and closed-market changes. My guess is that between 1978 and 1981, at least an equivalent amount is due to macroeconomic factors as well as microeconomic factors that relate to market barriers.

Katz: If Japan were to open up its market completely, and answer all of our complaints, do you have a rough estimate of the effect on our exports?
Olmer: The answer is that over a period of four to five years, we think it could amount to $10-$12 billion annual difference in our exports.

Katz: Do you have a breakdown of that?
Olmer: My staff can get you the numbers. [As of press time a week later, Olmer's staff said they "had no numbers to provide" that would back up Olmer's claim of a $10 billion increase, equivalent to 50 percent of 1981's U.S. exports to Japan. Rather, they said the increase would be "substantial."—R.K.]

Katz: Based on your thesis that Japan's closed markets are the problem, you have said fundamental parts of Japan's business structure have to be changed, such as the *keiretsu* system, and the role of MITI. Why do you say this, and what must be changed?
Olmer: I would like to see an elimination or reduction of the cartel arrangement for depressed industry. I would like to see a lessening of the *keiretsu* brother system, in which one buys from the family rather than outside so that, if, for example, a U.S. exporter has a better product at competitive prices, he doesn't get told by a prospective customer, "I can't buy from you, for example, stainless steel, or I'll find that Nippon Steel or Nippon Kokkan won't buy my electric motors."

Katz: If you look at Japan's higher capital investment rates, up to 20 percent of GNP, the "scrap-and-build" system, productivity ratios, improvements in living standard and real wages, and overall growth—it could be argued that the Japanese system of close business-government cooperation, MITI guidance, *keiretsu* groups, i.e. the things that you want dismantled, are responsible for Japan's achievement.
Olmer: I think in significant measure it is a cause of Japanese economic success. I just don't want to see it at the expense of comparable American industries. There was a time when healthy American industries faced targeted competition from abroad. The social costs to the United States have been staggering. Does the consumer benefit more from a somewhat cheaper product if he has to pay taxes for the effects of disruption of a sector? Japan has had free access to our market in making their achievement. Of 85 anti-dumping cases, the Japanese have more than 30.

Katz: But if I look at the auto industry, our production fell about 3 million since the peak year of 1978, and in that period Japanese imports rose 300,000. Three hundred thousand imports did not cause the fall of 3 million domestic units. Similarly in steel; Japanese tonnage exported here has not increased since the 1977 trigger-price system. I agree the social costs are huge. I don't think Japan is the cause.
Olmer: Yes, but you've chosen certain years.

Katz: I've compared the peak years to this year. The question is whether Japan is responsible.
Olmer: I think the answer is yes, in part.

Katz: This administration has changed the focus from Japanese exports here to our access to Japan's market, and you're saying they have to change their business structure. If Japan's structure is responsible for their success, wouldn't changing their structure lower their economic performance? Why instead can't the U.S. adopt some of the Japanese methods?
Olmer: Japanese productivity growth, but not absolute productivity, has been higher. Japan started from such a low base. Inevitably their productivity will slow. I think you will see other countries in Southeast Asia replace Japan as productivity leaders. You see evidence of that in Japanese trade policy toward Korea recently, shutting off technology in steel and electronics.

Katz: The Japanese of course built the steel plant in Korea.
Olmer: Yes, I know that, and now they are beginning to see some of that come back to them.

Katz: I would argue that the fantastic success of the U.S. is due to our use in the past of exactly the kind of policies Japan now uses, which countries like Korea or Mexico are following. Now, the U.S. wants to limit the ability of developing countries to develop infant industry through this kind of policy before they become new Japans.
Olmer: But the U.S. development occurred as a result of a growing America, not as a product of exporting to other countries. Japanese or Korean development is delightful to behold. I just don't want it to happen at the expense of U.S. industry. If a nation wants to subsidize its domestic industry, let it, but don't export 90 percent of the product to the U.S.

Katz: A Japanese reporter said of the current frictions, "These always happen when one country is going up and another going down. But I don't understand why the U.S. doesn't have an industrial policy."
Olmer: We don't have an industrial policy because it's not in our nature to applaud government central planning. There are things government directly does or doesn't do that ought to facilitate industrial planning on its own. We made a conscious decision to support space. That had tremendous spinoffs for commercial aviation, for consumer electronics, at which the Japanese have done so well at our expense. We don't believe in going about it the way they have done.

Katz: One aspect of the system is providing low-interest credit to productivity-enhancing new industries or industrial techniques.
Olmer: We don't favor that.

Katz: We might be able to promote a general increase in industrial technology and productivity by the Japanese structure of business-government cooperation that you want to dismantle.
Olmer: I don't know. I think there are a lot of different answers to that question.

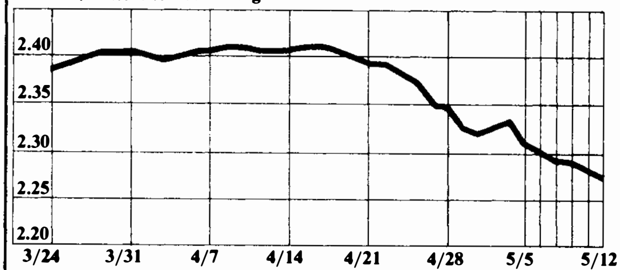
Katz: In 1981, world trade fell by an estimated 3 percent and will likely fall again in 1982, the first back-to-back fall since the depression. This will lead to greater trade frictions as nations fight over a shrinking pie. Do you think it is administration responsibility not simply to fight for a fair share of trade for American firms, but also to take positive action to increase world trade? If so, what?
Olmer: That's a good question. The quick response would be the relationship between a strong domestic economy and an increase in world trade. As the U.S. comes out of the recession, then others will. I don't see world trade picking up independent of strong domestic economies in at least the significant industrial economies.

Katz: Will the U.S. bring any proposal on expanding world trade to the Versailles summit in June?
Olmer: No, not that I know of.

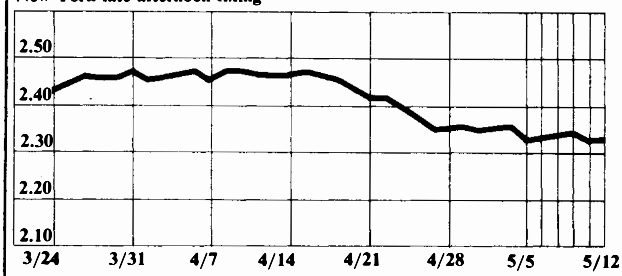
Katz: What about restoring Export-Import Bank cuts to help our own exporters?
Olmer: I don't have a happy answer. The answer is that we don't believe in subsidies. We have been working with our OECD partners to elevate the interest rates toward market rates. I support the actions to limit the Export-Import Bank budget, though I sympathize with the problems of American corporations competing with business from other countries that are given government-backed credit.

Currency Rates

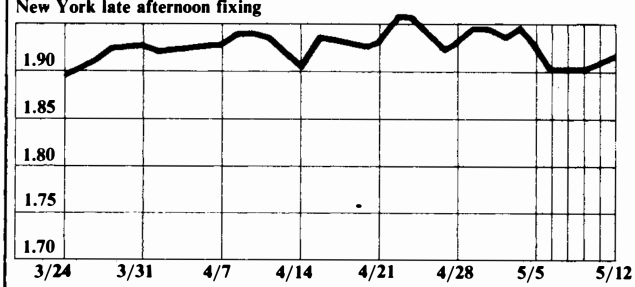
The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
New York late afternoon fixing



The dollar in Swiss francs
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing