S. HRG. 102-423

REVIEW OF ONGOING TRADE NEGOTIATIONS AND COMPLETED TRADE AGREEMENTS

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

AUGUST 2, 1991

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

49-890 ⇆ WASHINGTON : 1992

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-037369-7

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REVIEW OF ONGOING TRADE NEGOTIATIONS AND COMPLETED TRADE AGREEMENTS

FRIDAY, AUGUST 2, 1991

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:20 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the subcommittee) presiding.

Also present: Senators Breaux and Grassley.

[The press release announcing the hearing follows:]

[Press Release No. H-34, July 31, 1991]

TRADE SUBCOMMITTEE TO REVIEW ONGOING NEGOTIATIONS; SENATOR BAUCUS CONCERNED WITH LACK OF PROGRESS ON SHIPBUILDING TALKS

WASHINGTON, DC—Senator Max Baucus, Chairman, announced Wednesday that the Finance Subcommittee on International Trade will hold a hearing this week to review ongoing trade negotiations and recently completed trade agreements.

Baucus (D., Montana) said the hearing will focus on the Structural Impediments Initiative and the new Semiconductor and Construction Agreements with Japan, and multilateral talks in the Organization for Economic Cooperation and Development (OECD) on shipbuilding subsidies.

The hearing will be at *10 a.m. this Friday, August 2, 1991 in Room SD-215* of the Dirksen Senate Office Building.

"Although there has been improvement in the last 18 months, there are many sources of friction between the U.S. and Japan on the trade front. The bilateral imbalance remains high and U.S. exports are blocked by Japanese barriers in many sectors. The situation requires continual attention in order to avoid a major crisis," Baucus said.

"On a related front, I am concerned with the lack of progress made in the OECD talks on shipbuilding subsidies. At this hearing, I look forward to reviewing the progress made in the talks and considering our options should the talks fail," Baucus said.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN OF THE SUBCOMMITTEE

Senator BAUCUS. The hearing will come to order. I first apologize to witnesses for the delays. A vote is now occurring in the Senate. Unfortunately, there will also be other votes during the morning. It is human nature to procrastinate; the Senate is probably one of human nature's best examples of that phenomenon. We are piling up lots of business before the August recess, and, unfortunately we are now paying the price.

For most Americans, the international trade problem is a Japan problem. This obviously over-simplifies America's trade problem, but it is not entirely inaccurate.

In recent years, the bilateral deficit with Japan has accounted for 40 percent to 50 percent of our total trade deficit. The United States and Japan have had a seemingly endless series of bilateral trade disputes.

Just in recent years, there have been disputes over semiconductors, construction services, beef, supercomputers, forest products, medical devices, automobiles, satellites, and the list could go, literally, on and on.

In many of these sectors, progress has been made. But now in almost all cases, more remains to be done. For example, after years of negotiations, Japan has eliminated its beef quota; it did so just last spring. But a 70 percent tariff remains.

In the same vein, the market share for U.S. semiconductors in Japan has risen, but still lags far behind the U.S. market share in third markets. Beyond these sector specific trade problems, larger system problems also remain.

Although the issue was addressed in the Structural Impediments Initiative, the Japanese distribution system remains impenetrable for many U.S. exporters.

Further, despite increased efforts to enforce the Japanese Antimonopoly Act, collusive groupings of Japanese companies—Keiretsus—block U.S. exports in many sectors.

Unfortunately, these systemic problems are not even on the agenda for the Uruguay Round of the GATT talks. If they are not addressed bilaterally, they will not be addressed at all.

Two years ago, the U.S. launched the Structural Impediments Initiative to address these systemic problems. And after a year of hard negotiations, the United States and Japan issued a joint report on the structural causes for the trade imbalance in both countries.

The first annual review of progress, as made under SII—was released this May. In the SII talks, the United States finally began asking the right questions. Unfortunately, after reviewing the final report and the results of follow-up meetings, I am not certain that it has gotten the right answers.

U.S. exporters still face considerable problems. The experience of one American company—Guardian Industries—is quite instructive. Guardian Industries is a U.S. company. It is one of the largest and most successful glass producers in the world. Guardian has been successful in every major glass market in the world—except Japan. For that reason, it is one of the 20 companies that the Commerce Department chose to focus on in its recent efforts to help U.S. manufacturers break into the Japanese market.

But the effort has not succeeded. Although Japanese glass companies have free access to the U.S. market, Keiretsus keep Guardian out of the Japanese market. Guardian has faced collusion and threats of retaliation against Guardian's customers in Japan.

Unfortunately, Guardian's story is not unique. Similar stories are told by many U.S. companies, including Intel, Cray, Motorola, and Chrysler.

Even after SII, all the major Japanese systemic barriers—the exclusionary distribution system, Keiretsus, and targeting—remain.

In fact, SII has done little more than identify the problems. The problems still exist.

In my view, it is time to go beyond the SII forum and attempt to address some of the structural barriers under Section 301.

Some progress has been made in recent months, however, on sector specific problems. The United States and Japan have concluded major agreements on trade and semiconductors and construction services. In my view, both of these agreements will help U.S. exporters.

The Construction Agreement—though it falls far short of opening the entire Japanese construction market—does open major construction projects to U.S. bidders.

The new semiconductor agreement does reaffirm the goal of opening the Japanese market and establish new procedures for preventing predatory dumping.

Unfortunately, the market access provisions are—at the very least—somewhat ambiguous. The agreement does set a benchmark for the U.S. share of the Japanese market at 20 percent by July of 1992. But the agreement includes two separate formulas—one American, and one Japanese—for determining market share. If the Japanese formula is used, the 20 percent benchmark is of little more than symbolic importance.

Further, the United States has agreed to lift sanctions imposed on Japan for failing to meet the 20 percent market share of benchmark in the 1986 Semiconductor Trade Agreement. Since Japan still has not met this benchmark for market access, it was premature to lift sanctions.

The United States has previously concluded agreements on both semiconductors and construction services. In both cases, Japan failed to live up to the commitments it made in those agreements.

We must recognize that a trade agreement is only useful if we have the will to enforce it. If we turn a blind eye when our trading partners violate those agreements, the agreements are worthless.

In the case of the new construction and semiconductor trade agreements, particular attention must be paid to enforcement.

We must stop defining success as merely concluding an agreement. We have declared victory on construction and semiconductors before only to be disappointed. This time, we should not declare victory until Japan lives up to the commitments, and U.S. exports of semiconductors and construction services have, indeed, increased.

At the request of several members of the subcommittee, including Senators Breaux and Mitchell, I have asked the administration to address the current OECD negotiations on shipbuilding subsidies and ship pricing.

These negotiations involve Japan, the EC, South Korea, Finland, Norway, Sweden, the Netherlands, and the United States. Unfortunately, these negotiations seem to be making very little progress. Many U.S. shipyards have grown understandably impatient.

I do not favor the sector specific retaliatory legislation that has been introduced in shipbuilding. But if the OECD negotiations fail to yield results in the very near future, I do believe it would be appropriate for the United States to take action under Section 301.

Since we are fortunate enough to have Joe Massey—the Assistant USTR for both Japan and China—testifying today, I have

asked the administration to also address our trade concerns with the People's Republic of China.

The Senate has just had a bruising debate on extending MFN status for China. Many Senators were concerned over China's piracy of U.S. intellectual property, and rising Chinese trade barriers.

In a letter delivered to the Senate shortly before the Senate voted on the MFN extension, the President made a number of commitments to address those concerns. The most important of which was a commitment to use Section 301 to address Chinese market access barriers. The President, in his letter to me and to other Senators, wrote:

"The Administration has proposed holding another round of market access consultations in August 1991. If that round of negotiations fails to yield substantial commitments from the Chinese authorities to dismantle market access barriers, the Administration will self-initiate Section 301 action to address those barriers."

In my view, this commitment from the President is critical. Without it, many Senators—including myself—would not have voted to extend MFN to China without conditions.

In accordance with this commitment, I expect the administration to either conclude a sweeping agreement with China, or to self-initiate a Section 301 case directed at Chinese trade barriers.

I look forward to hearing Mr. Massey's views on the trade talks now under way with China on protection of intellectual property and market access.

As the world's number one and number two economic powers, the United States and Japan must work together. The bilateral trade relationship between the United States and Japan is the second largest in the world—exceeded only by that between the United States and Canada.

The United States and Japan must work together on a variety of global economic issues ranging from exchange rates to aid to developing countries. But this economic interdependence should not be used as an excuse for ignoring trade problems.

As economic studies from both the Brookings Institute and the Institute for International Economics have confirmed, Japan still remains largely closed to manufactured imports.

As the 1991 National Trade Estimate once again confirmed, Japan still retains trade barriers in a number of sectors. If the U.S. economy is to continue to grow, and the bilateral relationship between the United States and Japan is to continue to improve, Japan must open its markets.

Unfortunately, experience has shown that Japan will not open its markets altruistically. Only sustained pressure from the United States and other countries pushes Japan away from protectionism and toward freer trade.

The Congress and the administration must keep up the pressure on Japan until the Japanese markets are, in fact, truly open.

Now, Mr. Massey, please proceed.

STATEMENT OF JOSEPH A. MASSEY, ASSISTANT UNITED STATES TRADE REPRESENTATIVE FOR JAPAN AND CHINA, WASHINGTON, DC

Mr. MASSEY. Thank you very much, Mr. Chairman. It is a pleasure to appear before you and the subcommittee this morning to review with you the current state of our trade relations with Japan and the administration's trade policy toward that country.

I have a formal statement for the record, Mr. Chairman, and would like briefly to summarize my remarks for you this morning.

Senator BAUCUS. Yes. I will tell you, Mr. Massey, and all the other witnesses, that all of your statements automatically will be included in the record, and I just ask you to summarize them as well as you can. Thank you very much.

[The prepared statement of Mr. Massey appears in the appendix.]

Mr. MASSEY. Mr. Chairman, there are some encouraging signs in the trends in United States-Japan trade flows that indicate that we have been making some progress. For each of the past five years, United States exports to Japan have grown significantly faster than our exports to the rest of the world, and faster than our imports from Japan.

After many years of remaining stagnant at a level of between $21-$23 billion, U.S. total exports to Japan began increasing in 1986, reaching a level of nearly $49 billion last year.

And manufactured exports are now playing an increasing role in our export mix, reaching about 62 percent last year, compared to about 52 percent 5 years ago.

The result of this faster growth in our exports than imports has been a decline in our bilateral deficit with Japan. From its peak of $57 billion in 1987, the deficit has declined steadily over the past 3 years to $41 billion in 1990, and the Commerce Department statistics this year so far indicate the continuation of these trends.

On an annualized basis, this year's deficit looks to be about $39.4 billion. Our exports are up about 6 percent, while our imports are up from Japan only about one and a half percent.

While the trends are in the right direction, Mr. Chairman, I agree with you that there is still a great deal of room for improvement in our own trade performance with Japan, and in Japan's performance as a market for imports—particularly as a market for manufactured imports.

Last year, only 3.7 percent of Japan's gross domestic product was accounted for by manufactured imports. That is only about half of ours, and substantially less than that of all of the other OECD countries.

The real issue is, in fact, of course, not the bilateral deficit, but gaining access to the Japanese market for our exports, particularly our manufactured exports and our value added products.

At USTR, our first objective and our mission is to open markets. Open markets are the foundation of the global trading system.

When Japanese markets are not open to competitive U.S. goods and services, Japan not only hurts itself, but denies U.S. companies opportunities to expand efficient production and achieve a major presence in the second largest economy in the world.

A second and extremely important corollary goal of our trade policy is to make the Japanese economy an open market not only in terms of formal trade barriers, but effectively, in terms of actual participation by United States and other foreign firms in that market.

This administration, therefore, has made it a major objective of our trade policy to identify and overcome the barriers to the Japanese market that are rooted or embodied in structural characteristics.

In the pursuit of an open Japanese market, we have also actively and aggressively sought the removal of specific sectoral barriers.

And, as a third major component of our trade policy toward Japan, we have sought to use the Uruguay Round of GATT talks to negotiate strong and enforceable multilateral rules, particularly in agriculture, and in areas not currently subject to multilateral trade disciplines, including services and intellectual property.

A key element of our effort with Japan, as you mentioned, Senator, is SII. SII is an effort to address structural barriers broadly, across industries, across sectors.

In the Joint Report on Structural Impediments issued in June 1990, we identified six broad areas that operate as structural barriers to market access in Japan: savings and investment; land use; the distribution system that you specifically pointed out; exclusionary business practices; keiretsu; and pricing. Each of these aspects also adversely affects Japanese consumers. Our detailed discussions and consultations with the Government of Japan in all of these areas continue.

There have already been a number of notable developments from SII. In all six areas of concern to us, the Japanese Government has made a number of important undertakings, and taken specific actions. This would not have happened but for the SII process.

For example, the Japanese law was amended to provide that large retail stores will be able to be established in no longer than 12 months, and to date, more than 1,000 new stores have applied for permits.

The Japanese Government has imposed disclosure requirements that would expose some of the business activities between companies in Japan, an essential element to promote foreign investment.

Expenditures on public infrastructure related to imports have also increased, as well as expenditures on personnel in the areas of customs and patents, which would not have occurred without the SII. These things should facilitate greater imports into Japan.

Based on our negotiating experience, we can attest that SII provides a useful process to supplement our sector specific trade negotiations. The comprehensive changes sought during SII do not lend themselves to quick fixes, however, and we thus have under way a 3-year follow-up process that allows for systematic review of progress.

Mr. Chairman, we have made progress with the Japanese Government in resolving trade issues in specific sectors, as well.

You mentioned construction. The issue of construction has been one of continuing importance in terms of our efforts to penetrate the Japanese market. We have had a bumpy road in construction.

I am happy to say, however, that just 2 days ago Secretary Mosbacher and Ambassador Murata signed a new construction accord which expands the scope of our existing 1988 agreement and does—among other things—the following: it stipulates that competition in all Japanese public works projects will be open, transparent, competitive, and non-discriminatory.

It significantly expands the scope of major projects covered, with a new list of 17 major construction projects that will come under the special measures that facilitate foreign access, and with an additional six projects that may be added in the first annual review, if they receive official Japanese Government go-ahead.

This brings to a total of 40 the number of projects covered by such special measures. Interestingly and importantly, I believe, the new agreement also specifically states that bidders must certify that they are not engaged in collusive bidding activities.

On another major sectoral front, Mr. Chairman, with respect to semiconductors, in June of this year we concluded a new bilateral agreement. That agreement took effect yesterday, upon expiration of our 1986 arrangement.

The new agreement should accelerate U.S. access to the Japanese semiconductor market. It emphasizes the importance of Japanese electronics firms contracting with U.S. semiconductor suppliers in long-term, design-in relationships to develop new semiconductors for use in future products.

The language in the new arrangement reflects our expectation that foreign semiconductors can, through their continued efforts and the efforts of Japanese users, attain a 20 percent market share by 1992. The Government of Japan considers that this can be realized, and welcomes its realization.

We believe that the provisions of the new arrangement provide an even stronger and more explicit commitment to full market access than did the 1986 arrangement.

The list of bilateral issues between us, Mr. Chairman, is much shorter than when the Bush administration took office, but a number of very important issues remain. Key sectors where greater access to the Japanese market is needed include legal services, computers, paper, pharmaceuticals, recording artist's rights, and auto parts.

The administration has also been engaged with Japan and a number of other nations in multilateral negotiations on shipbuilding. These negotiations have been long and complex, in large part because ships are not treated as imports and, therefore, new trade rules need to be negotiated.

The last set of negotiations were conducted in mid-July. On the basis of those meetings, a new text will be prepared which will identify the major issues that need to be resolved to reach agreement. Our next meeting is scheduled for mid-September, and the likelihood of an agreement depends on whether the governments in the negotiations are able to make the commitments—the politically difficult commitments—needed to resolve these issues.

Our participation in the Uruguay Round of multilateral trade negotiations complements many of our bilateral efforts. Our bilateral agenda with Japan should be facilitated by agreements in the Round covering the broad range of interests in agriculture, market

access, GATT rules, services, investment, and intellectual property protection.

Ambassador Hills has stated on many occasions that the Uruguay Round is about access—access to markets—for agriculture; for manufactured goods; services; government procurement; and the rules that protect and guarantee that access. We are working closely with Japan to achieve ambitious results in liberalizing market access in all areas.

Mr. Chairman, the removal of Japanese barriers to imports, both formal and structural, is one of the administration's top trade policy priorities. An expanding U.S. presence in the Japanese market is vital to the global competitiveness of U.S. firms.

We have pursued this objective using three broad and complementary approaches: sector specific negotiations; the Structural Impediments Initiative; and multilateral negotiations within the GATT framework.

Each of these approaches plays an essential role in our trade relations with Japan. Our effort to open the Japanese marketplace to U.S. products and services would be handicapped were we to eliminate any one of them.

Mr. Chairman, that concludes my oral statement. I would be happy to take any questions you may have.

Senator BAUCUS. Thank you very much, Mr. Massey. Most of our problems now with Japan are not addressed in the GATT, is that not correct?

Mr. MASSEY. We do have a variety of forums within which we address these issues. Most of the specific sectoral issues we address in bilateral talks. We have addressed agriculture and a number of the areas, services, investment, intellectual property, and others, in the GATT. But if one were to tote up the list of specific sectors, it would be a longer list in our bilateral talks.

Senator BAUCUS. So that even if the Uruguay Round is successful, the probability is high that it would not—in any significant measure—address the bilateral trade problems—at least the market access problems we have with Japan, at least those covered under the SII talks.

Mr. MASSEY. I think it is fair to say yes, that the GATT talks would not address most of the structural barriers that are being addressed in SII. That is, indeed, why we have this new and important structural initiative with Japan.

Senator BAUCUS. What leverage do we have under SII?

Mr. MASSEY. Oh, I think the leverage we have is a bit intangible, but important—we have made SII one of the cornerstones of the administration's trade policy toward Japan. It has had, perhaps, the greatest degree of visibility and significance.

It has brought together—and I think this is important to understand—all of those agencies of both governments that are typically not involved in trade negotiations. This is a new effort. There has been an educational process for my colleagues in the administration and for the colleagues of the trade negotiators on the Japanese side and their administration. I think that has been salutary. We are talking about things that are not susceptible, necessarily, to quick fixes. In and of themselves, structural impediments, of course, are deep-rooted and hard to fix.

Senator BAUCUS. Has the administration considered using Section 301 to address some of the problems that are covered under SII?

Mr. MASSEY. I think the answer to that really is that we are talking about subject matter that is not always within the palm of the government. Typically, it is not specifically within the palm of the government, or in its direct control.

We think that the Structural Impediments Initiative offers a better, more direct, and certainly——

Senator BAUCUS. Well, I asked the question because I understand the administration did consider bringing the Section 301 with respect to Japan's pricing system, is that correct? Was that ever considered with the—

Mr. MASSEY. I am sorry, Senator? To my knowledge, that is not correct. And I have been involved, I can assure you, in all of our discussions—at least to my knowledge—on potential candidates for 301 treatment with Japan.

You may recall that when the administration took office, we did a major review of our trade strategy and policy toward Japan in the context both of a new administration's inception, and of the implementation of the 1988 Trade Act.

Under the terms of that Act, when we chose candidates for Super 301 treatment, three of the six candidates that were selected were Japanese policies and practices in the fields of supercomputers, satellites, and wood products.

So, we have, where we thought it appropriate and, I think correctly so, identified those Japanese policies and practices where Section 301 would be most effective.

Senator BAUCUS. Does the administration have roughly a cut off date? That is, if very significant progress is not reached by a certain date, then they consider some other action? I mean, what is the timetable?

Mr. MASSEY. On SII, the timetable is a 3-year follow-on process from the initial Joint Report, which means we will be going on for an additional 2 years in those discussions. We think that that is an important time period, because these are structural matters that are difficult to address, and certainly, even more difficult to change.

Senator BAUCUS. In my experience, Section 301 has been a pretty useful market-opening tool.

Mr. MASSEY. That is also my experience, Senator.

Senator BAUCUS. Well, if it is our mutual experience, why do we not consider utilizing it a little bit more, even in this area?

Mr. MASSEY. Well, I think our judgment has been that it is effective where the circumstances are most appropriate for it, where the acts, policies, and practices of the government are susceptible to its influence, and also, appropriate for its purview. That is, where we can identify specific barriers linked to specific governmental acts, policies, and practices.

Senator BAUCUS. Well, Section 301 also covers government tolerance of anti-competitive practices.

Mr. MASSEY. Yes.

Senator BAUCUS. So, is it not true that Japan tolerates many unfair activities, such as preclusive actions of Keiretsus?

Mr. MASSEY. Yes. Well, we have, of course—as you mentioned, and I did as well—put keiretsu and their trade impeding activities on the agenda of SII. These long-established relationships among firms are, perhaps, one of the fundamental parts of Japanese economic and business structure.

We hope and believe that SII will produce significant changes. There have been some changes, indeed, already in the disclosure relationships among firms. So, we would like to pursue the issue through the SII context.

Senator BAUCUS. Well, I urge you to be even more aggressive, than you probably have. And I also say to the country of Japan that I do not think that the U.S. Congress is going to be much more patient. It is imperative that we have much more meaningful results in the SII talks at a pace that is more quick and earlier than now seems to be the case.

Mr. MASSEY. We will be glad to communicate that to the Japanese on your behalf, Senator.

Senator BAUCUS. Thank you very much. Senator Grassley.

Senator GRASSLEY. Mr. Chairman, thank you very much.

In reviewing some of the background and material that was presented to us to get ready for this hearing, one thing really stuck out. And that was the fact that I noted in the case of the Semiconductor Agreement, the Structural Impediments Initiative, and the Japanese Construction Agreement, every one of the related industries agreed not to pursue a Section 301 case and sanctions were then cancelled. My question is who requested the cancellation of sanctions, Japan, USTR, the industry? Do you know who it was?

Mr. MASSEY. Well, you can be sure, Senator, that on each occasion when sanctions are considered, the Japanese Government objects and requests that we not impose sanctions. In the case of the semiconductor arrangement, I think it is fair to say that the industry believed, as we did, that once we had negotiated a new and more effective means of achieving access to the market, that it would be inappropriate to maintain the existing sanctions.

So, it really is an iterative process, an interactive process among the players, and particularly between the administration and the business sector. We consult very closely with the affected American industries. And, of course, as you know, in the semiconductor case, there are a number of industries with divergent views. Those views came together.

Senator GRASSLEY. So, the answer is it is a consensus arrangement.

Mr. MASSEY. Right.

Senator GRASSLEY. Well, let me ask you this. Regardless of who made the request—and I guess the answer is that it was a consensus agreement—was this the only way that agreement was going to be reached in these three instances—the Japanese Construction Agreement, the SSI, and the semiconductor agreement?

Mr. MASSEY. That is an interesting question. I am not sure I can give you a direct answer, Senator.

Senator GRASSLEY. All right.

Mr. MASSEY. We have not had a process in which there has been an explicit—well, I take that back. Yes, indeed, in the construction case, I think it is fair to say that had we proceeded to maintain the

sanctions, there was, at least, a significant probability of the discontinuance of the major projects agreement. Would that have affected how we proceeded with the negotiations? Those kinds of negotiating strategies employed by both sides in a negotiation have to be factored in, but they did not weigh that heavily.

Senator GRASSLEY. They were not significant?

Mr. MASSEY. In my view, they were not that significant as a negotiating matter. That is correct.

Senator GRASSLEY. Because I consider it such an important question, let me accept what you say now. But since you said it was an interesting question and something you needed to think about——

Mr. MASSEY. We will be happy to provide——

Senator GRASSLEY. If there is any other response, please fill in the——

Mr. MASSEY. Sure. I will be happy to provide you with the details for the record, but my own view as a negotiator is that implications or threats that agreements will be discontinued if sanctions are not lifted matter not importantly to us as negotiators.

Senator GRASSLEY. In regards to the SII agreement, the U.S. delegation noted significant price disparity for comparable goods and services in the United States and Japan. It termed as "disappointing" the lack of progress on exclusionary business practices in Keiretsu business relationships.

My question relates to a letter I received from Boone Pickens in which he provided a report produced by Mid-America Project. In that report, he indicates that Japanese cartels have become a dominant economic force within America's automotive industry throughout the six-State region of Indiana, Ohio, Michigan, Illinois, Kentucky, and Tennessee.

According to the MAP study, 73 percent of the companies that belonged to Tokyo's Keiretsus cartel operation in the six-State region supplying Toyota's American plant operation. Has the USTR assessed the threat that these cartels pose to the U.S. economy?

Mr. MASSEY. Mr. Chairman, the extensive transplanting of Japanese automotive suppliers to the United States is, indeed, a fact. As you know, it has come under concern in a number of quarters, including the Advisory Committee to the Secretary of Commerce on Auto Parts.

We in SII have been looking at the relationship among firms, the keiretsu relationships, and also at the continuance of highly exclusive supplier relationships to Japanese corporate customers. And we have made this a focal point. Specifically with respect to autos, I would have to give you a response for the record after consulting with my colleagues at the Department of Commerce.

Senator GRASSLEY. Well, I might suggest that it is much broader than just automobiles, because other sectors of the Japanese investment covers a lot of areas. Let me ask this of you in closing since my time is up. You are saying that you are assessing the impact upon the economy, or you are just concerned about it?

Mr. MASSEY. No, we have been systematically looking at the keiretsu relationships for a number of years, even preceding SII, and preceding the present administration it has been an issue at USTR.

We, I think, feel that in having put keiretsu onto the agenda on a government to government basis in SII, we have made progress in defining the terms of our trade negotiations with the Japanese.

We consider it to be an important matter, and have done so, and are concerned with the ability of U.S. suppliers to gain access to these corporate networks.

Senator GRASSLEY. Thank you Mr. Chairman.

Senator BAUCUS. Thank you very much. Senator Breaux.

Senator BREAUX. Thank you very much, Mr. Chairman, and thank our witness. I am glad you are here, Mr. Massey, but where is Linn Williams? What happened to him?

Mr. MASSEY. I believe he is fishing, Senator.

Senator BREAUX. He has more sense than all of us. I am beginning to get the impression that these talks are like a journey to eternity in the sense that they just go on, and on, and on.

I am particularly interested, obviously, as Chairman of the Senate Merchant Marine Subcommittee, and shipbuilders, and shippers, and shipowners, are concerned about the obvious, blatant subsidies of foreign shipbuilders in a number of foreign countries, particularly Japan, South Korea, Norway, and Germany.

Let me give you just a little history of what has been happening on this and bring the Committee, perhaps, up to date. Back in 1989, the Shipbuilders Council filed a 301 trade petition against those countries saying, hey, you are unfair; clearly unfair with your subsidies. The United States eliminated all of our shipbuilder subsidies back in 1981. So, I think we come to this case with clean hands from a shipbuilding standpoint. So, the industry files a 301 unfair trade practice petition against those countries in 1989, and I remember very well meeting with Carla Hills and others, who asked us to withdraw the support for that petition. Do not do it, we are going to take care of it, they said.

And we talked about when was it going to be taken care of, and the deadline that was agreed upon by the Shipbuilders Council and the USTR's office was December 4, 1990. This deadline obviously has passed, two other deadlines that have been set since then have also passed.

In a letter dated July 14, 1989, 48 Senators said to USTR, hey, something is wrong, and we need to do something about it. And here we are in 1991, and what can you tell me about the solution to those countries' subsidies with regard to shipbuilding?

Mr. MASSEY. Well, Senator, the reality is, in fact, that we are still in the midst of the negotiations. We have made some progress. We have identified the major issues that need to be resolved, and we continue to press for their resolution. As I mentioned, our next negotiating session is scheduled for mid-September. The two key issues are first seeking agreement on the language to cover unfair pricing that would address the problem of ship sales below cost, and second, the schedule for phasing out subsidies. There are a number of other issues which are not fully agreed, but we believe that once we resolve these two key issues, we will resolve the other issues.

Senator BREAUX. When you say resolve the issues, you are just resolving what the issues are, not a solution to them.

Mr. MASSEY. Well, we share your frustration. We had hoped that these negotiations would have concluded by now.

Senator BREAUX. Is there any reason why we should not go ahead and push for a 301? Here is a country—our country—that legislatively in 1981, at the urging of this administration—the Republican administration—do away with your subsidies, and they did.

And since 1981—ten years, now—we have played with clean hands and have lost business to West Germany, and lost business to Japan, and lost business to South Korea, and lost business to every one of those countries which are clearly subsidizing their shipyards. And the only thing we can show to our industry as a result of that is that 10 years later we are talking about what the issues are. Is it not time to do more than just talk about what the issues are? Everybody knows what the issues are. They are subsidizing their shipbuilders, and we are not. I mean, is it not time to do something a little stronger than talk about it?

Mr. MASSEY. Well, these issues are often difficult and many complex issues involve timeframes that are frustratingly long. I sympathize and understand your frustrations, and that of the industry. We are doing, we think, the right thing in pursuing these negotiations. We do not think that the negotiations are doomed to failure, or that we should abandon them now. To the contrary, we believe that our trading partners are committed to negotiating an effective agreement and——

Senator BREAUX. They are committed to negotiating ad infinitum. I mean, ten years later they are still subsidizing their shipbuilders and we are losing the business. And the fact that they are willing to continue to talk, it is wonderful to talk. You have got all the cards on your side. I mean, does the administration support now—after ten years of no subsidies on our side—a 301 petition?

Mr. MASSEY. At this point we continue to believe that the negotiation of an international agreement to eliminate subsidies and other obstacles offers the best possibility for achieving the level playing field.

Senator BREAUX. All right. Let us play this game. What is the next deadline you would like?

Mr. MASSEY. Well, we have meetings scheduled in September.

Senator BREAUX. All right. If you do not have an agreement in September, would you support the next step—which would be a 301 petition—after the September deadline?

Mr. MASSEY. Well, I think we would have to assess how much progress we had made, whether 301 would offer a better solution at that point than it does now. We think now the continuation of the negotiations is the best step.

Senator BREAUX. Well, Mr. Massey, I just want to thank you. I know you are new, and I do not want to beat up on you too much. It is just the process that is not working. I mean, ten years ago we got rid of subsidies, and we have been beaten over the head by the countries that I have mentioned every day of every year since. And the only thing that we can show to the American constituent is that we are talking. For ten years, there is too much talk, but not enough action. Thank you.

Senator BAUCUS. Thank you very much, Senator. You make a very good point. As you were speaking, I was thinking of the United States-Canadian Free Trade Agreement where Canada is supposed to reduce its subsidies and is dragging its heels. It is not reducing subsidies as it should.

I am reminded of the very heavy EC subsidies in air bus, for example, which very directly threaten commercial aviation in this country. And I think the Senator from Louisiana makes a very good point. There has been a lot of talk. I know these issues are complicated.

I also know that in the administration sample, the State Department sometimes is concerned about political considerations with countries, but that raises another point.

Namely, I think too often trade policies are the handmaiden of foreign policy in this country, and if that continues much longer, and if that is not changed dramatically, I think U.S. living standards are going to suffer comparatively.

It really comes down to the degree to which this country—and particularly this administration—places a higher priority on U.S. living standards compared with other countries, and it is a complicated issue.

The solution is not clear cut. There are a lot of factors that go into it. But certainly one is market access to other countries, and certainly trade barriers that other countries erect.

We are not pure. We Americans do not wear a white hat when it comes to international trade. And Japan and other countries are not Darth Vaders; they do not wear black hats. But I think it is equally true that the shade of gray of their hats is much darker than the shade of gray of our hats. And no one can deny or dispute that point. We no longer have the luxury—as the Senator of Louisiana states—of just talking; we have got to act.

And I think the American people are expecting us to act, and if we do not act, I think they will make their frustration known in various ways, particularly as various Novembers come along.

I have a couple of more questions to ask you, Mr. Massey, and that is in respect to China. What progresses are made toward stopping Chinese piracy of U.S. intellectual property? Is that on a Special 301 frame?

Mr. MASSEY. Mr. Chairman, as you know, I have been actively involved myself in the intellectual property negotiations with the Chinese. We had negotiated in May of 1989 a memorandum of understanding that produced some steps toward improved protection for U.S. intellectual property in China. The Chinese have finally enacted a copyright law, under the threat of Special 301.

Senator BAUCUS. I understand it has got a lot of holes in it, though.

Mr. MASSEY. It has got lots of holes, and it does not, at this moment—either the law itself, nor the implementing regulations for the copyright, or for computer software regulations—offer adequate and effective protection.

We have asked the Chinese to come to Washington later in this month and to sit with us once again to see what we can do to secure Chinese policy measures to revise the law and regulations to provide adequate and effective protection.

And, of course, we have a November 26th deadline under our initiation of the Special 301 case with China. The negotiations have been difficult. The Chinese, by their view, have come a long way, because they had not had a copyright law before; they had not dealt with computer software regulations.

We point out that in the context of the world, they are the principal laggards and principal pirates—particularly of computer software, of pharmaceuticals and chemicals—and we have made, therefore, the identification of China as a priority foreign country under Special 301 a keystone in our intellectual property effort.

Senator BAUCUS. Thank you. What about market access? Any progress at all in your market access talks?

Mr. MASSEY. We were in China just a few weeks ago, Mr. Chairman. As you know, we held meetings with every relevant agency of the Chinese Government that is involved with market access and market barriers. Since 1988, the Chinese Government has substantially increased the number of barriers to its market.

We have made the removal of those barriers our top priority in our trade relationship with China. Once again, we have invited them back to sit with us in August to see what progress we can make. We have identified nine broad categories and specific steps we would like to see them take.

Senator BAUCUS. And now you are also going to reconvene those talks this month?

Mr. MASSEY. We have a tentative agreement from them. We do not yet have formal confirmation of the specific dates.

Senator BAUCUS. So, what are the administration's plans? I assume that the administration will self-initiate 301 at the end of August.

Mr. MASSEY. As the President told you in his letter, if we do not make sufficient progress in those discussions in August, we intend to self-initiate Section 301 investigations.

Senator BAUCUS. And that will cover all major barriers?

Mr. MASSEY. We have not yet decided either the specifics or the scope of the 301 investigation. We do have a wide variety of barriers that confront us, and we have to make an assessment of where the greatest effect, the greatest advantage to U.S. trade interests, would lie in choosing a particular sector, or sectors, or specific barriers.

Senator BAUCUS. Well, back to Japan. Why are there two separate formulas for calculating market share? That, on the face of it, sounds like it is going to be quite confusing, and I would assume that Japan is going to say its formula is the one that should be used, and Japan will save about 19 percent, and soon there will be a 20 percent. The U.S. formula will have a different calculation, say, 14 percent, 15 percent. And that is going to be the debate—which formula?

And because there is a formula that does authorize the higher figure, I assume the State Department is going to say, no, you cannot force this agreement under the U.S. formula, because it is already a Japanese formula. That does not sound like a very good agreement to me.

Mr. MASSEY. Well, the issue of how to define market share, or what basis, has been one of both methodological and policy signifi-

cance ever since we began talking semiconductors with the Japanese way back when in the United States-Japan high-tech working group days of 1983 when we had the same issue. We had it in 1986; we have it now. But the administration's view is that there is only one basis on which to make the assessment, and that is the first formula, which measures foreign merchant shipments into the Japanese market. That is the only formula that we will use to make our assessments with respect to foreign market share.

And the reason is that to include non-merchant shipments does not make any sense. There are, as you know, firms which produce only for themselves internally. They are not part of the market, they do not affect market prices, and we believe they should not be part of the equation.

So, the first formula—the one that excludes captives and excludes foreign-branded products manufactured by Japanese companies—is the one which we believe should be used to track market share and to measure market access.

Senator BAUCUS. All right. Well, thank you very much, Mr. Massey. There is a vote now in the Senate, so I have to go to it. So, I am going to recess now for about ten minutes. Then when I return, we will begin the next panel.

Mr. MASSEY. Thank you very much.

Senator BAUCUS. Thank you very much. Recess for 10 minutes.

[Whereupon, at 11:10 a.m., the hearing was recessed.]

AFTER RECESS

Senator BAUCUS. All right. I would like to bring all three up at the same time. Mr. John Stocker, president of Shipbuilders Council of America; Mr. Ernest Corrado, president of the American Institute of Merchant Shipping; Mr. Alan Wolff, counsel for the Semiconductor Industry of America. Is Mr. Wolff here? Why don't you come on up, Alan? We can try to get everything done here as quickly as possible.

All right. Mr. Stocker, please begin.

STATEMENT OF JOHN J. STOCKER, PRESIDENT, SHIPBUILDERS COUNCIL OF AMERICA, ARLINGTON, VA

Mr. STOCKER. Mr. Chairman, thank you very much. My name is John J. Stocker.

Mr. Chairman, taking your advice earlier in the day, I would like to address a couple of specific points that you have raised in your questions of the witness from the U.S. Trade Representatives' Office, as well as some of the comments made by Senator Breaux.

I would point out, for the record, that I am President of the Shipbuilders Council of American, which is the national trade association of American shipyards and marine equipment manufacturers.

The problem we have had with foreign subsidy practices, as Senator Breaux mentioned, has been going on for 10 years. Capacity in the United States has dropped by over a third in that 10-year period, and we are fearful that as the international shipbuilding market recovers from the depression of the 1980's, we will be effectively precluded from participation in that market because of foreign government subsidy practices.

As you are aware, the council filed a 301 trade petition in June of 1989 seeking redress through the U.S. Government of this situation in the international market. I would like to give you a few of my personal observations on Section 301 and the enthusiasm with which USTR approaches Section 301.

We were specifically asked by USTR not to proceed with the 301 in the summer of 1989. They prevailed on us to withdraw our petition to give the international community an opportunity to conduct multilateral negotiations to achieve a discipline in shipbuilding subsidy practices.

Since we concluded that an international agreement would probably make the best sense because of the international character of the shipbuilding market, we agreed. But it was also clear to us that there was hesitancy about taking up the investigation process then, and perhaps entering into unilateral action by the U.S. Government. So, we concluded it was in our best interests to go along with USTR to proceed with the negotiations.

Needless to say, we have actually missed three deadlines in these negotiations. Ambassador Hills initially set a first deadline of March 31, 1990, which was moved to May 31, 1990, and then the OECD itself set a target of December 14, 1990, which was the ultimate deadline that was missed.

You heard from Mr. Massey this morning that the negotiations are continuing. We are fearful in the shipbuilding industry here in the United States that we could be talked to death through this process.

We have, of course, worked very closely with USTR throughout this process, and have discussed undertaking a 301 on a number of occasions. It has been made very clear to us that undertaking a 301 would not be "useful at this time."

We have asked the government to self-initiate a 301, because clearly the practices that have been found to exist and the definition of the extent to which those practices exist is one that now the USTR is very familiar with. And, as Mr. Massey pointed out this morning, there is a substantial lack of political will in achieving a discipline.

So, we—the industry—are now faced really with a critical decision. As you know, Mr. Chairman, several bills have been introduced in both the House and the Senate to deal with this through legislation.

We understand your concerns about sector specific legislation, but I must point out that if the administration is unwilling to use the instruments that the Congress has given it, what choice do we have?

Particularly given the fact that ships are not covered under our countervailing duty laws, or under our dumping provisions, since ships are not considered to be articles of import. So, we are left in this particular case with only one alternative.

You raised several issues on a generic level about the Keiretsu in Japan. I would simply say that in this time period that we have undergone over the past 2 years of negotiations, the Japanese Government for a number of years officially sponsored a cartel arrangement for the restructuring of their industry. And so, this is something that we have faced in shipbuilding, as in other sectors.

And finally, I would point out that during the period of time that the negotiations have been going on, the three major shipbuilding producers—Japan, Korea, and Germany—have given their industry over $4.5 billion in State support during that time period.

Our concern is if the negotiations go on much longer, how much more money will actually go from those governments to their shipbuilders, and how much longer will we continue to be denied market access?

Thank you very much.

[The prepared statement of Mr. Stocker appears in the appendix.]

Senator BAUCUS. Thank you, Mr. Stocker. Mr. Corrado. Did I pronounce that right?

Mr. CORRADO. Exactly, Mr. Chairman.

Senator BAUCUS. Thank you.

Mr. CORRADO. Exactly right. Thank you, sir.

STATEMENT OF ERNEST J. CORRADO, PRESIDENT, AMERICAN INSTITUTE OF MERCHANT SHIPPING, WASHINGTON, DC

Mr. CORRADO. My name is Ernest J. Corrado. I am the president of the American Institute of Merchant Shipping. We represent wet and dry bulk carriers and liners in the international and domestic U.S. trades.

I dislike eating into my time, Mr. Chairman, but we got short notice of this hearing and I am representing a number of diverse interests so, just for the record, I would like to read the list of interests I am representing today because I think it is important in buttressing our points here.

Today I am representing the American Association of Port Authorities (AAPA); the American Institute of Merchant Shipping AIMS; American Maritime Congress (AMC); American Petroleum Institute (API); American President Companies, Limited (APL); Consumers for World Trade; Council of European and Japanese National Shipowners Association, (CENSA); Federation of American-controlled Shipping (FACTS); Maritime Institute for Research and Industrial Development (MIRAID); Masters, Mates, and Pilots (MM&P); National Marine Engineers Beneficial Association (MEBA); Shippers for Competitive Ocean Transportation (SCOT); Sea, Land Service, Inc.; Transportation Institute (TI); United Shipowners of America (USA); the U.S. Chamber of Commerce, and U.S. Council for International Business.

The reason why I went through this litany, Mr. Chairman, is because it is really extraordinary to have all these parties together with the same view on an issue.

Ordinarily we cannot agree among ourselves in the maritime industry on many issues, and even within the individual organizations. So, this is really extraordinary, and I am privileged to speak for them, and am happy to do so.

Our position, Mr. Chairman, is that we do not come in opposition to the shipyard industry. We hope that they flourish. We do not want to see them go down the tubes. I notice all this non-American electronics equipment here in the room today. We do not want the same thing in the maratime industry. We certainly would rather

build our vessels in U.S. yards if they are competitive, and if we could do it at a competitive price and timeframe.

However, Mr. Chairman, with respect to the current issue before us, we wholeheartedly support the multilateral trade negotiations going on within the OECD. We do oppose sector specific trade devices such as are envisioned by the three bills—two in the House and one in the Senate—that are before us and in the background of this issue.

Our opposition to these bills, Mr. Chairman, is, as we say, we think multilateral negotiations are the proper way to go, and the proper route, not unilateral legislation. The bills offer a number of difficulties. The first difficulty they offer is that we feel that they address the wrong target in putting the assessments, the penalty, if you will, on the shipowner.

In the three bills there are various gradations of penalties on the vessel, but it comes down to the same thing. The shipowner is the target, and the shipowner ultimately is the one who has to pay. And the sanction is in all of these bills you cannot come into a U.S. port if either the subsidy offending country or the owner has not repaid the subsidy.

This mania in these bills, Mr. Chairman, for preventing a shipowner from coming into a port just boggles my mind. It is like cutting the legs off a runner and then telling him to run. The very essence of business in the maritime industry is the ability to come and go in and out of port. This prohibition of vessels coming into U.S. ports would have a very adverse impact not only on the owners, but on the ports in the United States and on the export and import commodities.

If a commodity owner pays a great deal to get his rice or his grain delivered to one of the ports and then they cannot move it because the vessel cannot come in because it was built with some kind of foreign YARD subsidy, or a foreign YARD subsidy as alleged in these bills, it is going to work a severe economic hardship, not only on the shipowner, but the port, the commodity owner, and the consumer.

Mr. Breaux's deep water port in Louisiana, for example, Loop. I daresay that every tanker that comes into Loop was constructed with some sort of subsidy, envisioned at least, by these bills. I do not think Senator Breaux will not be very happy if these bills are ever enacted and commerce dries up to the Loop deep water port, just for example.

Our second problem with this, Mr. Chairman, is one of retroactivity. S. 1361 talks about a vessel being in issue at the time of enactment of the Act. But then a page later, it goes on to say, "the sanctions apply 2 years back." Well, shipbuilding contracts are entered into and are business decisions, and there is no reason why a businessman who entered into a good faith agreement 2 years ago should be put in jeopardy now by this. This retroactivity feature is unfair.

Our third problem with the bill, Mr. Chairman, is a question of retaliation. We feel that if these bills were to be enacted, there would be retaliation by all the other maritime countries in the world. If the vessels of these countries are going to have a stiff fine coming into U.S. trade and U.S. ports, we could expect the same

treatment in foreign ports. Unfortunately that would also impact on so-called Jones Act Qualified Vessels in various ports in the world.

And the fourth and last point, very quickly, Mr. Chairman, as much as it grieves me to disagree a little bit with Senator Breaux, all the shipbuilding subsidies have not been taken away.

CDS was eliminated in 1981, but there is still a 50 percent ad valorem duty on U.S. repairs in foreign yards. Now, I submit, Mr. Chairman, that is a subsidy to U.S. shipyards. And negotiations in OECD address this problem, these bills do not, which we feel is a great imbalance and weakness in the bills.

Thank you for your indulgence, Mr. Chairman.

Senator BAUCUS. Thank you very much, Mr. Corrado.

[The prepared statement of Mr. Corrado appears in the appendix.]

Senator BAUCUS. Mr. Wolff. Although you speak of a different subject, go ahead.

STATEMENT OF ALAN WILLIAM WOLFF, COUNSEL, SEMICONDUCTOR INDUSTRY OF AMERICA, WASHINGTON, DC

Mr. WOLFF. Thank you very much, Mr. Chairman. I am here today on behalf of the Semiconductor Industry Association, to which I have been counsel for the last 11 years. A list of members of the association is attached to my written statement for the record.

Today I would like to discuss the new semiconductor agreement, the prospects for its implementation, and the other public policies which must be adopted if the United States is to maintain a healthy world-class semiconductor industry.

As you know, there has been debate in this country about whether the composition of the U.S. economy matters. Some believe that the United States should be indifferent about the success or failure of individual industries. I believe that some technologies—and I believe microelectronics is clearly one—are critical to our National and economic security.

Certainly, our foreign competitors have targeted the semiconductor industry using many policy instruments, and it is has been determined by the Department of Defense and other panels that success in microelectronics is essential to our economic well-being and national security.

Unfortunately, the U.S. industry is at risk. From 1982 to 1990, our share in the world market has declined precipitously, as Japan's share has increased. The United States has lost many industries which use semiconductors—such as the consumer electronics industry, which has been one of the causes of U.S. decline.

But we have also been injured by unfair trading practices in Japan, such as a closed market, and dumping. In the 1980's, six out of eight of our U.S. manufacturers of DRAMS—Dynamic Random Access Memories—were put out of business by dumping.

Other governments have made the development of semiconductors a national priority and have targeted the industry, and the result has been an out-investment abroad—particularly in Japan—in R&D and plant and equipment.

This has created a gap that will grow at current trends to $15 billion between 1990 and 1995. We have had some 20 years of negotiations over semiconductors, and I share your frustration voiced this morning over the pace of the opening of the Japanese market. It has been too slow. It has caused untold damage to a large variety of American industries, and I think that it really cannot be tolerated any longer.

A history of the semiconductor industry is contained in the fourth Annual Report to the President from the Semiconductor Industry Association, and I would ask that the summary, if possible, be included in the record.

Senator BAUCUS. It will be included.

Mr. WOLFF. By early 1990, it was clear that the semiconductor agreement—the 1986 agreement—was not going to be fully successful by its terms by 1991. We only were headed towards a market share of some 13 percent—in fact, now that the five-year period of the agreement is behind us, we can say that we have not exceeded the 13 percent range—for foreign semiconductors in Japan rather than the 20 percent promised under the Agreement. This required that a new agreement be negotiated. We were fortunate to have the full support of the Computer Systems Policy Project (CSPP).

The computer makers in this country, our customers, pressed with us for an extension and negotiation of a new agreement. And in this new agreement, Japan reaffirmed its commitment to provide full access to its semiconductor market, and that is to be measured by—in the view of the United States—a single formula, excluding labeled products and captive sales, that would be reached by the end of 1992. With respect to dumping, there are provisions to deter dumping, a fast-track mechanism to stop dumping early in the process and prevent the injury of the kind that occurred the last time around when we lost out in the area of DRAM's. There are also provisions for dealing with dumping in third-country markets.

The lessons learned are, I think, important to many industries as well as to our own, and to the country in the conduct of its trade policy. Industries, of course, must demonstrate an ability and willingness to serve the Japanese market. They must be united in seeking that objective. Once an agreement has been reached, industry-to-industry working groups must be formed to achieve success in opening the market. And we must remember that the goal is expanded trade, not the endless signing of agreements. The results must be measurable and, in fact, measured. Sanctions must be applied, if necessary. Dumping must be responded to quickly.

I would just end this oral summary on the note of what Congress can do at this stage. Obviously, continued congressional oversight of progress under the Agreement is essential. I would urge prompt passage of the bill that you are taking the lead on—the Trade Agreements Compliance Act—which will give an industry the right to come in and request a determination promptly by the government as to whether an agreement is being lived up to. And I would hope that there would be progress on other fronts as well, such as accelerated depreciation for semiconductor equipment.

Thank you, Mr. Chairman and members of the committee. That concludes my testimony. We appreciate the opportunity to appear, and would be happy to answer any questions you may have.

Senator BAUCUS. Thank you, Mr. Wolff.

[The prepared statement of Mr. Wolff appears in the appendix.]

Senator BAUCUS. Mr. Stocker, if the OECD talks fail, will the shipbuilding industry request that a Section 301 be commenced?

Mr. STOCKER. Mr. Chairman, we have had a number of discussions internally about that, and I think because of the reluctance that we have seen on the part of the administration to use 301 in this particular case, I think we will continue to be talking to our Congressional supporters about the appropriateness of legislation. Of course, we will remain open-minded on that subject, particularly if we see the attitude of the U.S. Trade Representative's Office change here in the near future.

Senator BAUCUS. If the major offenders were to stop their subsidies, would the U.S. shipbuilding industry be competitive?

Mr. STOCKER. We believe that if the countries do stop their subsidy practices in certain market niches, we would be immediately competitive, and by the end of the decade, we would be broadly competitive in the market as a whole.

Senator BAUCUS. What market niches immediately?

Mr. STOCKER. In the high value added vessels, particularly in ones that require extensive outfitting, like cruise vessels, for example; handy-sized product tankers, self-unloading bulkers, LNG tankers; vessels of those type.

Senator BAUCUS. Mr. Corrado said that American industry is also subsidized. Your reaction?

Mr. STOCKER. Well, Mr. Corrado is looking at a number of very indirect measures that remain on the books. We have indicated to USTR that we would expect those measures to be repealed if a trade agreement, in fact, is entered into. And certainly, I have made it a public statement in front of your colleagues on the House side that if we were to get legislation, we would support an effort to repeal those protective measures immediately thereafter.

Senator BAUCUS. Mr. Corrado, how much more does it cost to buy U.S. ships compared to foreign-produced ships?

Mr. CORRADO. Well, I think, Mr. Chairman, traditionally in the past 10 years it has been roughly two to three times as much. And, I might add, two or three times as much to operate the U.S.-FLAG vessel, too.

The fact of the matter is, that in the United States of America the cost of living is higher. We have a very competitive union system here, and the costs for maintenance and insurance are higher, and it costs more to operate a vessel, and it costs more to build the vessel.

Now, we hope that Mr. Stocker is right, if, in fact, when all these so-called subsidies are eliminated—when and if they are—that the U.S. shipyards can build a vessel competitively. But frankly, we have some doubts about that.

Senator BAUCUS. Apart from cost of living and other reasons, how much of the cost differential is due only to subsidies?

Mr. STOCKER. We think subsidies have an impact of 30 percent on pricing.

Senator BAUCUS. Let me ask Mr. Corrado that same question.

Mr. CORRADO. Mr. Chairman, before the subsidies were eliminated in 1981, the subsidy rate was 50 percent. At one time, it was 55 percent, and still, even at that, it did not seem to reach parity.

Senator BAUCUS. So, it is fair to say it is somewhere between 30 and 55 percent?

Mr. CORRADO. Yes, sir. In the 1970 Merchant Marine Act, there was a schedule, a system put in the 1970 Act to scale down shipbuilding subsidies. It was 55 percent just before that, and it was then 50, and it was supposed to scale down to 35 percent in increments every 2 years.

And then after a couple of years, Mr. Chairman, that was abandoned as being just a completely hopeless goal and not attainable at all. Then it went back up to 50 percent, and some people say if you were to reinstitute subsidies today, even 50 percent would not be able to reach parity. We would hope that that would not be so.

Mr. STOCKER. Mr. Chairman, the problem is is that the economics of world shipbuilding have changed dramatically since the 1970's. As we have pointed out earlier, there have been no subsidies in this country for over 10 years. The costs of new ships is rapidly increasing in the world market.

The United States is no longer a high labor cost producer because of the higher rates that now exist in Northern Europe in particular, and also in Japan. So, we think we have a reasonable access to the market. This is all speculation on Mr. Corrado's part. We simply want access to the market and be given a chance to compete.

Mr. CORRINO. Not just speculation, Mr. chairman.

Senator BAUCUS. Mr. Wolff, you heard Mr. Massey's statement as to which formulas are going to be observed. Your reaction to his statement?

Mr. WOLFF. I agree entirely with what Mr. Massey said. Wilf Corrigan, the chairman of the Semiconductor Industry Association, said that he anticipated that based on U.S. competitiveness, that we could have 30 percent of the Japanese market over time. We are probably not going to have that, given the difficulties in entry in that marketplace.

The commitment under the agreement is to market access. The measure of that commitment is the U.S. industry's expectation, which is based only on a single formula that excludes captives and brands. It is the first formula in the agreement, and the U.S. Government agrees with our position entirely.

Senator BAUCUS. Now, are you concerned about the agreement's inclusion of two formulas?

Mr. WOLFF. I think that the—

Senator BAUCUS. Is that going to make it difficult to enforce?

Mr. WOLFF. I do not believe so. I think the U.S. Government has been very clear in the way it views the achievement of the objective of the agreement, which is full market access. And that 20 percent cannot include a count which includes captive purchases—which would be, for example, IBM shipping to IBM, and not part of the market at all—or Japanese chips produced in Japan that bear American labels because they are being re-sold by American companies. That is not true access to the Japanese market.

I think that the inclusion of a second formula can be positive in the following sense: If there is an improvement in the marketplace that is through captive sales or sales of branded items bearing U.S. brand names but produced in Japan, it would be seen quite quickly that this is not true market access. We will understand exactly what is going on in the Japanese market, and that will be a step forward.

Senator BAUCUS. Do you think this agreement is better than the 1986 agreement?

Mr. WOLFF. I think it is better than the 1986 agreement in the following sense. It provides for continuation of the process that was put into place. It took sanctions in 1987 for the Japanese to begin to live up to this agreement. It uses the same words as the original agreement for the market access objective, and it has a less intrusive formula for monitoring of anti-dumping, the data collection system.

So, I think in that sense it is an improvement. It now has the support of the entire U.S. electronics sector, meaning both computer makers, as well as semiconductor producers. And that is a step forward. We did not have that in 1986.

Senator BAUCUS. Thank you very much. Senator Grassley.

Senator GRASSLEY. On the one hand, I understand your concerns about the continued subsidies that you face with our competitors as it relates to shipbuilding, but do you not agree that if we pass legislation that forces the repayment of these subsidies it is going to result in higher freight rates and costs?

Mr. STOCKER. Senator Grassley, we are already beginning to see very rapid increases in prices of new buildings in the marketplace anyway. From a shipper's point of view, the unfortunate news is that because of the severity of the depression during the 1980's in shipbuilding, we have seen worldwide capacity drop, and drop in fairly large numbers.

As a result, as demand for new ships increases in the 1990's—which has already begun, particularly in the tanker field because of the need to replace older vessels—there will be some constraints on capacity and price increases.

Frankly, in our own view, if subsidies were removed, the marketplace would, in fact, begin to show a true reflection between supply and demand. And so, prices go up because demand is going up, that is simply the result of a classic economic model. Right now I guess there is a question of fairness. Is cheap transportation a useful goal at the sacrifice of tens of thousands of jobs in the United States of people skilled in the building of ships?

Senator GRASSLEY. I guess simple economics would have said to me that if you subsidize something, you are going to get more of it. We are going to have higher freight rates, American consumers are going to be forced to pay more for their imported consumer goods.

Let me go on. Does this not also force U.S. exporters of goods to pay higher rates and thus become less competitive in world trade?

Mr. STOCKER. Higher rates would result across the board for all products imported and exported. Thus, no sector would be placed at a competitive disadvantage visavis where it stands today. If the legislation were to pass, for example—and this is a point I want to

make clear—the initial point of sanctions will be against the foreign governments.

The foreign governments will be requested by the U.S. Government to collect the subsidy that was paid to their shipyard. The impact on the ship owner would only come later if that foreign government refuses to collect the subsidy, or the foreign shipyard fails to repay the subsidy to either its government, or the U.S. Treasury. So, the impact on the owners will not be felt until the secondary step.

The reason that owners are identified in the legislation at all is that we were trying to make this legislation consistent with generalized U.S. domestic trade laws where the importers of articles that have been subjected or found to be the recipients of unfair trade practices carry the burden of the countervailing duty or the dumping amount that is attached to the cost of that particular item. So, it is not inconsistent with current U.S. domestic trade law.

Senator GRASSLEY. Mr. Corrado, I think I need to hear your point of view on that.

Mr. CORRADO. Well, Senator, as usual, I have to disagree with John on these matters and some inaccuracies. For example, in Mr. Gibbons' bill in the House, they amended it after they had the hearing as a result of our objections. But the amendment was that first the subsidy would be paid by the foreign government to the U.S. Treasury, then the target, once again, was the shipowner. Well, clearly, no foreign government is going to pay anything back to the U.S. Treasury, Senator. I think we understand that. Thus the shipowner, as in all these bills, ends up the target. And if you look at the bill on the Senate side—S. 1361—Senator Mikulski and Senator Lotts' bill—the assessment or penalty provision talks only in terms of the vessel owner.

Now, I agree that a little earlier in the bill they talk about getting the money from the foreign government, but I submit that the assessment provision relates ultimately and realistically only to the shipowner.

And back to something else that was said a little earlier, I do not think I quite share the optimistic view that Mr. Stocker has with respect to the future of the U.S. Flag tanker fleet.

The Congress, in its wisdom, passed OPA-90 a year ago, and levied all kinds of draconian measures on not only the U.S. Flag tanker fleet, but the tanker fleets of the world that come to this country. But one of the features is double hulls. Well, the double hull is going to be required on a phase-out schedule beginning in 1995, and a double hull vessel costs approximately 25 percent more.

The bulk of the U.S. Flag tanker fleet cargo, Senator, is coming from the Alaskan North Slope, which is beginning to decline. If the Congress does not authorize the exploration of the development of ANWAR, there simply will not be any cargo, or not any substantial amounts of cargo to sustain the existing tanker fleet, or its replacement at greater costs.

So, with respect to the U.S. Flag tanker fleet, I am not as optimistic as the spokesman from the shipbuilders.

Senator GRASSLEY. Is it not true that the American shipbuilding industry, along with the maritime industry, generally fought hard against having their problems resolved at the most recent round of

GATT? And it seemed to me like if we are concerned about subsidies from other countries, that this would be the place to take care of those subsidies.

Mr. STOCKER. Senator, the opposition that you describe came principally as a result of the GATT discussions on services. That was an issue that was clearly a priority to the operators rather than to the builders.

I would simply add that there was a feeling that given the unique characteristics of the international shipbuilding market and the extent to which foreign governments were subsidizing their shipbuilders, that it was important to have sector specific negotiations on this particular topic. And as a result, did not lend itself to potential coverage under GATT.

Now, if we were to get an international trade agreement, there has been some discussion about perhaps attaching it to the GATT, because there are shipbuilding countries who are not members of OECD that would have to be covered by the agreement. But that certainly is a second generation problem. We have to get the OECD agreement first.

Senator GRASSLEY. I see my time has run out.

Senator BREAUX. I thank the Senator for his questions. I thank the panel, as well. There is an old song, I guess, in "Oklahoma", about the rancher and the farmer should be friends.

My goal in Congress has been to get the shipowners and the shipbuilders and the seamen to be friends. It has been a frustrating 20 years, but we are still at it; we are still working on it.

Let me ask a few questions about the best procedure for eliminating the subsidies, and it has been a very frustrating battle that the shipbuilders industry has had to go through. Would not the 301 petition—if USTR and this country pushed it—probably be the most appropriate way of handling this if, in fact, they were willing to do it, Mr. Stocker?

Mr. STOCKER. Senator Breaux, 301 was put into place by the Congress for exactly this purpose. It is appropriate for government to government discussions and negotiations where we are talking about government practices that have been distorting the market.

As I indicated earlier to the Chairman, we have run into a particular attitude at USTR where it has been felt that it was not appropriate to undertake our case under Section 301. We filed a Section 301 and were asked to withdraw it. USTR has not been willing to undertake a 301 in spite of three missed deadlines and 2 years of talk.

Senator BREAUX. We were really told, look, please withdraw your complaint and hold back, and we are going to take care of it for you if you just cooperate with us.

Mr. STOCKER. Yes, sir.

Senator BREAUX. I mean, was that not what was told by USTR?

Mr. STOCKER. Yes, it is exactly what we were told.

Senator BREAUX. I was a fly in the soup. Is the industry willing to compete on the open market if the subsidies were eliminated from the countries that were the offending parties? Do you feel that the American shipbuilders industry could compete for business on the open market if we were able to eliminate the subsidies?

Mr. STOCKER. We are confident enough of that particular point that we would not have undertaken this fight unless we believed we had a reasonable chance of getting access to markets.

Senator BREAUX. I think things are different—I would say to Mr. Corrado—from back in the 1970's, perhaps. These other countries they have had some changes too, in the sense of their wages have gone up, and their safety and environmental laws have come to pass.

And there are other legitimate outside costs that have come up over the years. And I really feel that if we were to play on a level playing field, that the prices of the ships would come out based on productivity as opposed to being based on the subsidies of the countries.

Mr. CORRADO. Well, you hit a key word, Senator—"productivity." We are not talking in this whole equation of just the question of competing prices, but we are talking about yard practices, yard management, yard efficiency, productivity, the efficiency of financing; all of these factors enter into the yard competitiveness equation. And when all the equation balances out, if, in fact, these alleged foreign subsidies are eliminated, it will be interesting to see whether the U.S. yards can compete on the world's marketplace in the light of all of these factors.

Senator BREAUX. Now, if they cannot compete, I do not think you are going to find a lot of people in Congress trying to advocate any subsidies to subsidize inefficiency. I think that most of us who are involved in this want to get them on a level playing field.

And then if they can compete—which I think they can—from a productivity standpoint of the 1990's and the out years, well, then they are going to get the business. And if they cannot, well, they cannot. I mean, is that fair, Mr. Stocker, as far as your industry is concerned?

Mr. STOCKER. Yes. I think that is a fair characterization of our position. For example, even if we get the legislation, or if we get the trade agreement, there will be a phase-out period. We will have two or 3 years to organize ourselves to penetrate the market. And with some programs that are being currently discussed with the Defense Department, we think that is the kind of transitional effort that will allow us to amortize up-front investment to, in fact, learn about some of the points that Mr. Corrado has brought to your attention, particularly in the area of ship finance.

But we are very confident, and the reason we are confident is for exactly the point that you raised earlier. Conditions in the marketplace have changed dramatically in the last 10–15 years; costs of production have gone up all over the world, particularly in Europe. Our first point of competition is not going to be directly with the Japanese.

Frankly, we see the first area in the market we are going to get into is exactly in those areas where the Europeans have been, because we think we can beat their prices. We have seen French shipyard quotes on LNG tankers that are very high. A French shipyard just won a five ship contract. It was $1.3 billion.

And I should remind you that it was in LNG tankers that the United States pioneered the technology and, in fact, was quite com-

petitive back in the 1970's. So, we think we have a reasonable shot at the market.

Senator BREAUX. Let me ask a question or two about the legislation—the Mikulski bill—of which I am a co-sponsor. I, too, am a little bit concerned about the target, and I am afraid we may be shooting ourselves in the foot in one area. And that is on page nine when you talk about when a country has subsidies and it is proven, and we have American companies that have bought ships from a country that subsidizes their shipbuilding industry.

The legislation really requires each company to repay to its government the total value of the subsidy. And when we speak about "repay to its government," what is your understanding of who "to its government" would be? Is that the government that provides the subsidy?

Mr. STOCKER. That is right. The legislation has a series of steps to be undertaken. The first would be that the U.S. Government would attempt to get the foreign government to cease their practices and to recover the subsidy from the shipyard that was provided the subsidy.

Senator BREAUX. Yes. Well, we heard about that with the first witness.

Mr. STOCKER. Right.

Senator BREAUX. The last 10 years he has been trying to do that.

Mr. STOCKER. Right. That is right. The secondary sanction is for a fine or penalty to be collected from the shipowner, which would go to the U.S. Treasury if that ship called at a U.S. port.

The intent is to have a similar practice in place, as I have mentioned earlier, as we do for the importers of shoes or other goods that may have, in fact, been the subject of countervailing duty cases or dumping cases.

And the reason we did that is first because philosophically it is in line with other U.S. trade provisions, and secondly, the reason it is in the bill is because currently under Title VII of the Trade Act, ships are not covered under CVD or dumping provisions.

Senator BREAUX. I am a little concerned that it seems that we are hitting the wrong target. I mean, the target should be the country that is providing the illegal subsidy and not necessarily the American company who purchased a product with the benefit of the subsidy.

I mean, under these type of circumstances, I would imagine that the foreign government would have no incentive to discontinue the subsidy as long as he keeps selling ships. I am really concerned about that. I think that is one of the reasons why the 301 provision is probably a cleaner way of doing it. What do you suggest, or do you have a suggestion as to what the next step should be without government—not legislative route, but with regard to 301? Is it time to tell them, hey, the game is over, or are you willing to go through September, which is only a few more weeks away? What is your recommendation?

Mr. STOCKER. Well, let me first of all say, Senator Breaux, that our first preference was always the achievement of an international agreement. And if an international agreement was brought home in September or even sometime early in this fall, obviously we would be pleased. Now, there are some minimum standards

that that agreement would have to meet, and we have detailed that in our statement. That would be our first preference.

However, I am concerned about the lack of real political commitment on the part of the European community, as well as the Japanese, to the conclusion of these talks. My own estimate now is that the talks will fail. So, then your question is do we at that point urge the U.S. Government to undertake a 301 case? Thus far, USTR has been unwilling to do so. Obviously, if, in its wisdom, the Senate concluded that it would be preferable to undertake a 301 as opposed to passing legislation, we would be fully cooperative and supportive in undertaking the 301, provided USTR's attitude on 301 changes. Either through a trade agreement—through a 301—or through legislation. There must be a sanction for violating an agreement or U.S. law. Trade disciplines have always been enforced through tariffs on imported products. The question is whether the tariff should be levied against non-related products or against the subsidized product itself.

Owners are beneficiaries of the practices. They can, in fact, seek indemnification clauses in their contracts with shipyards to protect themselves. But the people who are ultimately breaking the rules are the governments themselves, and we would be, frankly, open-minded on how we approach this problem.

If you want to drop paratroopers out of the sky into downtown Bonn, or something like that, to try to discipline German practices, we would certainly support that kind of move.

But the frustration we have had—and I have to confess the frustration that others have felt as well—is what is the most appropriate avenue for us to undertake, and what sanctions should, in fact, be put in place to go after countries who continue to disadvantage us.

Senator BREAUX. Well, let us stay tuned and follow the September meeting—obviously, Congress will be out in August. I do not think anything is going to move in August. But I really think the final, final deadline should be the talks in September.

And if I think they come out about like I think everybody feels they will, I think it is time to move, and I think it is time to move as aggressively as we possibly can. Mr. Corrado and Mr. Stocker, I appreciate it.

Mr. Wolff, I did not mean to ignore you. It is just an area that you presented the testimony very clearly, and I know that Senator Baucus and Senator Grassley had questions for you, and I appreciate your being with us as well. Thank you very much.

Mr. WOLFF. Thank you.

Senator BREAUX. With that, this will conclude——

Mr. CORRADO. I wonder if I might make a comment.

Senator BREAUX. Sure.

Mr. CORRADO. Senator, you referred to page nine of S. 1361. Also on page nine, I would point out that there is language that when the determination is made with "the best information available." There is no definition of this, there is no guideline for this, and with respect to the shipowners being the party at issue here, we do not come before you doing anything to the shipyards. We are here because they have come with a bill that really puts the shipowner at issue, and the vessel owner, the ports, and the commodity owner

are hurt. The offending party here is the foreign government and the foreign shipyard, and something should be figured out to put the sanction on them, not on the vessel owner, the ports, and the commodity owners Senator. Thank you, sir.

Senator BREAUX. Obviously the bill was not drafted by Ernie Corrado.

Mr. CORRADO. Well, that is clear; especially the Gibbons bill. I never saw a bill put together that way before in all my years dealing with these matters.

Senator BREAUX. This will conclude the hearing. Thank you.

[Whereupon, the hearing was concluded at 12:08 p.m.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED

PREPARED STATEMENT OF SENATOR MAX BAUCUS

For most Americans, the international trade problem is a Japan problem. This view oversimplifies America's trade problem, but it is not entirely inaccurate. In recent years, the bilateral deficit with Japan has accounted for 40% to 50% of our total trade deficit.

The U.S. and Japan have had a seemingly endless series of bilateral trade disputes. Just in recent years, there have been disputes over semiconductors, construction services, beef, supercomputers, forest products, medical devices, automobiles, satellites, and the list could literally go on and on.

In many of these sectors, progress has been made. But in almost all cases, more remains to be done. For example, after years of negotiations, Japan has eliminated its beef quota last spring. But a 70% tariff remains.

Similarly, the market share for U.S. semiconductors in Japan has risen, but still lags far behind the U.S. market share in third markets.

Beyond these sector specific trade problems, larger, systemic problems also remain. Although the issue was addresses in the Structural Impediments Initiative, the Japanese distribution system remains impenetrable for many U.S. exporters.

Further, despite increased efforts to enforce the Japanese Anti Monopoly Act, collusive groupings of Japanese companies— Keiretsus block U.S. exports in many sectors.

Unfortunately, these systemic problems are not even on the agenda for the Uruguay Round of GATT talks. If they are not addressed bilaterally, they will not be addressed.

Two years ago, the U.S. launched the Structural Impediments Initiative to address these systemic problems.

After a year of hard negotiations, the U.S. and Japan issued a joint report on the structural causes for the trade imbalance in both countries. In the SII talks the U.S. finally began asking the right questions.

Unfortunately, after reviewing the final report and the results of follow up meetings, I am not certain that it has gotten the right answers.

U.S. exporters still face considerable problems. The experience of one American company—Guardian Industries—is very instructive.

Guardian Industries is a U.S. company. It is one of the largest and most successful glass producers in the world.

Guardian has been successful in every major glass market in the world—except Japan. For that reason, it is one of the 20 companies that the Commerce Department chose to focus on in its recent efforts to help U.S. manufacturers break into the Japanese market.

But the effort has not succeeded. Though Japanese glass companies have free access to the U.S. market, Keiretsus keep Guardian out of the Japanese market. Guardian has faced collusion and threats of retaliation against their customers in Japan.

Unfortunately, Guardian's story is not unique. Similar stories are told by many U.S. companies, including Intel, Cray, Motorola, and Chrysler.

Even after SII, all the major Japanese systemic barriers—the exclusionary distribution system, Keiretsus, and targeting—remain.

In fact, SII has done little more than identify the problems. The problems still exist.

In my view, it is time to go beyond the SII forum and attempt to address some of the structural barriers under Section 301.

Some progress has been made in recent months, however, on sector specific problems. The U.S. and Japan have concluded major agreements on trade in semiconductors and construction services.

In my view, both of these agreements will help U.S. exporters.

The Construction Agreement—though it falls far short of opening the entire Japanese construction market—does open major construction projects to U.S. bidders.

The new Semiconductor Agreement does reaffirm the goal of opening the Japanese market and establish new procedures for preventing predatory dumping.

Unfortunately, the market access provisions are—at the very least—somewhat ambiguous. The agreement does set a benchmark for the U.S. share of the Japanese market at 20% by July of 1992. But the agreement includes two separate formulas—one American and one Japanese—for determining market share. If the Japanese formula is used, the 20% benchmark is of little more than symbolic importance.

Further, the U.S. also agreed to lift sanctions imposed on Japan for failing to meet the 20% market share benchmark in the 1986 Semiconductor Trade Agreement. Since Japan still not met this benchmark for market access, it was premature to lift sanctions.

The U.S. has previously concluded agreements on both semiconductors and construction services. In both cases, Japan failed to live up to the commitments it made in those agreements.

We must recognize that a trade agreement is only useful if we have the will to enforce it. If we turn a blind eye when our trading partners violate those agreements, the agreements are worthless.

In the case of the new construction and semiconductor trade agreements, particular attention must be paid to enforcement.

We must stop defining success as merely concluding an agreement. We have declared victory on construction and semiconductors before only to be disappointed. This time, we should not declare victory until Japan lives up to the commitments and U.S. exports of semiconductors and construction services have increased.

At the request of several Members of the Subcommittee, including Senators Breaux and Mitchell, I have asked the Administration to address the current OECD negotiations on shipbuilding subsidies and ship pricing.

These negotiations involve Japan, the EC, South Korea, Finland, Norway, Sweden, the Netherlands, and the U.S. Unfortunately, these negotiations seem to be making very little progress. Many U.S. shipyards have grown understandably impatient.

I do not favor the sector specific retaliatory legislation that has been introduced on shipbuilding. But if the OECD negotiations fail to yield results in the very near future, I do believe it would be appropriate for the U.S. to take action under Section 301.

Since we are fortunate enough to have Joe Massey—the Assistant USTR for both Japan and China—testifying today, I have asked the Administration to also address our trade concerns with the Peoples' Republic of China.

The Senate has just had a bruising debate on extending MFN status for China. Many Senators were concerned over China's piracy of U.S. intellectual property and rising Chinese trade barriers.

In a letter delivered to the Senate shortly before the Senate voted on MFN extension, the President made a number of commitments to address these trade concerns. The most important of which was a commitment to use Section 301 to address Chinese market access barriers. The President wrote:

> "The Administration has proposed holding another round of market access consultations in August 1991. If that round of negotiations fails to yield substantial commitments from the Chinese authorities to dismantle market access barriers, the Administration will self-initiate Section 301 action to address those barriers . . . "

In my view, this commitment from the President is critical. Without it, many Senators—including myself—would not have voted to extend MFN to China without conditions.

In accordance with this commitment, I expect the Administration to either conclude a sweeping agreement with China or to self-initiate a Section 301 case directed at those barriers.

I look forward to hearing Mr. Massey's views on the trade talks now underway with China on protection of intellectual property and market access.

As the world's number one and number two economic powers, the U.S. and Japan must work together.

The bilateral trade relationship between the U.S. and Japan is the second largest in the world—exceeded only by that between the U.S. and Canada.

The U.S. and Japan must work together on a variety of global economic issues ranging from exchange rates to aid to developing countries.

But this economic interdependence should not be used as an excuse for ignoring trade problems.

As economic studies from both the Brookings Institute and and the Institute for International Economics have confirmed, Japan still remains largely closed to manufactured imports. As the 1991 National Trade Estimate once again confirmed, Japan still retains trade barriers in a number of sectors.

If the U.S. economy is to continue to grow and the bilateral relationship between the U.S. and Japan is to continue to improve, Japan must open its market. Unfortunately, experience has shown that Japan will not open its market altruistically. Only sustained pressure from the U.S. pushes Japan away from protectionism and toward freer trade.

The Congress and the Administration must keep up pressure on Japan until the Japanese market is truly open.

PREPARED STATEMENT OF ERNEST J. CORRADO

I am Ernest J. Corrado, President of the American Institute of Merchant Shipping (AIMS). Today, I am the spokesperson for the following broad range of U.S. and foreign maritime companies and associations: AMERICAN ASSOCIATION OF PORT AUTHORITIES (AAPA), AMERICAN INSTITUTE OF MERCHANT SHIPPING (AIMS), AMERICAN MARITIME CONGRESS (AMC), AMERICAN PETROLEUM INSTITUTE (API), AMERICAN PRESIDENT COMPANIES, LTD. (APL), CONSUMERS FOR WORLD TRADE, COUNCIL OF EUROPEAN AND JAPANESE NATIONAL SHIPOWNERS' ASSOCIATION (CENSA), FEDERATION OF AMERICAN CONTROLLED SHIPPING (FACS), MARITIME INSTITUTE FOR RESEARCH AND INDUSTRIAL DEVELOPMENT (MIRAID), MASTERS, MATES & PILOTS (MM&P), NATIONAL MARINE ENGINEERS' BENEFICIAL ASSOCIATION (MEBA), SHIPPERS FOR COMPETITIVE OCEAN TRANSPORTATION (SCOT), SEA-LAND SERVICE, INC., TRANSPORTATION INSTITUTE (TI), UNITED SHIPOWNERS OF AMERICA (USA), THE U.S. CHAMBER OF COMMERCE, and U.S. COUNCIL FOR INTERNATIONAL BUSINESS.

Most interests in the marine transportation and trade sector flatly oppose S. 1361, H.R. 2056, and H.R. 2709. Most believe that now is the time to support the OECD talks in the hope of securing a multinational agreement to eliminate commercial shipyard subsidies. We appreciate this opportunity to appear before the Subcommittee on International Trade of the Senate Finance Committee to present testimony in support of the OECD talks and in opposition to pending bills that would promote a new, sector-specific trade remedy structure.

Today, I would like to direct the subcommittee's attention to perceived flaws in S. 1361, H.R. 2056, and H.R. 2709 and the potential harm these bills may have on peripheral and innocent third parties. Among other things, the bills penalize the wrong party. In addition, the bills do not balance present market realities with the shipbuilders' unilateral effort to eradicate the prevailing problem of foreign subsidies.

SUPPORT FOR OECD TALKS

The elimination of foreign shipyard subsidies is an extremely complex matter.

We support the multilateral negotiations and recognize that despite the frustrations of long-term negotiations, this is a superior approach. We oppose unilateral U.S. efforts to achieve the immediate elimination of foreign shipbuilding subsidies.

As noted by Ambassador Williams at the March 21, 1991 hearing before the Trade Subcommittee of the House Ways and Means Committee, the U.S. negotiating team is attempting to finalize the multilateral agreement, now in its second year of negotiation. Every effort is being made to determine a definition of "subsidy" and finalize all other aspects of the agreement.

S. 1361, H.R. 2056, and H.R. 2709 are a premature attempt at finding a resolution to this problem. The problem is international in scope. The parties to this debate are presently engaged in a process that shows signs of reaching a conclusion in the foreseeable future. The goal is a strong, effective multilateral agreement and pending legislation would be a poor substitute for such an agreement.

Despite the frustration of awaiting resolution of the talks, it is far better to allow the international negotiators to continue, free of the burden of this domestic unilateral legislation. These measures would encourage other unilateral attempts to resolve this matter by other countries. Any changes in the trade laws in the United States and in other countries that would result from this measure would require a period of adjustment and costly changes in administration. It is best to support the OECD talks and await a resolution rather than advance a unilateral approach such as the proposed legislation which targets the wrong party and which may result in seriously impeding international trade.

DISCUSSION OF PENDING LEGISLATION

The basic thrust of the proposed legislation is to eliminate commercial shipyard subsidies worldwide, i.e., to make shipbuilding construction equal on a global basis. We do not have any problem with this concept. However, if the approach of pending legislation were adopted, the vessel owner would be the party subject to redress for a foreign country's shipyard subsidy practices. It is not feasible to target a vessel owner as the party at risk for this effort. Moreover, even if this equalization goal were accomplished, U.S. yards will not benefit in any substantial way.

The bills would require a shipowner to certify to the U.S. Customs Service or to the Secretary of Commerce (S. 1361) that the ship in question is subsidy free. This makes the shipowner responsible for the repayment of foreign shipyard subsidies not effectively eliminated or paid back by other means. In fact, foreign governments are the entities properly responsible for their subsidy practices in relation to their shipyards. Innocent shipowners should not be subject to operating penalties and economic burdens to redress a foreign government's alleged subsidy practice transgressions.

By proposing a certification process that targets the subsidized foreign built vessel, proposed legislation links shipowner incentives with shipyard subsidies. The result is a certification scheme that penalizes the shipowner. It appears that this notion creates "shipowner disincentives," rather than effectively eliminating foreign shipyard subsidies.

To the greatest extent possible, the scope of this debate should be limited to shipyard preferences and should not include any other maritime program. The elimination of commercial shipyard subsidy is best distinguished from incentives made available to any other sector of maritime services. This is a stated objective of the U.S. Trade Representative's office in regard to the OECD talks on shipyard subsidy elimination. Also, the OECD talks do not encompass military ship construction which will continue to provide U.S. shipyards with annual support of more than five billion dollars per year.

The concept of placing shipowners in the position of redressing the alleged unfair subsidies provided by a foreign country by means of a complex certification procedure is misguided. The business of shipowners would be unduly delayed and overburdened by complex administration of this task. The shipowner's role in the market is not in dispute. It is the role of the subsidizing countries that is in dispute. Shipowners purchase vessels in the world market out of necessity based on a variety of factors: production time, quality, yard availability, cost and location. Shipowners are by no means party to the direct subsidies granted from a foreign country to its shipyards. Therefore, a solution to the problem of foreign shipyard subsidies based on economic disincentives for shipowners is not a valid solution to this complicated matter.

In addition to the misguided sanctions of the bills, they create an unpropitious business environment for individual shipbuilding contracts executed in good faith. For example, the result of S. 1361 would be to create economic disincentives to trade in U.S. ports. In more general terms, S. 1361 has an adverse impact on all domestic maritime policy inviting international retaliation and prejudicing the outcome of the OECD negotiations which are currently underway in Paris. Finally, the bills have the practical effect of adding costs that seriously penalize vessel owners, while providing no relief from shipyard penalties already in place in the U.S., namely the 50 percent ad valorem duty imposed on the cost of equipment and repairs made to U.S.-flag vessels in foreign countries.

SPECIFIC OBJECTIONS

I. Retroactive Effect

For some inexplicable reason, S. 1361 reaches back 2 years in imposing sanctions. As you understand, a shipbuilding contract is the result of business decisions made over a course of months, even years. The first notice of this legislation was an-

nounced at the House Ways and Means Committee hearing held March 21, 1991. Having no previous notice of this unilateral approach to shipbuilding subsidies, investors have entered into capital intensive contracts based on certain economic predictions and incentives. Clearly, the retroactive nature of this bill places at risk the economic incentive for entering into shipbuilding contracts negotiated in the last few years. From the time these newly constructed vessels (under contract and/or construction or repair as of the operative date) would begin to engage in trade with the United States, the vessels would be penalized. The retroactive nature of the bill not only does nothing to enhance fair trade in prospective commercial shipbuilding and repair industries but is patently unfair. S. 1361 can only be read as a punitive measure against those shipowners who negotiated in good faith legitimate contracts before these bills were even conceived, much less devised.

Assuming the value of foreign subsidies can even be assessed in the complex and turgid procedure set out in the bills, subsidy repayment fees will have a serious negative impact on the economic projections for the vessel. We must oppose S. 1361 as well as other proposed legislation because such measures attempt to create unreasonable and unfair burdens on innocent vessel owners who have entered good faith contracts for vessel construction without the opportunity to evaluate the potential fees and punitive sanctions involved in the proposed cumbersome certification process.

The detrimental retroactive impact of these bills is not balanced by a corresponding advantage to U.S. shipyards nor by any foreseeable advantage to the prospects of finalizing a multinational agreement.

II. Pending Shipbuilder Supported Legislation Invites International Retaliation

The purpose of these bills is claimed to be "to ensure fair trade in the commercial shipbuilding and repair industry by providing for effective trade remedies against subsidized and dumped foreign commercial ships." On the contrary, they may have the opposite effect and work to encourage foreign countries to initiate laws to redress U.S. practices that are perceived as trade-distorting and unfair. This result would be counter productive.

The multilateral approach to the elimination of shipyard subsidies worldwide affords each country participation in a uniform and structured regime. One indication of the complexity in devising such a regime is the difficulty in determining the definition of a subsidy and in determining the limitations of the terms for eliminating such trade-distorting practices. This difficulty is evidenced by the extended period of time already needed for the OECD talks. If each country were to determine individually the definition of a subsidy and the limitations on their own country's subsidy reform, the likely result would be a chaotic and ineffective regime, and probably no agreement at all. A series of conflicting unilateral laws would be created, perhaps to the detriment of owners and operators of vessels, including Jones Act-qualified vessels. For example, foreign governments may perceive as "subsidized" U.S.-built vessels that have benefitted from Federal programs, perhaps even from construction programs that are no longer in effect.

Foreign retaliation may be a very real threat to Jones Act-qualified operators. The bills define subsidies in extremely broad terms and, in essence, link the shipbuilding industry to the owners and operators of vessels. Should foreign governments enact laws to counterbalance existing U.S. shipyard subsidies, all ships are affected, U.S. and foreign-flag. By penalizing the vessel operator for foreign government subsidized vessel construction and repair instead of penalizing the foreign governments or yards or placing duties on the exports of foreign countries that subsidize shipyards, such measures invite foreign countries to examine not only U.S. shipyard subsidy programs but U.S. shipowner subsidy programs as well. This detracts considerably from the meager advantages that exist for U.S.-flag operators. Already the Administration has put the Capital Construction Fund Program (CCF) on the negotiating table arguing that it is a shipbuilding subsidy when it is clearly a tax deferral device for U.S. shipowners in the face of foreign carrier exemptions from taxation.

We oppose U.S. unilateral legislative measures because they invite foreign countries to proceed with retaliatory unilateral measures. Should foreign countries enact laws similar to the bills proposed in the United States, U.S.-flag shipowners will then be made the target of subsidy elimination efforts including sanctions as severe as those embodied in S. 61, H.R. 2056, and H.R. 2709. Clearly the objective of the OECD talks is to deal only with shipyard subsidies and not to include any other maritime industries or maritime services. However, the bills before us today place the shipowner at the center of this debate and controversy. As a result, U.S.-flag shipowners would be the target of retaliatory measures by foreign countries.

III. Provides No Relief From the 50 Percent Ad Valorem Duty

Strangely none of the proposed legislation even addresses, much less eliminates, the 50 percent ad valorem duty imposed on the cost of equipment and repairs made on United States documented vessels in foreign countries ("repair duty"). (Tariff Act of 1930, sec. 466, 46 Stat. 719, codified as 19 U.S.C. 1466). The duty is listed as Special Statistical Reporting Number 9999.00.10 of the United States Harmonized Tariff Schedule. These bills are totally unbalanced inasmuch as their entire thrust is to punish foreign shipyard subsidies but do not address the egregious subsidy for U.S. shipyards embodied in the 50% ad valorem duty on U.S.-flag ship repairs in foreign yards. The U.S. yards cannot be permitted to have it both ways.

The repair tariff unduly burdens and handicaps U.S. carriers. Elimination of the repair duty would provide substantial economic relief to U.S.-flag carriers. In addition, economic relief for U.S. carriers ultimately will benefit the public. Furthermore, elimination of the repair duty would have little economic impact on U.S. ship repair facilities.

Attached is a brief that sets forth the history of amendments and judicial interpretations of the repair duty statute. The history shows that the intent of the statute was to encourage U.S. shipowners to employ domestic shipyard labor and not to provide blanket protection for domestic repair yards. History also shows the complexity of the law which results in a greater burden on trade.

The ship repair duty as it stands today does serve as an important negotiating tool in overall talks on shipbuilding and ship repair subsidies. Proposed legislation seeks the reduction or elimination of foreign shipbuilding and ship repair subsidies. In exchange for the elimination of these foreign subsidies, the bill must eliminate the U.S. protectionist ship repair duty. Foreign governments would welcome the removal of this substantial U.S. barrier to their competitive industries. Thus, the best economic interests of the United States would be served by negotiating the elimination of the duty rather than heaping more restrictions on domestic carriers.

Importantly, the elimination of the repair duty can be used as a valuable negotiating tool in the OECD talks. Just as significant benefits were gained by domestic aircraft and aerospace industries partly in exchange for eliminating the repair duty on aircraft, comparable benefits can be achieved in exchange for the vessel repair duty.

In summary, the repair duty is embodied in a complex law which is expensive to comply with, costly to administer, and that burdens foreign commerce.

IV. Treatment of Vessels Under the Countervailing and Anti-dumping Duty Laws

This concept is not in S. 1361 or H.R. 2709, but is found in H.R. 2056. This particular aspect of the Gibbons Bill (H.R. 2056) is extremely confusing to the uninitiated and, as a consequence, it is troublesome to U.S. vessel owners and operators because for the first time this bill appears to be introducing, as to U.S. vessels, the concept of vessels being considered as "merchandise" and being considered as sold for importation in the context of Subtitle A—Importance of Countervailing Duties and Subtitle B—Importation of Anti-dumping Duties for vessels constructed, reconstructed, or repaired in foreign countries. There is a fundamental difference between a ship and other devices. A vessel is not imported but imports products, loads products for export and continues around the world in commercial trade. With respect to United States-flag and foreign-flag vessels, this section in considering vessels as "merchandise" and for "importation" would be a far-reaching concept not explained in the bill which leaves a feeling of uncertainty as to scope, impact and substance and we therefore strongly oppose its inclusion.

CONCLUSION

The interests I represent strongly support OECD efforts to reach an agreement and oppose S. 1361, H.R. 2056, and H.R. 2709. The notion that shipowners are at all situated to compensate for foreign shipyard subsidy is refuted. The U.S.-flag merchant fleet would incur serious international disadvantages should this proposal move forward because it takes the wrong approach and penalizes the wrong party. Its retroactivity is certainly punitive with respect to vessel owners and the matter of the 50% ad valorem duty is not addressed. In addition, this legislation adversely impacts U.S. exports and imports by prohibiting, the vessels that carry these export/import commodities from entering U.S. ports. Movement of rice, grain, foodstuffs, etc. would be halted, penalizing the ports, the owners of these commodities, and resulting in loss and greater costs to U.S. and foreign consumers. For these reasons our collective interests oppose these bills and are convinced that they should not be enacted.

We appreciate this opportunity to testify before the Subcommittee. This statement is submitted for the record and I would be pleased to answer any questions.

ATTACHMENT TO STATEMENT BY ERNEST J. CORRADO

I. BACKGROUND OF THE TARIFF ACT OF 1930

The predecessor of the modern statute was enacted by Congress in 1866. Act of July 18, 1866, Ch 24, sec. 23, 14 Stat. 183. The Act imposed a 50 percent *ad valorem* duty on the cost of foreign repairs to United States vessels documented to engage in the foreign or coastwise trade on the Northern, Northeastern, and Northwestern frontiers. *Id.* As a practical matter, the duty applied to U.S. vessels trading from the Great Lakes, the Atlantic, and the Pacific Coasts with Canada. The statute also provided for remission or refund of the duty where a shipowner established by sufficient evidence that the vessel had been compelled to seek foreign repairs due to a weather related casualty or other emergency. *Id.*

Congress codified the statute in sections 3114 and 3115 of the Revised Statutes of the United States in 1874. R.S. 3114, 3115 (1874). The statute remained essentially unchanged until 1922 when Congress extended the trade areas subject to repair duty to include all vessels of the United States documented to engage in the foreign or coastwise trade, or intended to be so employed, anywhere in the world. Tariff Act of 1922, sec. 466.

Congress again made substantial changes to sections 3114 and 3115 of the Revised Statutes as part of the Tariff Act of 1930. First, Congress excluded from the repair duty any compensation paid to members of the regular crew of a vessel in a foreign country in connection with performing repairs or installing equipment, even if the repairs or equipment were dutiable. Tariff Act of 1930, sec. 466, 19 U.S.C. 1466(a). Second, Congress provided duty remission for repairs and equipment to secure the safety and seaworthiness of the vessel. Id., 19 U.S.C. 1466(d)(1) (1982). Seaworthiness generally is defined as the practical ability to engage in the service for which the vessel is intended to engage. Lastly, Congress provided duty remission for the installation abroad by U.S. residents or members of the regular crew of equipment, repair parts, or materials manufactured or produced in the United States, regardless of the purpose of the repair or installation. *Id.*, 19 U.S.C. 1466(d)(2) (1982).

In 1971, Congress amended section 466 of the Tariff Act of 1930 to incorporate the repair duty provisions of the Revised Statutes into title 19, section 1466 of the U.S. Code, and repealed sections 3114 and 3115 of the Revised Statutes. Act of January 5, 1971, Pub. L. 91-654, 84 Stat. 1944, 19 U.S.C. 1466 (1982). The Act also provided for several additional exceptions to the repair duty. First, the duty was excepted for labor, materials, parts, or equipment used for cargo dunnage, packing, and shoring, or for the erection of temporary bulkheads for the control of bulk cargo, or for the preparation of tanks for the carriage of liquid cargo. *Id.*, 19 U.S.C. 1466(d)(3). Second, the duty was excepted for repairs to and equipment for non-cargo vessels (i.e. vessels used primarily for purposes other than transporting passengers or property in the foreign or coasting trade; e.g., fishing vessels) remaining continuously outside the U.S. for a period of two years. However, the duty specifically was maintained for (1) repairs made and equipment purchased during the first six months after departing the United States, and (2) fish nets and netting. *Id.*, 19 U.S.C. 1466(e).

Since 1971, Congress has made a number of minor modifications to the repair duty statute. Congress amended the repair duty statute by the Act of October 1978, Pub. L. 95-410, 92 Stat. 900, (making minor changes to the seizure and forfeiture penalty provisions); the Act of July 26, 1979, Pub. L. 96-39, title VI, sec. 601(a)(3), 93 Stat. 268, codified as 19 U.S.C. 1466(f), as amended by the Act of October 17, 1980, Pub. L. 96-467, 94 Stat. 2225 (exempting United States civil aircraft from the repair duty); and, the Act of December 28, 1980, Pub. L. 96-609, title I, sec. 115(a), 94 Stat. 3558, codified as 19 U.S.C. 1466(f) (exempting entries relating to tuna purse seine nets between October 1, 1979 and January 1, 1982).

The last significant change to the statute occurred in 1984 when Congress extended to all vessels, regardless of the character of their service, the exemption from the duty previously offered only to non-cargo vessels by the 1971 amendment. Act of October 30, 1984, Pub. L. 98-573, title II, sec. 208, 98 Stat. 2976 19 U.S.C. 1466(e) (1982, Supp. IV). However, the duty remained applicable where a passenger or cargo vessel departed the U.S. solely for the purpose of obtaining equipment or repairs abroad. *Id.*

II. ADMINISTRATIVE AND JUDICIAL INTERPRETATION OF THE STATUTE

The modern statute imposes the 50 percent *ad valorem* duty on "[t]he equipments, or any part thereof, including boats, purchased for, or the repair parts or materials to be used, or the expenses of repairs made in a foreign country upon a vessel documented under the laws of the United States . . . ." Determining which items of overseas work are dutiable requires a review of Customs regulations and judicial interpretations of the statute.

The U.S. Customs Service ("Customs") administers the repair duty statute, as amended, in accordance with the purpose of the statute, the statutory language, and the judicial interpretations of the language. Customs regulations implementing the repair duty statute are found at 19 C.F.R. 4.14. The regulations set forth detailed procedures for entry following foreign repairs, procedures for remission or refund of the duty, and procedures for liquidation of vessel repair entries. Also, the regulations provide guidance as to items subject to duty.

Congress' intent in enacting the repair duty statute, as stated by the courts, was to equalize the cost of repairs performed by foreign, as opposed to domestic labor, to encourage U.S. shipowners to employ domestic shipyard labor whenever possible. *See Mount Washington Tanker Co.* v. *United States,* 665 F.2d 340 (C.C.P.A. 1981); *Suwannee Steamship Co.* v. *United States,* 435 F. Supp. 389 (Cust. Ct. 1977). Similarly, the history of amendments to the statute and longstanding judicial interpretation of the statute's terms clearly show that the repair duty was never intended to provide blanket protection for domestic repair facilities. Yet, part of the burdensome nature of the statute results from distinguishing dutiable from non-dutiable work, i.e., what constitutes "equipment" and "repair." This requires a review of court interpretations of the statute.

The first issue that must be examined is whether work effected in a foreign yard constitutes a "repair" within the meaning of the statute. The courts have generally defined ship repair as the restoration of a vessel or its equipment to its original state after decay, waste, partial destruction, or injury. *See United States* v. *Admiral Oriental Line,* 18 C.C.P.A. 137, 41 (1930); *American Viking Corp* v. *United States,* 150 F. Supp. 746 (Cust. Ct. 1956). In applying this definition, a court in an early case found that expenses associated with repairs are outside the definition and thus classified non-dutiable. *United States* v. *George Hall Coal Co.,* 134 F. 1003 (C.C.D.N.Y. 1905). The court held that the expense of docking a vessel to undertake repairs, along with associated docking expenses, are not dutiable "repairs." *Id.* at 1006. As a result, the docking rule today is applied to additional associated expenses, which are inseparable from modern drydocking, including drydock block arrangement, sea water supply, air supply, hose connection and disconnection, firewatch services, crane services for drydock operations, and drydock cleaning.

Similarly, courts have ruled that the examination of a vessel's apparatus and machinery to determine whether repairs are necessary is not a dutiable "repair" so long as the inspection does not result in repairs being performed. *American Viking Corp.,* 150 F. Supp. at 754. Accordingly, annual and periodic inspections and surveys required by the U.S. Coast Guard and classification societies are not generally subject to the repair duty.

Lastly, outside the definition of dutiable "repairs" are costs incurred for travel expenses for repairmen, *Mount Washington Tanker Co.* v. *United States,* 505 F. Supp. 209, 16 (Ct. Int'l Trade 1980), and crating and shipping charges for repair materials. *American Viking Corp.,* 150 F. Supp. at 752.

The second issue that must be examined is whether the foreign work can be classified as "equipment" within the meaning of the statute. Vessel "equipment" is generally defined as "any portable thing that is used for, or provided in, preparing a vessel whose hull is already finished for service." *Otte* v. *United States,* 7 C.C.P.A. 166 (1916) (holding trawl nets were dutiable equipment). In Otte, the court noted that the language of the statute indicated a Congressional intent to distinguish between "equipment" and the vessel itself including its hull and fittings. *Id.* at 168. Consequently, the rule evolved that dutiable "equipment" does not include work involving the installation, in some permanent fashion, of an article which is likely to remain on board if the vessel is laid up for a long period. *See Admiral Oriental Line,* 18 C.C.P.A. at 39 (holding that the installation of a steel swimming tank was not dutiable "equipment").

Clearly, shipowners face a burdensome legal morass in dealing with the repair duty statute and regulations. At the same time, the statute was not intended to nor does it afford a great deal of protection to domestic repair yards. Because the duty burdens and restricts foreign trade while providing little benefit, we recommend its elimination, and oppose any expansion of these restrictions.

III. ELIMINATION OF THE REPAIR DUTY IN INTERNATIONAL AGREEMENTS AS ESTABLISHED UNITED STATES POLICY

The 50 percent *ad valorem* duty on foreign repairs has been eliminated in the context of three major international trade agreements, including one multilateral in scope. In each of the trade agreements the repair duty was eliminated because it unduly burdened and restricted the foreign trade of the United States. Thus, the elimination of, rather than the expansion of, the repair duty in the context of international trade agreements is established U.S. policy.

The precedent cases for elimination of the repair duty are as follows. First, the duty was eliminated for the cost of repairs and equipment on U.S. civil aircraft in all foreign countries in 1979 as part of the Tokyo Round of GATT. The agreement for aircraft was implemented by section 601(a)(3) of the Trade Agreements Act of 1979, Pub. L. 99-39, 93 Stat. 268, 19 U.S.C. 1466(f) (1982). Second, the repair duty on U.S. documented vessels was eliminated with respect to Israel in 1985 as part of the U.S.-Israel Free Trade Agreement. *See* United States-Israel Free Trade Agreement Implementation Act of 1985, section 4(a), Pub. L. 99-47, 99 Stat. 82; as implemented by Presidential Proclamation 5924 of December 21, 1988, 53 Fed. Reg. 51,725. Lastly, the repair duty will be eliminated with respect to Canada over a 10 year period as a result of the U.S.-Canada Free Trade Agreement. See United States-Canada Free Trade Agreement Implementation Act of 1988, Pub. L. 100-449, 102 Stat. 1851; as implemented by Presidential Proclamation 5923 of December 14, 1988, 53 Fed. Reg. 50,639. Accordingly, the precedents are well established for a finding of unduly burdening and restricting foreign trade and for complete elimination of the repair duty through international trade agreements.

The ship repair duty as it stands today does serve as an important negotiating tool in overall talks on shipbuilding and ship repair subsidies. The U.S. Trade Representative, at the request of the Shipbuilders Council of America, recently agreed to seek the reduction or elimination of foreign shipbuilding and ship repair subsidies. In exchange for the elimination of these subsidies, the United States should offer to eliminate its own protectionist ship repair duty. Foreign governments would welcome the removal of this substantial U.S. barrier to their competitive industries. Thus, the best economic interests of the United States would be served by negotiating the elimination of the duty rather than heaping more restrictions upon domestic carriers. The United States, as a matter of policy, has negotiated the elimination of the repair duty in prior trade agreements. *Elimination* of the duty, rather than the proposed expansion of restrictions, would provide a significant economic benefit to U.S.-flag carriers.

PREPARED STATEMENT OF JOSEPH A. MASSEY

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, IT IS A PLEASURE TO APPEAR BEFORE THE SUBCOMMITTEE TO REVIEW THE CURRENT STATE OF U.S.-JAPAN TRADE RELATIONS AND THE ADMINISTRATION'S JAPAN TRADE POLICY.

SINCE PRESIDENT BUSH TOOK OFFICE, THE ADMINISTRATION HAS MADE IT A CENTRAL OBJECTIVE OF U.S. TRADE POLICY TO SECURE THE OPENING OF THE MARKETS OF OUR TRADING PARTNERS TO COMPETITIVE U.S. EXPORTS. WE HAVE PURSUED THAT OBJECTIVE VIGOROUSLY, INTENSIVELY, AND AGGRESSIVELY IN OUR TRADE RELATIONS WITH JAPAN. OUR EFFORTS TO OPEN JAPANESE MARKETS HAVE INVOLVED NOT ONLY A WIDE RANGE OF SECTORS BUT HAVE MOVED BEYOND FORMAL GOVERNMENTAL TRADE BARRIERS INTO STRUCTURAL CHARACTERISTICS OF THE JAPANESE MARKETPLACE. THOSE STRUCTURAL CHARACTERISTICS PLAY A KEY ROLE IN EXPLAINING THE FACT THAT DESPITE THE REDUCTION OR REMOVAL OF MANY FORMAL JAPANESE TRADE BARRIERS, COMPETITIVE U.S. AND OTHER FOREIGN PRODUCTS HAVE CONTINUED TO EXPERIENCE SERIOUS DIFFICULTIES IN OBTAINING ACCESS TO THE JAPANESE MARKET.

OUR NEGOTIATING EFFORTS HAVE PRODUCED A NUMBER OF SECTORAL AGREEMENTS AND STRUCTURAL COMMITMENTS WHICH SHOULD, WHEN FULLY IMPLEMENTED, MAKE THE JAPANESE MARKET MORE OPEN TO IMPORTS. BEFORE SUMMARIZING THESE INITIATIVES AND RECENT BILATERAL DEVELOPMENTS, LET ME FIRST BRIEFLY REVIEW THE RECENT TRENDS IN OUR TRADE WITH JAPAN AND OUTLINE THE BASIC OBJECTIVES OF THE ADMINISTRATION'S TRADE POLICY TOWARD JAPAN.

BILATERAL TRADE FLOWS: INCREASING U.S. EXPORTS AND THE DECREASING BILATERAL DEFICIT

THERE ARE SOME ENCOURAGING SIGNS IN THE TRENDS IN U.S.-JAPAN TRADE FLOWS THAT INDICATE WE ARE MAKING PROGRESS. FOR EACH OF THE PAST FIVE YEARS, 1986 TO 1990, OUR EXPORTS TO JAPAN HAVE GROWN SIGNIFICANTLY FASTER THAN OUR EXPORTS TO THE REST OF THE WORLD, AND FASTER THAN OUR IMPORTS FROM JAPAN. AFTER MANY YEARS OF REMAINING STAGNANT AT A LEVEL OF $21 TO $23 BILLION, OUR TOTAL EXPORTS TO JAPAN BEGAN INCREASING IN 1986, REACHING A LEVEL OF $48.6 BILLION LAST YEAR. MANUFACTURED EXPORTS ARE NOW PLAYING AN INCREASING ROLE IN OUR EXPORT MIX TO JAPAN. OF THE $48.6 BILLION TOTAL EXPORTS TO JAPAN IN 1990, SOME $30.1 BILLION, OR 61.9 PERCENT, WERE MANUFACTURED GOODS, COMPARED WITH THE $11.7 BILLION OUT OF A TOTAL OF $22.2 BILLION, OR 52.7 PERCENT, OCCUPIED BY MANUFACTURES IN TOTAL U.S. EXPORTS TO JAPAN IN 1985.

THE RESULT OF THE FASTER GROWTH IN EXPORTS THAN IMPORTS HAS BEEN A DECLINE IN OUR BILATERAL DEFICIT WITH JAPAN. FROM ITS PEAK OF $57 BILLION IN 1987, THE DEFICIT HAS DECLINED STEADILY OVER THE PAST THREE YEARS TO $41.1 BILLION IN 1990. AND THE STATISTICS THIS YEAR SO FAR INDICATE THE CONTINUATION OF THESE TRENDS. THE DEPARTMENT OF COMMERCE TRADE FIGURES FOR THE FIRST FIVE MONTHS OF 1991 SHOWED THAT OUR TRADE DEFICIT WITH JAPAN WAS RUNNING AT AN ANNUALIZED RATE OF $39.4 BILLION, A DECLINE OF 4.2 PERCENT FROM LAST YEAR. ON THE SAME ANNUALIZED BASIS, OUR EXPORTS TO JAPAN ARE UP 6.0 PERCENT, WHILE IMPORTS ARE UP ONLY 1.3 PERCENT OVER 1990.

WHILE THE TRENDS ARE IN THE RIGHT DIRECTION, MR. CHAIRMAN, THERE IS STILL A GREAT DEAL OF ROOM FOR IMPROVEMENT IN OUR TRADE PERFORMANCE WITH JAPAN. THE $41 BILLION BILATERAL DEFICIT WITH JAPAN IN 1990 WAS STILL BY FAR OUR LARGEST BILATERAL DEFICIT AND BIGGEST CONTRIBUTOR TO OUR GLOBAL DEFICIT OF $102 BILLION. IT CONTRASTS, IN PARTICULAR, WITH THE $6 BILLION SURPLUS IN OUR TRADE WITH THE EUROPEAN ECONOMIC COMMUNITY. WE IMPORTED FROM THE EC ROUGHLY THE SAME AMOUNT OF GOODS ($91.9 BILLION) AS FROM JAPAN

($89.7 BILLION); BUT WE SOLD THEM MORE THAN TWICE AS MUCH ($98.0 BILLION VERSUS $48.6 BILLION). WE ALSO WERE FAR MORE SUCCESSFUL IN EXPORTING TO CANADA THAN TO JAPAN, ALTHOUGH WE IMPORT SIMILAR AMOUNTS FROM BOTH COUNTRIES. LAST YEAR WE EXPORTED $83 BILLION WORTH OF GOODS TO CANADA, 70 PERCENT MORE THAN WE EXPORTED TO JAPAN.

THE REAL ISSUE, OF COURSE, IS NOT THE BILATERAL DEFICIT BUT GAINING ACCESS TO THE JAPANESE MARKET FOR OUR EXPORTS. JAPAN HAS HISTORICALLY TENDED TO FOCUS ITS IMPORTS ON RAW MATERIALS, AND TO IMPORT RELATIVELY FEW MANUFACTURED GOODS. JAPAN'S IMPORTS OF MANUFACTURED GOODS FROM US AND FROM ITS OTHER TRADING PARTNERS HAVE BEEN GROWING SHARPLY IN THE PAST FEW YEARS. BUT THE LEVEL OF MANUFACTURED GOODS AS A SHARE OF GROSS NATIONAL PRODUCT STILL CONTINUES TO BE FAR LOWER IN JAPAN THAN IN THE OTHER INDUSTRIALIZED ECONOMIES. JAPAN IS TODAY A GOOD DEAL LESS OF A HOT-HOUSE ECONOMY THAN IT ONCE WAS. BUT COMPETITIVE FOREIGN MANUFACTURED GOODS AND VALUE-ADDED PRODUCTS CONTINUE TO ENCOUNTER SUBSTANTIALLY MORE RESISTANCE THERE THAN IN OTHER DEVELOPED ECONOMIES.

THE ADMINISTRATION'S PRINCIPAL TRADE OBJECTIVES AND INITIATIVES VIS-A-VIS JAPAN

MR. CHAIRMAN, THE ADMINISTRATION IS GUIDED IN ITS TRADE POLICY WITH JAPAN NOT BY CONCERN OVER THE BILATERAL DEFICIT PER SE, BUT RATHER BY THE OBJECTIVE OF EXPANDING U.S. EXPORTS AND INCREASING WORLD TRADE. THIS MEANS THAT OUR FIRST OBJECTIVE AND OUR MISSION AT USTR IS TO OPEN MARKETS. OPEN MARKETS ARE THE FOUNDATION OF THE GLOBAL TRADING SYSTEM. WHEN JAPANESE MARKETS ARE NOT OPEN TO COMPETITIVE U.S. GOODS AND SERVICES, JAPAN NOT ONLY HURTS ITSELF BUT DENIES U.S. COMPANIES OPPORTUNITIES TO EXPAND EFFICIENT PRODUCTION AND ACHIEVE A MAJOR PRESENCE IN THE SECOND-LARGEST ECONOMY IN THE WORLD. FAILURE TO GAIN EFFECTIVE MARKET ACCESS HAS PROFOUND IMPLICATIONS FOR THE GLOBAL COMPETITIVENESS OF U.S. FIRMS. OUR COMPANIES MUST BE ABLE TO COMPETE WITH JAPANESE COMPANIES IN JAPAN OR WE SHALL ULTIMATELY BE UNABLE TO COMPETE WITH THEM AT ALL. GLOBALIZATION OF INDUSTRIES AND MARKETS OFTEN MAKES A PRESENCE IN JAPAN IMPERATIVE.

INDEED, MARKET ACCESS IS IMPORTANT, IRRESPECTIVE OF OUR BILATERAL TRADE DEFICITS. EVEN IF WE WERE EXPERIENCING A TRADE SURPLUS WITH JAPAN, WE WOULD CONTINUE TO VIGOROUSLY PURSUE GREATER ACCESS TO THE JAPANESE MARKET. WITHOUT IT, THE EFFICIENCIES OF THE GLOBAL SYSTEM ARE REDUCED, OUR OWN COMPANIES ARE LESS COMPETITIVE WORLDWIDE, AND IT BECOMES POLITICALLY DIFFICULT TO SUSTAIN OPEN MARKETS AT HOME.

A SECOND AND EXTREMELY IMPORTANT COROLLARY GOAL OF OUR TRADE POLICY IS TO MAKE THE JAPANESE ECONOMY AN OPEN MARKET NOT ONLY FORMALLY BUT EFFECTIVELY. ALTHOUGH MANY U.S. COMPANIES OUTPERFORM THEIR COMPETITORS IN THE U.S. AND IN THIRD-COUNTRY MARKETS, MANY OF THESE SAME COMPANIES ARE UNABLE TO ACHIEVE COMPARABLE SUCCESSES IN THE JAPANESE MARKET. THIS REMAINS TRUE DESPITE THE FACT THAT AS A RESULT OF A LONG SERIES OF NEGOTIATIONS CONDUCTED BY THIS ADMINISTRATION AND ITS PREDECESSORS WITH JAPAN, THE GREAT BULK OF FORMAL JAPANESE TRADE BARRIERS HAVE BEEN ELIMINATED OR SUBSTANTIALLY REDUCED. THIS ADMINISTRATION, THEREFORE, HAS MADE IT A MAJOR OBJECTIVE OF OUR TRADE POLICY TOWARD JAPAN TO IDENTIFY AND OVERCOME THE BARRIERS TO THE JAPANESE MARKET THAT ARE ROOTED OR EMBODIED IN STRUCTURAL CHARACTERISTICS. WE HAVE ENGAGED THE JAPANESE GOVERNMENT IN A NEW AND GROUND-BREAKING EFFORT, THE STRUCTURAL IMPEDIMENTS INITIATIVE, OR SII, TO GET AT THOSE KINDS OF BARRIERS.

IN THE PURSUIT OF AN OPEN JAPANESE MARKET, WE HAVE ALSO ACTIVELY AND AGGRESSIVELY SOUGHT THE REMOVAL OF SPECIFIC SECTORAL BARRIERS IN THE JAPANESE MARKET. WHERE WE HAVE HAD THE NEED TO DO SO, WE

HAVE EMPLOYED THE TOOLS AVAILABLE TO US UNDER OUR TRADE LAWS, INCLUDING THE SO-CALLED SUPER 301 PROVISIONS OF THE TRADE ACT.

WE HAVE, OVER THE PAST TWO YEARS, REACHED AGREEMENTS WITH THE JAPANESE TO OPEN THEIR MARKETS OVER A WIDE VARIETY OF SECTORS IMPORTANT TO THE UNITED STATES. THESE INCLUDE SATELLITES, SUPERCOMPUTERS, WOOD PRODUCTS, SEMICONDUCTORS, AMORPHOUS METALS, TELECOMMUNICATIONS EQUIPMENT AND SERVICES, AND CONSTRUCTION SERVICES. WHEN FULLY IMPLEMENTED, THESE AGREEMENTS, THE PRODUCTS OF THE ADMINISTRATION'S UNSWERVING COMMITMENT TO OPEN MARKETS FOR COMPETITIVE U.S. EXPORTS, SHOULD HELP MAKE THE JAPANESE MARKET A MORE OPEN ONE.

A THIRD MAJOR COMPONENT OF OUR TRADE POLICY TOWARD JAPAN HAS BEEN THE URUGUAY ROUND. WE HAVE SOUGHT TO USE THE CURRENT ROUND OF TALKS UNDER THE AUSPICES OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE, OR GATT, TO NEGOTIATE STRONG AND ENFORCEABLE MULTILATERAL RULES, PARTICULARLY IN AGRICULTURE AND IN AREAS NOT CURRENTLY SUBJECT TO MULTILATERAL TRADE DISCIPLINES, INCLUDING SERVICES AND INTELLECTUAL PROPERTY.

IN ALL OF THESE TRADE INITIATIVES WITH THE JAPANESE, WE HAVE SOUGHT TO BUILD CONSTITUENCIES IN JAPAN THAT SUPPORT MARKET-OPENING MEASURES. OPEN MARKETS BENEFIT NOT ONLY OUR EXPORTERS BUT ALSO JAPANESE CONSUMERS.

SII

SII WAS BORN OUT OF THE RECOGNITION IN BOTH THE UNITED STATES AND JAPAN THAT EACH NEEDED TO TAKE MEASURES OF A FUNDAMENTAL NATURE IN ORDER TO ADDRESS CURRENT ACCOUNT IMBALANCES. THE PURPOSE OF SII IS TO IDENTIFY AND SOLVE STRUCTURAL PROBLEMS IN BOTH COUNTRIES THAT STAND AS IMPEDIMENTS TO TRADE AND BALANCE OF PAYMENTS ADJUSTMENT.

SII IS AN EFFORT TO ADDRESS STRUCTURAL BARRIERS BROADLY, ACROSS INDUSTRIES. IN THE JOINT REPORT ON STRUCTURAL IMPEDIMENTS ISSUED IN JUNE 1990, WE IDENTIFIED SIX BROAD AREAS THAT, IN OUR JUDGMENT, OPERATED AS STRUCTURAL BARRIERS TO PAYMENTS ADJUSTMENTS AND MARKET ACCESS IN JAPAN: SAVINGS AND INVESTMENT, LAND USE, THE DISTRIBUTION SYSTEM, EXCLUSIONARY BUSINESS PRACTICES, KEIRETSU (OR CORPORATE GROUPS CHARACTERIZED BY CROSS-SHAREHOLDING LINKAGES), AND PRICING. EACH OF THESE ASPECTS ALSO ADVERSELY AFFECTS JAPANESE CONSUMERS. DETAILED DISCUSSIONS IN ALL OF THESE AREAS HAVE OCCURRED AND CONTINUE.

USTR HAS WORKED IN CLOSE COLLABORATION WITH THE DEPARTMENT OF JUSTICE IN THESE SII TALKS IN FOCUSING ON THE AREA OF EXCLUSIONARY BUSINESS PRACTICES. WE HAVE ADDRESSED, UNDER THIS RUBRIC, PRACTICES THAT ARE OR SHOULD BE COVERED BY PRINCIPLES OF ANTITRUST LAW; GOVERNMENT-BUSINESS RELATIONS; THE PROCUREMENT PRACTICES OF PRIVATE FIRMS; AND THE PATENT SYSTEM.

THE JOINT SII REPORT OF LAST YEAR COMMITS THE GOVERNMENT OF JAPAN TO AN "EFFECTIVE" REGIME OF ANTI-MONOPOLY ACT ENFORCEMENT. WE CONTINUE TO FOCUS ON THIS MUCH NEGOTIATED WORD "EFFECTIVE" AND TO URGE THE GOVERNMENT TO INTRODUCE MEASURES THAT WILL MEET THE STANDARD OF EFFECTIVENESS.

IN THE AREA OF GOVERNMENT-BUSINESS RELATIONS, THE GOVERNMENT OF JAPAN HAS COMMITTED TO GREATER TRANSPARENCY AND ACCOUNTABILITY, TO THE JAPANESE PUBLIC AND TO FOREIGN COMPANIES. WE BELIEVE THIS IS IMPORTANT, BECAUSE GOVERNMENT PROCEDURES IN JAPAN HAVE OPERATED TO EXCLUDE FOREIGNERS. ALSO, DECISIONS ARE MADE BY THE JAPANESE GOVERNMENT PURSUANT TO ADVICE BY "STUDY GROUPS" AND OTHER BODIES. FOREIGNERS HAVE BEEN EXCLUDED FROM THOSE BODIES. DECISIONS HAVE OFTEN BEEN MADE BY THE GOVERNMENT OF JAPAN ON THE BASIS OF WHAT IS CALLED "ADMINISTRATIVE GUIDANCE," WHICH NO ONE

EXCEPT THE AFFECTED PARTY SEES OR HEARS ABOUT. WE HAVE SOUGHT IN THE SII TO MAKE THE PROCESSES BETWEEN THE JAPANESE GOVERNMENT AND THE PUBLIC MORE TRANSPARENT AND TO MAKE THE JAPANESE GOVERNMENT MORE ACCOUNTABLE FOR ITS ACTIONS.

JAPANESE AND FOREIGN SOURCES HAVE LONG INDICATED THAT THE PROCUREMENT PRACTICES OF MANY JAPANESE COMPANIES ARE CLOSED TO ESTABLISHING NEW RELATIONSHIPS WITH FOREIGN COMPANIES. WHAT THIS MEANS IN PRACTICE IS THAT, WHILE U.S. BUSINESS CAN GET PRODUCTS PAST OFFICIAL BARRIERS--TARIFFS, QUOTAS, CERTIFICATION PROCEDURES, AND THE LIKE--FAR MORE EASILY THAN THEY COULD A DECADE AGO, THEY ARE STILL LIKELY TO ENCOUNTER OLD ATTITUDES AND LONG-ESTABLISHED SUPPLIER NETWORKS IN THE PROCUREMENT OFFICES AND BOARD ROOMS OF JAPANESE COMPANIES. JAPANESE FIRMS CONTINUE TO LOOK TO ESTABLISHED JAPANESE SUPPLIERS FOR CAPITAL GOODS AND PRODUCER GOODS. SOME ASPECTS OF THIS SYSTEM ARE PERFECTLY REASONABLE. INDEED, MANY U.S. COMPANIES ARE NOW SEEKING WAYS TO EMULATE JAPANESE-STYLE RELATIONSHIPS WITH SUPPLIERS. AT THE SAME TIME, MANY OF THESE PATTERNS WERE NOT DEVELOPED BY THE MARKET, BUT REPRESENT EXCLUSIONARY BUSINESS PRACTICES PERMITTED BY THE JAPANESE GOVERNMENT, PAST AND PRESENT. IN ANY EVENT, THIS CONTINUED RELIANCE ON JAPANESE SUPPLIERS REMAINS AN IMPEDIMENT TO U.S. EXPORTS TO JAPAN OF SUCH CAPITAL GOODS AND PRODUCER GOODS--GOODS IN WHICH U.S. FIRMS TEND TO BE COMPETITIVE ON WORLD MARKETS.

THE JAPANESE GOVERNMENT HAS TAKEN SOME RESPONSIBILITY FOR MAKING PRIVATE PROCUREMENT MORE OPEN AND FOR HELPING TO REDUCE THE "BUY JAPANESE" MENTALITY THAT EXISTS IN THE PRIVATE SECTOR. IN THIS REGARD, THE JAPANESE GOVERNMENT HAS COMMITTED TO ENCOURAGE TRANSPARENT AND NON-DISCRIMINATORY PROCUREMENT BY PRIVATE COMPANIES, INCLUDING ENCOURAGING SUPPORT OF THE PROCUREMENT GUIDELINES ADOPTED BY THE JAPAN FEDERATION OF ECONOMIC ORGANIZATIONS (KEIDANREN). IT WILL ALSO CONDUCT ANNUAL SURVEYS OF PRIVATE PROCUREMENT PROCEDURES. THE RESULTS OF THE FIRST OF THESE SURVEYS WAS RELEASED EARLIER THIS WEEK.

THE JAPANESE PATENT SYSTEM HAS LONG BEEN A SOURCE OF FRICTION BETWEEN OUR TWO COUNTRIES. IN THE JOINT REPORT, THE GOVERNMENT OF JAPAN COMMITTED TO REDUCE WITHIN FIVE YEARS THE AVERAGE PATENT EXAMINATION PERIOD TO 24 MONTHS--A REDUCTION FROM THE CURRENT AVERAGE OF SOME 37 MONTHS.

FOR THEIR PART, THE JAPANESE GOVERNMENT IDENTIFIED A NUMBER OF WHAT ARE, IN THEIR VIEW, STRUCTURAL BARRIERS IN THE U.S. TO THE PRODUCTION OF COMPETITIVE PRODUCTS, INCLUDING OUR SAVINGS AND INVESTMENT PATTERNS, WHAT THEY SEE AS THE SHORT PLANNING HORIZONS OF U.S. CORPORATIONS; INSUFFICIENT SPENDING ON R&D; INSUFFICIENT EMPHASIS ON EXPORT PROMOTION; AND WEAKNESSES IN OUR EDUCATIONAL SYSTEM.

THERE HAVE ALREADY BEEN A NUMBER OF NOTABLE DEVELOPMENTS FROM SII. IN ALL SIX AREAS OF CONCERN TO US, THE GOVERNMENT OF JAPAN HAS MADE A NUMBER OF IMPORTANT UNDERTAKINGS AND TAKEN SPECIFIC ACTIONS THAT WOULD NOT HAVE HAPPENED BUT FOR THE SII PROCESS.

INDEED, WE CAN POINT TO PERHAPS 20 OR SO CHANGES ALREADY IN JAPANESE LAW OR PRACTICE THAT WOULD CLEARLY NOT HAVE OCCURRED BUT FOR SII. FOR EXAMPLE:

- JAPANESE LAW WAS AMENDED TO PROVIDE THAT LARGE RETAIL STORES CAN BE ESTABLISHED IN NO LONGER THAN 12 MONTHS AND MORE THAN ONE THOUSAND NEW STORES HAVE APPLIED FOR PERMITS.

- THE GOVERNMENT HAS IMPOSED DISCLOSURE REQUIREMENTS THAT WOULD EXPOSE SOME OF THE BUSINESS ACTIVITIES OF UNRELATED COMPANIES, AN ESSENTIAL ELEMENT TO PROMOTE FOREIGN INVESTMENT.

- EXPENDITURES IN PUBLIC INFRASTRUCTURE RELATED TO IMPORTS HAVE INCREASED. EXPENDITURES ON PERSONNEL HAVE INCREASED IN AREAS FROM CUSTOMS TO PATENTS, WHICH WOULD NOT HAVE OCCURRED WITHOUT THE SII, IMPLYING MORE OPPORTUNITIES FOR FOREIGN COMPANIES.

BASED ON OUR NEGOTIATING EXPERIENCE, WE CAN ATTEST THAT THE STRUCTURAL IMPEDIMENTS INITIATIVE PROVIDES A USEFUL PROCESS TO SUPPLEMENT OUR SECTOR-SPECIFIC TRADE NEGOTIATIONS. THE COMPREHENSIVE CHANGES SOUGHT BY BOTH SIDES DURING SII TALKS DO NOT LEND THEMSELVES TO QUICK FIXES, HOWEVER, AND WE THUS HAVE UNDERWAY A THREE-YEAR FOLLOW-UP PROCESS THAT ALLOWS BOTH COUNTRIES TO SYSTEMATICALLY REVIEW PROGRESS ACHIEVED AND TO DISCUSS MATTERS RELEVANT TO THE PROBLEM AREAS OUTLINED IN THE JOINT REPORT.

SECTORAL ISSUES

WE HAVE ALSO MADE SIGNIFICANT PROGRESS WITH THE JAPANESE GOVERNMENT IN RESOLVING TRADE ISSUES IN SPECIFIC INDUSTRIES.

WE HAVE CONCENTRATED, TO THE EXTENT POSSIBLE, ON SECTORS IN WHICH COMPETITIVE U.S. INDUSTRIES ARE INTERESTED IN MAKING INROADS IN THE JAPANESE MARKET, AND IN WHICH PROGRESS IN OPENING THE JAPANESE MARKETPLACE WOULD PRODUCE A RIPPLE EFFECT BECAUSE OF LINKAGES BETWEEN THE TARGET SECTORS AND THE JAPANESE ECONOMY AS A WHOLE. AND, WE HAVE BEEN PREPARED TO USE CREDIBLE, MEASURED RETALIATION IN ORDER TO INFLUENCE BEHAVIOR. WE CONTINUE TO STAND READY TO USE THE LEVERAGE OF THE U.S. MARKET, WHERE NECESSARY, TO OPEN MARKETS ABROAD.

TELECOMMUNICATIONS

IN JULY 1990, THE UNITED STATES AND JAPAN REACHED AGREEMENT TO LIBERALIZE JAPANESE REGULATIONS GOVERNING BOTH ADVANCED TELECOMMUNICATIONS SERVICES--INTERNATIONAL VALUE-ADDED NETWORK SERVICES (IVANS)--AND DIGITAL TELECOMMUNICATIONS EQUIPMENT, (SPECIFICALLY, NETWORK CHANNEL TERMINAL EQUIPMENT--NCTE). THE AGREEMENTS FOLLOWED AN INVESTIGATION CONDUCTED UNDER SECTION 1374 OF THE 1988 TRADE ACT AND A REVIEW UNDER SECTION 1377.

- ON THE SERVICES SIDE, THE FIRST AGREEMENT COMMITTED JAPAN TO STREAMLINE THE PROCESS FOR U.S. FIRMS TO ENTER ITS MARKET FOR SUCH SERVICES AS VOICE MAIL AND ELECTRONIC BANKING, AND PROVIDED FOR JOINT USE OF INTRACORPORATE COMMUNICATIONS NETWORKS BETWEEN JAPAN AND THE UNITED STATES. IT ALSO ELIMINATED A BURDENSOME SURCHARGE OFTEN PLACED ON U.S. FIRMS BY JAPAN'S TELECOMMUNICATIONS CARRIERS.

- ON THE EQUIPMENT SIDE, THE SECOND AGREEMENT OPENED JAPAN'S MARKET FOR DEVICES, SUCH AS MODEMS, THAT MAKE COMPUTERS AND OTHER OFFICE EQUIPMENT COMPATIBLE WITH A DIGITAL TELEPHONE NETWORK. PREVIOUSLY, U.S. MANUFACTURERS OF THIS EQUIPMENT HAVE BEEN PERMITTED TO SELL ONLY TO JAPAN'S TELECOMMUNICATIONS CARRIERS, WHICH HAVE TRADITIONALLY BOUGHT ALMOST EXCLUSIVELY FROM JAPANESE FIRMS.

IN JUNE OF THIS YEAR, WE CONCLUDED FURTHER NEGOTIATIONS THAT ESTABLISH TRANSPARENT PROCEDURES FOR A COMPLAINT MECHANISM THAT WILL ENSURE THAT JAPANESE CARRIERS CANNOT USE UNSUBSTANTIATED ALLEGATIONS OF PROHIBITED RESALE OF LEASED CIRCUITS BY U.S. FIRMS TO DENY SERVICE TO THOSE FIRMS. IT IS STILL TOO EARLY TO MAKE AN ACCURATE APPRAISAL OF THE EFFECTS IN THE MARKETPLACE OF THESE AGREEMENTS. HOWEVER, OUR 1989 AGREEMENT ON CELLULAR TELEPHONE AND THIRD PARTY RADIO SERVICE HAS ALREADY BORNE SIGNIFICANT FRUIT. U.S. FIRMS NOW HAVE MORE THAN HALF OF THE JAPANESE MARKET IN THIRD PARTY RADIOS, AND THERE ARE AMERICAN PARTNERS IN TWO CONSORTIA THAT HAVE APPLIED FOR LICENSES TO PROVIDE CELLULAR SERVICES TO THE TOKYO METROPOLITAN AREA.

THREE SUPER-301 CASES

IN MAY 1989, THE UNITED STATES, UNDER SECTION 302 OF THE 1988 TRADE ACT, IDENTIFIED THREE JAPANESE TRADE PRACTICES AS PRIORITIES FOR INVESTIGATION AND NEGOTIATION: JAPAN'S BAN ON GOVERNMENT PROCUREMENT OF FOREIGN SATELLITES; JAPAN'S EXCLUSIONARY PRACTICES IN GOVERNMENT PROCUREMENT OF SUPERCOMPUTERS; AND JAPANESE GOVERNMENT POLICIES AND PRACTICES THAT RESTRICTED WOOD PRODUCT IMPORTS. AGREEMENTS WERE SUBSEQUENTLY REACHED IN ALL THREE AREAS, AND THE GOVERNMENT OF JAPAN APPEARS TO BE IMPLEMENTING ITS COMMITMENTS:

- SINCE THE SUPERCOMPUTER AGREEMENT WAS REACHED IN MARCH 1990, THERE HAS ALREADY BEEN ONE PURCHASE OF A U.S.-MADE SUPERCOMPUTER, FOR KYOTO UNIVERSITY.

- IN SATELLITES, WE REACHED AN AGREEMENT IN MARCH 1990 WITH THE GOVERNMENT OF JAPAN THAT OPENS THE GOVERNMENT MARKET FOR NON-R&D SATELLITES AND WE ARE AWARE OF A FORTHCOMING PROCUREMENT. OUR EMBASSY INDICATES THAT THE GOVERNMENT OF JAPAN IS FOLLOWING THE AGREED PROCUREMENT PROCEDURES.

- IN WOOD PRODUCTS, THE JAPANESE GOVERNMENT IS FAITHFULLY IMPLEMENTING THE AGREEMENT REACHED IN APRIL 1990. GLUE-LAMINATED PRODUCTS WERE RECLASSIFIED ON JUNE 1, 1990 AS SCHEDULED, WHICH REDUCED THE DUTY RATE ON THESE GOODS FROM 15 PERCENT TO 3.9 PERCENT. WITH RESPECT TO THE NON-TARIFF AND BUILDING CODE COMMITMENTS IN THAT AGREEMENT, THE JAPANESE GOVERNMENT IS ACTIVELY WORKING WITH US TO ENSURE THAT THE DEADLINES SET IN THE AGREEMENT ARE MET.

AMORPHOUS METALS

A PETITION UNDER SECTION 301 WAS BROUGHT TO USTR BY THE ALLIED SIGNAL CORPORATION IN MARCH 1990, ALLEGING THAT THE GOVERNMENT OF JAPAN HAD INTERFERED WITH ITS EFFORTS TO SELL AMORPHOUS METAL FOR USE IN TRANSFORMERS IN JAPAN. THE ADMINISTRATION USED THE LEVERAGE OF SECTION 301 TO OBTAIN JAPAN'S COMMITMENT TO SEEK RESOLUTIONS TO THIS ISSUE WITHIN 150 DAYS. THE U.S. FIRM THEREAFTER WITHHELD ITS PETITION. THE TWO GOVERNMENTS CONCLUDED AN AGREEMENT COVERING AMORPHOUS METAL ELECTRICAL TRANSFORMERS IN SEPTEMBER 1990 THAT WOULD REQUIRE JAPANESE UTILITIES TO USE THE SAME STANDARDS AS APPLIED BY U.S. UTILITIES IN PURCHASING TRANSFORMERS. THE AGREEMENT ALSO COMMITTED JAPANESE UTILITIES TO BUY FROM JAPANESE TRANSFORMER MANUFACTURERS A SPECIFIED NUMBER OF AMORPHOUS METAL TRANSFORMERS PRODUCED USING MATERIALS PURCHASED FROM THE UNITED STATES. JAPANESE MANUFACTURERS ARE NOW AHEAD OF SCHEDULE IN PURCHASING U.S.-MADE AMORPHOUS METAL FOR TRANSFORMERS.

CONSTRUCTION

A CONTINUING ISSUE OF MAJOR IMPORTANCE HAS BEEN ACCESS TO JAPAN'S MARKET FOR CONSTRUCTION SERVICES AND EQUIPMENT. IN NOVEMBER 1989, THE USTR DETERMINED, AFTER A ONE-YEAR SECTION 302 INVESTIGATION, THAT JAPANESE POLICIES AND PRACTICES FOR PROCURING ARCHITECTURAL, ENGINEERING, AND CONSTRUCTION SERVICES WERE UNREASONABLE AND BURDENED OR RESTRICTED U.S. COMMERCE. THE USTR FURTHER DETERMINED THAT NO RESPONSIVE ACTION UNDER SECTION 301 OF THE TRADE ACT WAS APPROPRIATE AT THAT TIME IN LIGHT OF CERTAIN WRITTEN COMMITMENTS BY THE GOVERNMENT OF JAPAN, INCLUDING CONSULTATIONS IN THE CONTEXT OF A REVIEW OF THE MAJOR PROJECTS ARRANGEMENT CONCLUDED BY THE GOVERNMENTS OF JAPAN AND THE U.S. IN MAY 1988. AS OF APRIL 1991, THOSE NEGOTIATIONS HAD NOT YET RESULTED IN A SATISFACTORY AGREEMENT. THEREFORE, ON APRIL 26, 1991, THE USTR PROPOSED TO IMPOSE RESTRICTIONS ON THE PROVISIONS IN THE UNITED STATES OF ARCHITECTURAL, ENGINEERING AND CONSTRUCTION-RELATED SERVICES. HOWEVER, INTENSIVE NEGOTIATIONS

SINCE THEN HAVE PRODUCED A SETTLEMENT OF THIS DISPUTE. SECRETARY MOSBACHER AND AMBASSADOR MURATA SIGNED THE ACCORD JUST TWO DAYS AGO, MR. CHAIRMAN. THE NEW AGREEMENT EXPANDED THE SCOPE OF OUR EXISTING 1988 AGREEMENT ON MAJOR JAPANESE GOVERNMENT CONSTRUCTION PROJECTS. THE NEW AGREEMENT:

- STIPULATES THAT COMPETITION IN ALL JAPANESE PUBLIC WORKS PROJECTS WILL BE OPEN, TRANSPARENT, COMPETITIVE, AND NON-DISCRIMINATORY;
- CONTAINS A NEW LIST OF 17 ADDITIONAL MAJOR CONSTRUCTION PROJECTS TO BE COVERED BY SPECIAL MEASURES THAT FACILITATE FOREIGN ACCESS, WITH SIX MORE PROJECTS THAT MAY BE ADDED IN THE FIRST ANNUAL REVIEW IF OFFICIALLY APPROVED. THIS BRINGS TO A TOTAL OF 40 THE NUMBER OF PROJECTS COVERED BY SUCH SPECIAL MEASURES.
- PROVIDES FOR A REVIEW OF THE SPECIAL MEASURES AND THEIR EFFECTIVENESS IN MAY 1992 AND THEREAFTER AS BOTH JAPAN AND THE U.S. DECIDE;
- CONTAINS, FOR THE FIRST TIME, A PROCEDURE FOR U.S. COMPANIES TO SUBMIT COMPLAINTS TO THE PROCUREMENT REVIEW BOARD, AN INDEPENDENT AGENCY;
- REQUIRES THAT TECHNICAL EVALUATION BE BASED ON A PREVIOUSLY ANNOUNCED LIST OF EVALUATION FACTORS AND A SEALED BID PROCEDURE TO DETERMINE WHICH TECHNICALLY QUALIFIED BIDDERS SUBMIT THE BEST OFFER; AND
- SPECIFICALLY STATES THAT BIDDERS MUST CERTIFY THAT THEY ARE NOT ENGAGED IN COLLUSIVE BIDDING ACTIVITIES.

SEMICONDUCTORS

WITH RESPECT TO SEMICONDUCTORS, A LONGSTANDING AREA OF CONTENTION, WE CONCLUDED A BILATERAL AGREEMENT WITH JAPAN IN SEPTEMBER 1986 DESIGNED TO INCREASE MARKET ACCESS OPPORTUNITIES IN JAPAN FOR FOREIGN-BASED SEMICONDUCTOR PRODUCERS AND TO PREVENT DUMPING OF JAPANESE SEMICONDUCTORS IN U.S. AND THIRD-COUNTRY MARKETS.

IN JUNE OF THIS YEAR, WE CONCLUDED A NEW BILATERAL SEMICONDUCTOR AGREEMENT, WHICH TOOK AFFECT YESTERDAY UPON EXPIRATION OF THE 1986 SEMICONDUCTOR ARRANGEMENT. THE NEW ARRANGEMENT SHOULD ACCELERATE U.S. ACCESS TO THE JAPANESE SEMICONDUCTOR MARKET. IT EMPHASIZES THE IMPORTANCE OF JAPANESE ELECTRONICS FIRMS CONTRACTING WITH U.S. SEMICONDUCTOR SUPPLIERS IN LONG-TERM "DESIGN-IN" RELATIONSHIPS TO DEVELOP NEW SEMICONDUCTORS FOR USE IN FUTURE PRODUCTS. THE LANGUAGE IN THE NEW ARRANGEMENTS REFLECTS OUR EXPECTATIONS THAT FOREIGN SEMICONDUCTOR MAKERS CAN, THROUGH CONTINUED EFFORTS BY BOTH FOREIGN SUPPLIERS AND JAPANESE USERS, ATTAIN A 20 PERCENT MARKET SHARE BY 1992. THE GOVERNMENT OF JAPAN CONSIDERS THAT THIS CAN BE REALIZED AND WELCOMES ITS REALIZATION.

WE BELIEVE THAT THE PROVISIONS OF THE NEW ARRANGEMENT PROVIDE AN EVEN STRONGER AND MORE EXPLICIT COMMITMENT TO FULL MARKET ACCESS THAN THE PAST ARRANGEMENT.

OUTSTANDING ISSUES

THE LIST OF BILATERAL ISSUES BETWEEN US IS MUCH SHORTER THAN WHEN THE BUSH ADMINISTRATION TOOK OFFICE, BUT A NUMBER OF VERY IMPORTANT ISSUES REMAIN IN 1991. KEY SECTORS WHERE GREATER ACCESS TO THE JAPANESE MARKET IS NEEDED INCLUDE LEGAL SERVICES, COMPUTERS, PAPER, PHARMACEUTICALS, RECORDING ARTISTS' RIGHTS, AND AUTO PARTS.

LEGAL SERVICES

GREATER ACCESS TO LEGAL SERVICES IS IMPORTANT BECAUSE WE BELIEVE THAT ONE ELEMENT FOR THE IMPROVEMENT OF U.S.-JAPAN TRADE THAT IS MISSING IN JAPAN IS WHAT MIGHT BE CALLED "FACILITATORS"--INTERMEDIARIES THAT CAN FACILITATE TWO WAY FLOWS OF TRADE AND INVESTMENT. LAW FIRMS CAN PLAY THAT ROLE, BUT ONLY IF THEY HAVE THE CAPACITY TO PROVIDE ADVICE ON BOTH FOREIGN AND JAPANESE LAW. BECAUSE OF CURRENT RESTRICTIONS IN JAPANESE LAW, FOREIGN LAWYERS ARE PROHIBITED FROM HIRING OR BECOMING PARTNERS WITH JAPANESE LAWYERS. THUS, THE CURRENT SYSTEM RELEGATES THE FOREIGN LAWYER IN JAPAN TO SIMPLY FACILITATING OUTWARD TRADE AND INVESTMENT FROM JAPAN TO OTHER COUNTRIES. BY CONTRAST, JAPANESE LAW FIRMS CAN AND DO HIRE FOREIGN LAWYERS. PERMITTING PARTNERSHIP AND EMPLOYMENT ARRANGEMENTS BETWEEN FOREIGN AND JAPANESE LAWYERS WOULD PERMIT FOREIGN LAWYERS AND LAW FIRMS TO PLAY AN IMPORTANT ROLE IN FACILITATING TRADE AND INVESTMENT INTO JAPAN.

PHARMACEUTICALS

ANOTHER CURRENT ISSUE OF IMPORTANCE CONCERNS THE PHARMACEUTICAL SECTOR. THE AMERICAN RESEARCH-BASED PHARMACEUTICAL INDUSTRY IS ONE OF AMERICA'S MOST COMPETITIVE INDUSTRIES, WITH NEARLY $60 BILLION IN GLOBAL SALES LAST YEAR, AND OVER $3 BILLION IN SALES IN JAPAN ALONE. YET, THAT INDUSTRY ALSO HAS FOUND ITS SHARE OF DIFFICULTIES IN THE JAPAN MARKET.

THESE DIFFICULTIES HAVE A GREAT DEAL TO DO WITH THE WAY IN WHICH THE JAPANESE GOVERNMENT REDUCES REIMBURSEMENT PRICES FOR PHARMACEUTICALS EVERY TWO YEARS UNDER THE NATIONAL HEALTH INSURANCE SYSTEM, WHILE MAKING IT EXTREMELY DIFFICULT FOR THE INDUSTRY TO RAISE PRICES TO OFFSET INFLATION. FOR MANY AMERICAN COMPANIES IN JAPAN, WHICH INVEST SIGNIFICANT PORTIONS OF SALES REVENUES IN R&D, THE INABILITY TO USE DISCRETION IN PRICING DECISIONS ON THEIR FULL PRODUCT LINES IN JAPAN PLACES SUBSTANTIAL PRESSURE ON THEIR ABILITY TO MAINTAIN THE HIGH INVESTMENT IN THE SEARCH FOR INNOVATIVE, BREAK-THROUGH THERAPIES.

IN THE WAKE OF CHANGES ANNOUNCED BY THE JAPANESE GOVERNMENT ON MAY 31 IN THE PRICING AND REIMBURSEMENT SYSTEM, THE U.S. INDUSTRY, THROUGH THE PHARMACEUTICAL MANUFACTURERS ASSOCIATION (PMA), HAS FILED A PETITION WITH THE MINISTRY OF HEALTH AND WELFARE. THE PETITION ASKS THAT THE JAPANESE GOVERNMENT MAKE ITS PRICING AND GOVERNMENT-RUN REIMBURSEMENT SYSTEM, INCLUDING THE ESTABLISHMENT OF REWARDS FOR INNOVATIVE PRODUCTS, MORE TRANSPARENT, ACCESSIBLE AND FAIR.

THE ADMINISTRATION INTENDS TO PURSUE THIS ISSUE AND RELATED ISSUES WHICH AFFECT THE DISTRIBUTION OF PHARMACEUTICALS IN JAPAN.

AUTO PARTS

WITH RESPECT TO AUTO PARTS TRADE MATTERS, THE ADMINISTRATION HAS MADE AND CONTINUES TO MAKE INTENSIVE EFFORTS TO SECURE IMPROVED MARKET ACCESS FOR U.S. AUTO PARTS SUPPLIERS BOTH TO THE JAPANESE INDIGENOUS MARKET AND TO THE NEW MARKET CREATED BY JAPANESE-OWNED OR JOINT VENTURE OPERATIONS LOCATING IN THE UNITED STATES AND IN OTHER COUNTRIES. THE FOCAL POINT OF OUR ENDEAVORS HAS BEEN THE TRANSPORTATION MACHINERY MARKET-ORIENTED SECTOR-SELECTIVE (MOSS) PROCESS LED BY THE DEPARTMENT OF COMMERCE. USTR HAS WORKED CLOSELY WITH THE DEPARTMENT OF COMMERCE IN EXPLORING AND DEVELOPING VARIOUS CONCEPTS FOR INCREASING MARKET ACCESS OPPORTUNITIES FOR AUTO PARTS AND ACCESSORIES IN THE MOSS CONTEST.

IN 1990, FOLLOWING PRESIDENT BUSH'S PUBLIC SUPPORT FOR CONTINUED EFFORTS TO RESOLVE DIFFICULTIES THAT U.S. SUPPLIERS STILL MIGHT BE HAVING IN SELLING TO JAPANESE VEHICLE MANUFACTURERS, A MARKET ORIENTED COOPERATION PLAN (MOCP) WAS NEGOTIATED BY COMMERCE UNDER

SECRETARY FARREN WITH HIS JAPANESE GOVERNMENT COUNTERPARTS. A MAJOR GOAL OF THIS PLAN IS TO REMOVE ANY GOVERNMENT BARRIERS TO TRADE AND TO ESTABLISH AND EXPAND LONG-TERM BUSINESS RELATIONSHIPS BETWEEN U.S. AUTO PARTS SUPPLIERS AND JAPANESE-OWNED VEHICLE MANUFACTURERS. AMONG THE STEPS TAKEN TO IMPLEMENT THIS PLAN, IN APRIL OF 1991, THE COMMERCE DEPARTMENT AND THE JAPANESE MINISTRY OF INTERNATIONAL TRADE AND INDUSTRY (MITI) CO-SPONSORED A GOVERNMENT-INDUSTRY CONFERENCE TO PROMOTE INVOLVEMENT OF U.S. SUPPLIERS AT THE DESIGN STAGE FOR PARTS TO BE DEVELOPED AS ORIGINAL EQUIPMENT FOR JAPANESE VEHICLES. JAPANESE MANUFACTURERS WERE ALSO REQUESTED AND HAVE BEEN PROVIDING VOLUNTARY PLANS ON THEIR OWN ACTIONS TO INCREASE BUSINESS OPPORTUNITIES FOR U.S. SUPPLIERS. DURING HIS RECENT TRIP TO JAPAN, VICE PRESIDENT QUAYLE VOICED CONTINUING ADMINISTRATION SUPPORT FOR THESE MOSS GOALS AND SPECIFICALLY RAISED U.S. AUTOMOTIVE PARTS TRADE ISSUES WITH THE JAPANESE GOVERNMENT OFFICIALS AND AUTO MANUFACTURERS.

AT HIGH-LEVEL MOSS MEETINGS HELD IN TOKYO LAST WEEK, UNDER SECRETARY FARREN MET WITH HIS MITI COUNTERPARTS TO REVIEW THE PROGRESS MADE TO DATE UNDER THE MOSS AGREEMENT AND THE MARKET-ORIENTED ACTION PLAN AGREED TO LAST SUMMER. THEY AGREED TO CONTINUE TO TAKE EFFORTS TO ENCOURAGE U.S. PARTS SALES--INCLUDING CO-SPONSORING ANOTHER GOVERNMENT-INDUSTRY SALES CONFERENCE IN THE SPRING OF 1992--AND TO MONITOR THE RESULTS OF THOSE EFFORTS. THEY ALSO AGREED TO SPONSOR AN INDEPENDENT STUDY OF FACTORS THAT MAY WORK TO INHIBIT SALES OF U.S.-BUILT CARS IN JAPAN.

RECORDING ARTISTS' RIGHTS

IN THE SPRING OF THIS YEAR, THE JAPANESE GOVERNMENT, RESPONDING TO STRONG U.S. CONCERNS, ENACTED REVISIONS TO THE JAPANESE COPYRIGHT LAW, WHICH WILL TAKE EFFECT NEXT JANUARY, AFFECTING THE PROTECTION OF SOUND RECORDINGS. THESE REVISIONS WERE INTENDED, AMONG OTHER POINTS, TO PROVIDE FOREIGN RECORDINGS WITH PROTECTION FOR ONE YEAR AGAINST UNAUTHORIZED RENTALS. THAT PROTECTION HAD PREVIOUSLY BEEN PROVIDED ONLY FOR JAPANESE RECORDINGS. THE U.S. GOVERNMENT EXPECTS THAT THE NEWLY ENACTED REVISIONS TO THE COPYRIGHT LAW PERMITTING ONE YEAR PROHIBITION ON RENTAL WILL BE HONORED AND STRONGLY ENFORCED. FOREIGN RECORD PRODUCERS MUST BE ABLE TO EXERCISE THE RIGHTS GIVEN TO THEM UNDER JAPANESE LAW, AND PURSUANT TO REPRESENTATIONS MADE BY THE GOVERNMENT OF JAPAN TO THE U.S. GOVERNMENT, TO PROHIBIT RENTALS FOR A ONE-YEAR PERIOD. WE SHALL BE WATCHING THIS AREA VERY CLOSELY IN THE MONTHS AHEAD.

COMPUTER PROCUREMENT

WE ALSO DECIDED TO FOCUS ON COMPUTERS, AND HAVE ESTABLISHED A COMPUTER SUBCOMMITTEE OF THE U.S.-JAPAN TRADE COMMITTEE, OUR LONG-ESTABLISHED FORUM FOR ADDRESSING SPECIFIC BILATERAL TRADE ISSUES WITH JAPAN. WE CHOSE COMPUTERS BECAUSE OF THEIR RELATIONSHIP TO GOVERNMENT PROCUREMENT. THE JAPANESE GOVERNMENT IS PLANNING SUBSTANTIAL PURCHASES OF PERSONAL COMPUTERS, ESPECIALLY FOR SCHOOLS. PURCHASES OF FOREIGN COMPUTERS BY THE JAPANESE GOVERNMENT HAVE REMAINED AT A FAIRLY CONSTANT 10 PERCENT LEVEL. BY CONTRAST, PURCHASES OF FOREIGN COMPUTERS IN THE PRIVATE MARKET HAVE BEEN AROUND 35 PERCENT. WE WANT TO MAKE SURE THAT PROCUREMENTS ARE OPEN AND THAT OUR COMPANIES ARE INCLUDED.

PAPER

WE ALSO HAVE ESTABLISHED A PAPER SUBCOMMITTEE OF THE TRADE COMMITTEE TO RESOLVE DIFFICULTIES IN THAT SECTOR. WE CHOSE PAPER BECAUSE IT IS A HIGHLY COMPETITIVE U.S. INDUSTRY WHOSE EFFORTS TO SELL INTO THE JAPANESE MARKET HAVE BEEN SERIOUSLY IMPEDED BY "STRUCTURAL" PROBLEMS ARISING FROM A JAPANESE DISTRIBUTION SYSTEM THAT IS CHARACTERIZED BY CONTINUOUS, LONG-TERM RELATIONSHIPS AND

CAPITAL LINKAGES BETWEEN JAPANESE MANUFACTURERS AND DISTRIBUTORS THAT MAKE MARKET ACCESS DIFFICULT AND PRIVATE SECTOR PROCUREMENT PRACTICES OPAQUE. WE ARE ADDRESSING STRUCTURAL ISSUES BROADLY THROUGH THE SII PROCESS, BUT WE ALSO SEEK TO ADDRESS STRUCTURAL PROBLEMS WITHIN THIS SECTOR.

MULTILATERAL INITIATIVES

SHIPBUILDING

THE ADMINISTRATION HAS ALSO BEEN ENGAGED WITH JAPAN AND A NUMBER OF OTHER NATIONS IN MULTILATERAL NEGOTIATIONS ON SHIPBUILDING. THESE NEGOTIATIONS HAVE BEEN LONG AND COMPLEX, IN LARGE PART BECAUSE SHIPS ARE NOT TREATED AS IMPORTS AND, THEREFORE, NEW TRADE RULES NEED TO BE NEGOTIATED. THE LAST SET OF NEGOTIATIONS WERE CONDUCTED IN MID-JULY. ON THE BASIS OF THOSE MEETINGS, A NEW TEXT WILL BE PREPARED WHICH WILL IDENTIFY THE MAJOR ISSUES THAT NEED TO BE RESOLVED TO REACH AGREEMENT. THAT TEXT WILL IDENTIFY, AMONG OTHERS, THE FOLLOWING ISSUES:

- UNFAIR PRICING, WHERE DIFFERENCES BETWEEN THE EC AND JAPAN HAVE TENDED TO EXIST;
- PAYMENT OF THE PENALTY, WHERE JAPAN OPPOSES REQUIRING THE SHIPBUILDER TO PAY ANY PENALTY;
- INDIRECT SUBSIDIES, WHERE JAPAN OBJECTS TO ELIMINATING SUBSIDIES FOR SHIP OWNERS TO BUY SHIPS; AND
- THE SCHEDULE OF PHASING OUT SUBSIDIES, INCLUDING HOW TO TREAT THE JONES ACT.

THE NEXT MEETING IS SCHEDULED FOR MID-SEPTEMBER AND THE LIKELIHOOD OF AN AGREEMENT DEPENDS ON WHETHER THE GOVERNMENTS IN THE NEGOTIATIONS ARE ABLE TO MAKE THE POLITICAL DECISIONS NEEDED TO RESOLVE THESE ISSUES.

THE URUGUAY ROUND

OUR PARTICIPATION IN THE HISTORIC URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS NOW UNDERWAY IN THE GATT COMPLEMENTS MANY OF OUR BILATERAL EFFORTS. OUR BILATERAL AGENDA WITH JAPAN SHOULD BE FACILITATED BY AGREEMENTS IN THE URUGUAY ROUND NEGOTIATIONS COVERING THE BROAD RANGE OF INTERESTS--AGRICULTURE, MARKET ACCESS, GATT RULES, SERVICES, INVESTMENT, AND INTELLECTUAL PROPERTY PROTECTION.

THE UNITED STATES AND JAPAN SHARE A COMMITMENT TO THE SUCCESSFUL CONCLUSION OF THE URUGUAY ROUND. SUCCESS IN THESE NEGOTIATIONS WILL RESULT IN A STRENGTHENING OF THE OPEN TRADING SYSTEM AND AN EXPANSION OF ECONOMIC OPPORTUNITIES FOR THE UNITED STATES AND OUR TRADING PARTNERS. JAPAN, LIKE THE UNITED STATES, HAS BEEN A MAJOR BENEFICIARY OF THE OPEN TRADING SYSTEM ESTABLISHED BY GATT. THE UNITED STATES, LIKE JAPAN, DEMANDS A COMPREHENSIVE AGREEMENT ENCOMPASSING ALL IMPORTANT AREAS IN THE NEGOTIATIONS.

OUR SUCCESS IN CONCLUDING THE URUGUAY ROUND WILL DEPEND ON OUR COLLECTIVE ABILITY TO BEGIN THE MUCH-NEEDED PROCESS OF MULTILATERAL AGRICULTURAL REFORM. AGRICULTURAL REFORM IS THE KEY TO OBTAINING AGREEMENTS IN OTHER AREAS OF THE NEGOTIATIONS--WE HAVE CALLED IT THE LINCHPIN TO THE NEGOTIATIONS. AS WE SAW IN BRUSSELS IN DECEMBER, WHEN THE NEGOTIATIONS BROKE DOWN, WITHOUT AGRICULTURE THERE CAN BE NO SUCCESSFUL CONCLUSION TO THESE NEGOTIATIONS. FOR MANY COUNTRIES, AGRICULTURE IS THE MAIN ISSUE IN THE NEGOTIATIONS AND THE REASON TO PARTICIPATE IN THE URUGUAY ROUND.

THE URUGUAY ROUND RESUMED IN FEBRUARY IN ALL AREAS AFTER THERE WAS AGREEMENT TO ACHIEVE AGRICULTURAL REFORM THROUGH THE NEGOTIATION OF SPECIFIC BINDING COMMITMENTS TO REDUCE DOMESTIC SUPPORT, BARRIERS TO MARKET ACCESS, EXPORT SUBSIDIES AND TO REACH AN AGREEMENT ON SANITARY AND PHYTOSANITARY ISSUES. THESE ARE THE CRITICAL ELEMENTS OF AGRICULTURAL REFORM. JAPAN, LIKE THE EUROPEAN COMMUNITY AND KOREA, PREVIOUSLY HAD ARGUED AGAINST SUCH A COMPREHENSIVE APPROACH TO AGRICULTURAL REFORM.

FUNDAMENTAL AGRICULTURAL REFORM REQUIRES THAT NO COMMODITY BE EXCLUDED FROM THE REFORM PROCESS. EVERY COUNTRY HAS COMMODITIES THAT IT WOULD PREFER TO EXCLUDE, BUT--LIKE OTHER COUNTRIES--JAPAN WILL HAVE TO MAKE BINDING COMMITMENTS IN EACH OF THESE AREAS IN ORDER FOR THE ROUND TO BE SUCCESSFULLY CONCLUDED. FOR JAPAN, JUST AS FOR THE UNITED STATES, THIS MEANS SPECIFIC ACTION ACROSS ALL AGRICULTURAL COMMODITIES.

WE REMAIN STEADFAST IN OUR EFFORTS TO SECURE LIBERALIZATION FROM JAPAN THAT MEETS OUR SPECIFIC INTERESTS IN AGRICULTURE AND PROCESSED AGRICULTURE. RICE IS THE BEST KNOWN EXAMPLE OF THAT INTEREST.

LIBERALIZATION OF JAPAN'S MARKET FOR RICE IS ONE OF MANY OBJECTIVES THE UNITED STATES MAINTAINS IN THE URUGUAY ROUND. IT WOULD BE MISLEADING TO SUGGEST THAT THIS COMPRISES OUR FULL AGENDA. IT IS ALSO IMPORTANT TO SAY THAT SHOULD RICE NOT BE ADEQUATELY ADDRESSED IN THE CONTEXT OF THE ROUND, WE WILL HAVE TO CONSIDER OTHER ALTERNATIVES.

AMBASSADOR HILLS HAS STATED ON MANY OCCASIONS THAT THE URUGUAY ROUND IS ABOUT ACCESS: ACCESS TO MARKETS FOR AGRICULTURE, MANUFACTURED GOODS, SERVICES, GOVERNMENT PROCUREMENT AND THE RULES THAT PROTECT AND GUARANTEE THAT ACCESS. WE ARE WORKING CLOSELY WITH JAPAN TO ACHIEVE AMBITIOUS RESULTS IN LIBERALIZING MARKET ACCESS IN ALL AREAS.

IN ADDITION TO THE BILATERAL NEGOTIATIONS WE ARE PURSUING WITHIN THE GATT FRAMEWORK TO ADDRESS THE PRODUCT-SPECIFIC INTERESTS OF U.S. EXPORTERS, WE ARE WORKING WITH JAPAN TO ACHIEVE OUR "ZERO FOR ZERO INITIATIVES"--A MULTILATERAL AGREEMENT TO ELIMINATE TARIFFS IN NINE SECTORS IDENTIFIED BY OUR PRIVATE SECTOR. THESE INITIATIVES FOR THE PAPER, WOOD, PHARMACEUTICALS, STEEL, ELECTRONICS, FISH, BEER, NON-FERROUS METALS AND CONSTRUCTION EQUIPMENT SECTORS ARE A MAJOR COMPONENT OF OUR MARKET ACCESS AGENDA. JAPAN HAS NOT YET AGREED TO ALL THE INITIATIVES, AND WE INTEND TO CONTINUE TO PURSUE THIS AGENDA.

JAPAN, LIKE THE UNITED STATES WANTS TO SECURE A STRONG FRAMEWORK OF RULES FOR TRADE IN SERVICES. SUCH A FRAMEWORK WILL ONLY BE AS STRONG AS THE LIBERALIZATION COMMITMENTS SCHEDULED IN THE FRAMEWORK. WE ARE ENGAGED IN SERIOUS BILATERAL NEGOTIATIONS TO ACHIEVE SUCH A RESULT WITH JAPAN.

FINALLY, LET ME MENTION THE INTELLECTUAL PROPERTY NEGOTIATIONS, OR "TRIPS" AS THEY ARE CALLED. WE HAVE MADE SOME PROGRESS IN THE NEGOTIATIONS. INDEED, MOST TRADING PARTNERS NOW RECOGNIZE THAT A TRIPS AGREEMENT IS AN ESSENTIAL PART OF ANY FINAL URUGUAY ROUND PACKAGE AND THAT SUCH AN AGREEMENT MUST SATISFY U.S. OBJECTIVES IF THE UNITED STATES IS TO SUPPORT THE RESULTS OF THE URUGUAY ROUND AS A WHOLE.

OVERALL, HOWEVER, WE DO NOT THINK THAT THE TRIPS NEGOTIATION IS CLOSE TO REACHING A SUCCESSFUL CONCLUSION. WHILE COUNTRIES PARTICIPATING IN THE NEGOTIATIONS, INCLUDING JAPAN, HAVE MADE EVERY EFFORT TO REACH AGREEMENT ON THE STRUCTURE AND COVERAGE OF THE AGREEMENT, WE HAVE MADE LITTLE PROGRESS IN RESOLVING A NUMBER OF KEY ISSUES IN THE STANDARDS AREA INCLUDING PATENTS, COPYRIGHTS AND TRADE SECRETS. POLITICAL DECISIONS WILL BE REQUIRED FOR RESOLUTION OF THESE ISSUES.

JAPAN AND OTHER DEVELOPED COUNTRIES HAVE APPEARED MORE WILLING THAN THE UNITED STATES TO ACCEPT LOWER LEVELS OF PROTECTION IN THE STANDARDS AREA IN ORDER TO ACCELERATE THE NEGOTIATIONS. WE HAVE DONE A CAREFUL ASSESSMENT OF THE CONSEQUENCES FOR U.S. INTERESTS IF THESE ISSUES WERE RESOLVED THROUGH COMPROMISES. WE HAVE CONCLUDED THAT IF THIS WERE TO OCCUR, THE TRIPS AGREEMENT WOULD FALL SHORT OF U.S. NEEDS, AND WOULD NOT SATISFY MANY OF OUR BASIC GOALS FOR THE NEGOTIATIONS. THUS, WE HAVE BEEN ENCOURAGING OUR TRADING PARTNERS--AND JAPAN HAS BEEN NEAR THE TOP OF OUR LIST OF CONTACTS--TO SEARCH DILIGENTLY FOR ADDITIONAL FLEXIBILITY IN THEIR POSITIONS SO THEY CAN ACCOMMODATE U.S. CONCERNS. I FEAR THAT WITHOUT SUCH ADDITIONAL FLEXIBILITY ON THE PART OF OUR KEY TRADING PARTNERS, THE TRIPS AGREEMENT WILL NOT BE CONCLUDED SUCCESSFULLY.

CONCLUSION

THE REMOVAL OF JAPANESE BARRIERS TO IMPORTS, BOTH FORMAL AND STRUCTURAL, IS ONE OF THE ADMINISTRATION'S TOP TRADE POLICY PRIORITIES. AN EXPANDING U.S. PRESENCE IN THE JAPANESE MARKET--THE WORLD'S SECOND-LARGEST--IS VITAL TO THE GLOBAL COMPETITIVENESS OF U.S. FIRMS.

WE HAVE PURSUED THIS OBJECTIVE USING THREE BROAD AND COMPLEMENTARY APPROACHES: SECTOR-SPECIFIC NEGOTIATIONS, DISCUSSIONS OF STRUCTURAL IMPEDIMENTS TO OPEN TRADE IN GOODS AND SERVICES, AND MULTILATERAL NEGOTIATIONS WITHIN THE GATT FRAMEWORK ON TRADE ISSUES OF GLOBAL SIGNIFICANCE.

EACH OF THESE APPROACHES PLAYS AN ESSENTIAL ROLE IN OUR TRADE RELATIONS WITH JAPAN. OUR EFFORTS TO OPEN THE JAPANESE MARKETPLACE TO U.S. PRODUCTS AND SERVICES WOULD BE HANDICAPPED WERE WE TO ELIMINATE ANY ONE OF THEM. WE MUST CONTINUE TO REDUCE JAPAN'S FORMAL TRADE BARRIERS IN SPECIFIC SECTORS, WHILE ALSO WORKING TO OVERCOME THE UNDERLYING STRUCTURAL CHARACTERISTICS OF THE JAPANESE ECONOMY THAT SERVE TO IMPEDE TRADE. OUR BILATERAL AGENDA WITH JAPAN IS FACILITATED BY NEGOTIATIONS IN THE URUGUAY ROUND AND AIDED BY THE COMMITMENT THE UNITED STATES AND JAPAN SHARE TO DEEPENING TRADE AND ECONOMIC RELATIONS BETWEEN OUR TWO COUNTRIES.

Prepared Statement of John J. Stocker

Mr. Chairman and Members of the Trade Subcommittee, my name is John J. Stocker and I am President of the Shipbuilders Council of America. The Council is the national trade association representing American shipbuilders, ship repairers, and manufacturers of marine equipment. The subject of today's hearing, the negotiations to eliminate foreign shipbuilding and repair subsidy practices, is central to the desire of American shipyards to produce for the international market.

Thirteen years ago, our shipbuilding industry had a healthy backlog of ship work for both our military and commercial customers. In 1978, the industry had under contract 60 ships for commercial customers and 60 ships for the U.S. Navy for a total of 120 ships. Today, the U.S. shipbuilding industry has 96 naval vessels and only three commercial ships under construction. Our industry has 129,300 employees, which represents a decline of 57,400 since the peak employment of 186,700 was achieved in 1981. In other words, private U.S. shipyards have lost about one third of their capacity since 1981.

The shift in the marketplace for U.S. shipyards was dramatic. While the decade of the 1980's was a period of rebuilding of America's naval forces—from which our shipyards benefitted—it was also a period in which commercial opportunities totally collapsed for U.S. builders. This industry went from one that was dependent on U.S. Government contracts for about one third of its workload—in the mid-1970's to one that became almost totally dependent' on the U.S. Government for its livelihood. In 1989, nearly 95 percent of the industry's—workload was for the Government. In

fact, in the last seven years, the industry has taken orders for only three new ships for commercial clients.

How did this incredible turnaround occur in the fortunes of American shipyards? In 1981, the Administration proposed the termination of the Construction-Differential Subsidy (CDS) for the building of ships in the United States. This decision was made without considering the effect on U.S. shipyards and without pursuing the elimination of foreign subsidy practices.

The Construction-Differential Subsidy was paid to U.S.-flag shipowners, who also received subsidies for the ship's operation. The subsidy was paid so that U.S.-flag owners could obtain their vessels at price parity with the world market. Rarely, however, did the U.S. Government need to budget more than $250 million in any given year for the program, and, in fact, the average budget was about $125 million per year.

While it is true that throughout the 1970's the program built ships in American shipyards, it is also true that it basically tied American shipyards to the domestic market. We never received export subsidy and, as a result, ship production in the United States became, in effect, a response to market demand driven by a relatively small fleet (by world standards). As a result, we built custom-designed ships for our domestic customers and never were able to institute the standardized production that we, in fact, developed during World War II and eventually transferred to Japan.

The Construction-Differential Subsidy program had been in existence since the passage of the Merchant Marine Act of 1936. The 1936 Act really financed the rebirth of American shipbuilding, which at that time was emerging from the chaos of the Great Depression. The rebuilding of American shipyards in the late 1930's made it possible for American shipyards to respond to the mobilization demands of the war. During World War II, American yards produced 5,063 cargo ships and 1,556 naval vessels. By the end of the war, we were the world's leading producer of ships.

Obviously, with all that wartime production, there was a surplus of shipping in the post war period. American yards downsized to meet reduced demand. But, even in the late 1950's, American shipyards were still healthy enough that ships were being built for domestic and export customers.

In the 1960's, however, the world's shipbuilders began to see the emergence of a new challenge—that of Japan. The Japanese, heavily dependent on ocean transportation, had decided that shipbuilding offered a way for them to control ocean freight rates so that both imports and exports would bear lowered transportation costs. This could be done through an effective market control of the shipbuilding market and its ability to price shipping's chief capital asset—the ship. In addition, shipbuilding offered them an opportunity to develop their industrial base.

Investment in new capital plant, equipment, and training began. By the end of the 1960's, the Japanese were becoming a force in the world market while at the same time, interventionist policies of the Japanese Government were taking hold in the marketplace. Not only did we see the emergence of a strong Japanese shipbuilding industrial policy—organized by the Ministry of Transport and the Ministry of International Trade and Industry-we also began seeing the inventive financial techniques used by the Government and industry to undercut world pricing levels.

Throughout the 1970's, the Japanese continued to dominate the world market. Although all shipyards suffered in the period following the oil crisis of 1973-1974, the Japanese were able to maintain market shares of about 40 percent of tonnage delivered.

The late 1970's represented the beginning of a severe depression in the world market. Orders for new ships, particularly tankers, began to fall following the oil crisis. In fact, since 1980, only 5 percent of the world's tanker fleet has seen its ships replaced by new tonnage.

Complicating the growing lack of work was the emergence of South Korea as a dominant shipbuilder in the 1980's. The Koreans took note of the utility that developing shipbuilding capability gave to the overall industrial economy of Japan. In the mid-1970's, the Korean Government decided that public sector investment should be targeted to shipbuilding. The strategy has worked. With Korean Government support, Korean shipbuilders saw their market share, in deadweight tonnage, grow from .4 percent in 1968 to 2.8 percent in 1978 to 28.6 percent in 1989.

Admittedly, the gravitation of shipbuilding capability and capacity had come at the expense of the Europeans and the Americans. European shipyards had recovered from the ravages of World War II by the late 1950's and 1960's only to face a significant threat from Japan. In 1968, the Europeans held about 55 percent of market share in deadweight tonnage, which they were able to maintain through the

1970's. As the depression of the 1980's settled in, the European share of the market dropped to 40 percent.

To combat the Asian shipbuilding capability, the Europeans began in the late 1970's and 1980's to aggressively increase their utilization of subsidies to match Korean and Japanese pricing. How severe was the shipbuilding depression? By 1989, worldwide production had dropped to 16 million deadweight tons. In 1973, the world produced 105 million deadweight tons. Thus, the depression of the 1980's culminated in a market that was producing only 15 percent of its pre-depression peak.

In order to obtain whatever new building contracts were available, many shipyards cut their prices dramatically. By 1985, the average price of a 280,000 deadweight ton very large crude oil carrier (VLCC) was about $40 million. This was the same price being charged for VLCCs in 1970, despite inflationary growth of 172 percent in the period 1970–1985.

European governments watched these developments with dismay, but they were not about to completely shut down their shipbuilding capability. It is true that many governments were only willing to increase their subsidy levels if shipyard capacity were reduced to meet expected demand. However, according to Dr. Martin Stopford, a shipping economist based in London, this effort was complicated by the following three factors:

> "(1) *Political Expediency.* Many of the yards were in towns that depended heavily on shipbuilding for employment, and politicians were prepared to provide subsidies which enabled their local shipbuilders to avoid the massive capacity cuts which would have solved the problem quickly and cleanly. In Japan, there was the additional problem of the lifetime employment system which ruled out redundancy as a means of reducing capacity.
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> "(2) *South Korean Expansion.* In 1972, South Korea had started developing a major shipbuilding industry. Just as European and Japanese shipbuilders were starting to cut their capacity, Hyundai, the first of the new Korean yards, came into production. The timing of the Korean entry into the market could not have been worse and their new capacity offset the capacity cuts in the traditional shipbuilding areas, especially Western Europe.
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> "(3) *Failure to Anticipate the Severity of the Crisis.* Since the scale of the problem was not fully appreciated at the outset, instead of tackling the capacity reduction with a single clean cut, most shipbuilders tackled restructuring as a series of steps down, interspersed with periods of consolidation, during which each shipyard sought to maintain its market share at the expense of others by means of price cutting backed by subsidy."

Meanwhile, in the United States, our response to the worldwide struggle for market share was to see the U.S. Government terminate the Construction-Differential Subsidy. While it is true that our commercial orders in the 1970's were targeted solely to the domestic market, it is also true that this market had allowed us to maintain a healthy mix of commercial and naval contracts. In fact, we were producing 9 percent of total commercial shipbuilding in the world as compared to less than 0.1 percent today.

The Government's response was totally counter-productive. Just when subsidies began to grow, our subsidies were terminated. Two other countries (Sweden and Canada) reduced their subsidy programs (although they were not terminated completely). The result in all three countries was the same: decline or collapse of their commercial shipbuilding capability.

For American shipyards,the period of the 1980's was marked by growth in the naval market. So, while there were concerns about the lack of commercial shipbuilding, for many in Government, the number of naval contracts helped to soften the impact of subsidy termination. However, 2½ years ago, the Shipbuilders Council of America made it clear to its members that a downturn in defense spending was approaching—a downturn generated by the changing international threat environment. For an industry almost totally dependent on the U.S. Government for its work, such a structural budgetary change would be catastrophic. To survive, we had to turn to the commercial market.

Starting in 1988, the world shipbuilding market was finally beginning to revive after a period of massive depression. The world fleet was aging, there were concerns about the safe operation of ships in the ocean environment, and there were technological improvements in ship systems performance (including propulsion plants) that would improve the quality of ocean shipping services.

Thus, it was possible to foresee that the 1990's could be a period of profound growth in shipbuilding demand. Aiding the process was the fact that worldwide capacity had declined. World shipbuilding capacity had dropped by about 40 percent. In 1990, demand began to accelerate, with worldwide production 25 percent higher

than in 1989. While forecasters were in continuous debate about the extent of this demand growth, even conservative estimates show that it will reach a peak of nearly 60 million deadweight tons by the end of the decade, or more than three times current levels.

Despite this growth demand, American shipyards will not have an opportunity to capture a share of this market if foreign governments continue to rely on subsidies to underwrite ship prices. Subsidy programs are of great importance to foreign shipbuilders since there is a strong correlation between levels of subsidy support and the size of the orderbook.

For example, in Japan, at the end of 1990, the orderbook stood at 558 ships totaling 29.9 million deadweight tons. This workload supported a 41 percent market share for Japan in tonnage and a 29 percent share in ship numbers. This backlog results not only from Japanese shipyard performance, but also from the $4.4 billion in subsidy support provided by the Government in the period 1987 through 1990.

In Korea, government support programs totaled nearly $2.2 billion in 1989 through 1990, while the German Government provided over $5 billion in subsidy support in the 1987 through 1990 time frame.

By comparison, during the period 1987 through 1990, the United States Government provided $4.6 million, which constituted their contribution to a joint government-industry partnership in the National Shipbuilding Research Program (NSRP). This might explain why there are only three commercial ships under construction today in the U.S.

Recognizing that subsidies are a major impediment to the reentry of American shipyards into the commercial marketplace, the Shipbuilders Council of America filed a 301 Petition against Japan, South Korea, Germany and Norway. We asked the U.S. Trade Representative to take unilateral action against these countries for their pervasive subsidy practices in an international shipbuilding market where American shipyards were essentially denied entry.

After 6 weeks of review, the USTR reached the conclusion that American shipyard plans to reenter the marketplace were being effectively denied. Ambassador Carla Hills requested that the industry withdraw its petition, and said that in exchange, the U.S. Government would initiate multi-lateral negotiations through Working Party Six on Shipbuilding within the Organization for Economic Cooperation and Development (OECD). After careful consideration of the Government's request, the industry reluctantly agreed to withdraw the petition. Ambassador Hills made a further commitment to set a deadline of March 31, 1990 for the achievement of an agreement in principle on a shipbuilding and repair subsidy discipline. Mrs. Hills made this commitment because the ambassadors from each of the countries targeted made a solemn vow that their governments were just as interested in subsidy discipline as the United Sates.

During the summer and fall of 1989, the U.S. Trade Representative's Office formed an inter-agency team to begin work on the shipbuilding negotiations. They moved aggressively to compile the data and strategy needed to make these negotiations a success. The U.S. shipbuilding industry has worked closely with the USTR throughout this process.

Initially, some progress was made. Each meeting saw improvements made to the text of the Agreement. The annexes defining which government support programs were to be covered and the phase-out schedule of existing programs was being discussed.

This all came to a halt in mid-1990 when the European Community brought the issue of dumping and unfair pricing of ships to the table. This complicated the negotiations and led to a slowdown in the process, because the Koreans and Japanese made it very clear that they did not want the proposed trade agreement to cover such issues.

Why had the Europeans brought the issue of unfair pricing to the table? The issue was brought up because the Japanese and the Koreans have had a consistent practice of underpricing their ships in order to drive out competition and secure market share. Recent statements by spokesmen for both industries have acknowledged the underpricing practices and have vowed that they will not be repeated.

But the damage had been done both to the industry and to the negotiations. Three successive deadlines have been missed. And, we now stand over 2 years later with the market continuing to evolve as the forecasters had predicted and continuing to deny American shipyards access.

As the subsidy talks have been going on, Japan, South Korea, and Germany have budgeted, disbursed, or proposed $4.5 billion in new shipbuilding subsidies. Altogether, since 1987, these three countries have proposed or budgeted more than $12 billion in commercial shipbuilding-related aid, of which over $9 billion has been pro-

vided in cash, loans, guarantees, and other assistance. These subsidies have come in the form of direct grants, export credits, restructuring or investment aid, home credits, and research and development assistance. Thus, during the period of negotiation, our trading partners continue to subsidize. They have not promised to freeze their programs while discussions are underway.

The U.S. shipbuilding/repair industry stands at a crossroads. We have always supported the concept of a negotiated trade agreement disciplining subsidy practices. We have agreed that any statutory provision protecting American shipyards in the commercial market should be repealed to make our laws and regulations consistent with the Agreement, even though these provisions have amounted to very little. It is apparent to all sides that we gave our leverage away unilaterally in 1981 with the termination of our subsidy program.

The U.S. shipbuilding industry has always held that a good international agreement has to contain the following elements:

1. Subsidies should be phased out as rapidly as possible; i.e., in no more than 2 years. In addition, there must be a requirement stating that shipbuilding contracts signed during the phase-out period are subject to the effective date of the agreement. Furthermore, no new measures or practices may be introduced during the phase-out period.

The U.S. industry began the process urging a 2-year phase-out based on a start date of December 1991. Obviously, that timetable will be missed. The Europeans are not in a hurry to phase-out their programs. They not only want a long phase-out of existing practices, but they are also interested in *not* capping spending on European state assistance. Without a strong, well articulated, and quick phase-out, the Europeans hope to continue to deny U.S. access to the world shipbuilding market.

2. Specific, as well as generic, programs must be identified in the annex that will cover the phase-out. To date, the U.S. Government is the only OECD member that has clearly identified which programs would be covered under the Trade Agreement. No other government has provided a complete list.

3. The penalties imposed under such an Agreement must be tough and meaningful. The Agreement should require repayment of the subsidy by the shipbuilding/repair company to its government. If that should fail, then the signatories should have the right to fine shipowners. This fine would apply to those who benefit from the subsidy practice, which is typical in most dumping or countervailing duty cases.

There is still disagreement among the negotiators concerning the nature of the additional penalty to be imposed. The U.S. and the EC have linked up to support the suspension of equivalent GATT concessions so that sanctions could be applied against other exports from the violating nation. The Japanese support sanctions against shipowners.

The Shipbuilders Council of America is concerned that the U.S. negotiators have backed away from their original proposal, which included as an alternative; the imposition of an additional penalty on the shipowner if the shipbuilder/repairer refused subsidy repayment.

4. All government financing programs for commercial ships built in the yards of the subsidizing country should be phased out. This includes loans, loan guarantees, insurance, and interest subsidies to export and domestic purchasers of ships, including those from lesser-developed countries (LDCs) as well as those from industrialized countries.

The Shipbuilders Council is extremely concerned that the U.S. negotiators are leaning toward allowing government-provided commercial ship financing in the agreement, as long as the financing meets certain conditions. Sanctioning the intrusion of governments into capital markets by allowing them to continue to be bankers to shipyards will keep American yards at a serious competitive disadvantage-a disadvantage that will become worse as government financing programs grow to assist yards in taking advantage of the favorable commercial market.

5. "Tied aid"—that is, unrestricted grants and financing aid provided by ' governments to shipowners from lesser-developed countries if the ships are built in the countries of the subsidizing governments—is a particularly abusive practice that should be specifically eliminated in the Agreement. At one point it was omitted from the scope of the Agreement because of separate OECD negotiations on the subject, but these negotiations are currently at an impasse, and, in fact, may not achieve the objective of a tied-aid discipline.

6. All government operational and investment aid to support commercial shipyards must be eliminated. As with government-assisted export and domestic credits for ship purchases, the current draft OECD agreement would allow government-sup-

plied loans, loan-guarantees, and equity infusions to support shipyards under certain conditions. The Shipbuilders Council is adamantly opposed to this.

7. Since the Koreans and the Japanese have admitted that they engaged in non-compensatory pricing practices in the 1980's, the U.S. shipbuilding/-repair industry agrees with the Europeans that an unfair pricing mechanism is needed.

After 2 years of negotiations, we still do not have a trade agreement that disciplines foreign shipbuilding subsidy practices. How much longer must we wait? Yet, when we ask the Administration to undertake unilateral action, it appears to be unwilling to use the trade instruments available to it. Despite the fact that we deeply appreciate the efforts undertaken by the USTR staff, we fear that the other side ultimately believes that the Administration will do nothing.

It should be noted here that an OECD agreement to reduce shipbuilding subsidies leading to their eventual elimination has been in place since early 1983. Called the Revised General Arrangement (RGA), it was signed by 13 nations, who have virtually ignored it. (The U.S. was not a participant to the agreement, having already terminated the Construction Differential Subsidy in 1981.) The RGA itself was the culmination of resolutions to reduce shipbuilding subsidies signed by the OECD Council of Ministers in 1972 and again in 1976. In other words, anti-shipbuilding subsidy agreements have existed—and been continuously violated—within the OECD for nearly 20 years. We had hoped that the current negotiations could reverse this pattern of behavior on the part of our trading partners, but that hope has faded.

Currently,the U.S. shipbuilding/repair industry believes that our trading partners fear nothing but the political will of the American people as embodied in the U.S. Congress. We believe that now is the time to send a strong message to our trading partners that the days are over when the U.S. ignores its own economic interests while it maintains international security so that other economies flourish.

The U.S. shipbuilding/repair industry asks this Subcommittee and the Congress to consider the passage of legislation that will generate the results we are all looking for; that is, a fair chance for U.S. shipbuilding and repair yards to meet future market demand.

Such legislation will allow the U.S. Government to calculate the economic benefit of subsidy practices and to seek foreign government collection or repayment of the subsidy by the foreign shipyard. Failing repayment, it would allow the United States to fine or penalize those owners that accept delivery of a ship that is illegally subsidized. The Trade Subcommittee of the House Ways & Means Committee reported H.R. 2056, the Shipbuilding Trade Reform Act, to the full Committee on July 11. Similar legislation, S. 1361, was introduced in the Senate on June 25.

We believe that, after more than 20 months of the OECD trade talks, our trading competitors have made it clear that they are unwilling to end their shipbuilding subsidies through these multi-lateral negotiations. They are unwilling to end their subsidies because they do not perceive such an action is in their best interests. The elimination of shipbuilding subsidies will only be achieved when the U.S. Congress provides them with an incentive to do so.

While we appreciate the USTR's efforts on behalf of our industry, we also have to say that the USTR's definition of "progress" in the talks is not the same as ours. The fact that our trading competitors are willing to participate in meeting, after meeting, after meeting, and have not refused yet another meeting does not represent sufficient progress to us. While these meetings go on ad infinitum, our industry continues to be locked out of the international market by foreign shipbuilding subsidies that are allowed to remain in place. Moreover, we have become increasingly concerned about the amount of backpedaling our own U.S. negotiators have been doing in order to try to get an agreement through.

We have watched our industry lose 60,000 jobs to a foreign shipbuilding and repair industry that has been propped up and force-fed subsidies that have distorted and very nearly destroyed the international shipbuilding market. These subsidies have led to over-production, artificial depression of prices, and to severe imbalances between demand and supply.

Now that American yards face the downturn in defense spending, necessitated by the change in international events, we need to be given a chance to compete fairly in the world market. We are not asking for subsidies for ourselves; we are simply asking that our government support us in our efforts to open up the world market and lead to the export of ships that are built and repaired by Americans.

PREPARED STATEMENT OF ALAN WM. WOLFF

The Semiconductor Industry Association is pleased to have the opportunity to testify at this hearing on trade agreements and negotiations. My name is Alan Wolff. I have been counsel to the Semiconductor Industry Association since 1980, and I am representing SIA today.

The Semiconductor Industry Association, which represents U.S.-based semiconductor manufacturers, was created in 1977 to address the public policy issues confronting the industry. SIA member firms represent over 90 percent of the American semiconductor industry. A list of member companies is attached

SIA concentrates its energies on those issues which affect the ability of the industry to remain internationally competitive, such as access to foreign markets, enforcement of our trade laws against unfair trade practices, and technology policy.

Today, I would like to discuss the new semiconductor agreement, prospects for its implementation, and the other public policies which must be adopted if the United States is to maintain a healthy, world-class semiconductor industry.

POTATO CHIPS VS. COMPUTER CHIPS: WHY IT MATTERS

As you know, there has been some debate as to whether the "composition" of the U.S. economy matters. Some believe that the United States should be indifferent about the success or failure of individual industries. I believe, however, that some technologies, such as microelectronics, are critical to our national and economic security. Certainly, our foreign competitors have targeted the semiconductor industry, using policy instruments such as production subsidies, funding of R&D consortia, formal and informal protection, and tax incentives. The National Critical Technologies Panel and the Department of Defense have both determined that success in microelectronics is essential to our economic well-being and national security.

The evidence is clear. The semiconductor industry is a key link in the electronics food-chain, a $750 billion industry (world-wide) which employs 2.6 million Americans. The loss of the U.S. industry would adversely effect our position in computers, telecommunications equipment, medical equipment, consumer electronics, and computer-integrated manufacturing. Semiconductors are at the heart of defense capabilities such as radar signalling, electronic countermeasures, precision-guided munitions and image processing. It is reasonable to assume that semiconductors will become more important in the future, given the phenomenal pace of technological change. The number of transistors on a chip has increased from 10 in the early 1960's to 10 million today. By the year 2000, the U.S. industry hopes to place over 10 billion transistors on a single chip. Such a chip could store the equivalent of a 20-volume encyclopedia, or provide all of the computing power of one of today's leading-edge supercomputers.

A STRATEGIC INDUSTRY AT RISK

Unfortunately, the U.S. semiconductor industry is "at risk." From 1982 and 1990, the U.S. industry's world-wide market share decreased from 56.7 percent to 39.8 percent, while Japan's share increased from 32.5 percent to 47.1 percent. This decline in the U.S. position has occurred for a number of reasons:

- The U.S. has lost many industries which use semiconductors, such as the consumer electronics industry.
- The U.S. industry has been injured by unfair trading practices, such as dumping and denial of market access. Japanese dumping of DRAM in the mid-1980's, for example, forced 6 out of 8 U.S. DRAM manufacturers out of the market. The U.S. share of Japan's market is only 12.7 percent, far below the level achievable if Japan's market were fully open to foreign semiconductors.
- Other governments have made the development of a semiconductor industry a national priority, and have "targeted" the industry by funding R&D consortia, extending low-interest loans, and providing favorable tax depreciation treatment and other tax incentives.
- Between 1984 and 1989, Japanese firms outinvested U.S. firms in plant and equipment and R&D by $12 billion, a gap that will grow (at current trends) to $15 billion between 1990 and 1995.

TWENTY YEARS OF TRADE NEGOTIATIONS

Over the years, SIA and the United States Government have devoted a great deal of energy to one of the problems mentioned above—namely, opening the Japanese market and combatting dumping. Market access has been a priority for several reasons. Japan is now the world's largest semiconductor market. In 1990, Japanese

semiconductor consumption was $19.6 billion, as compared to $14.5 billion in the United States and $9.6 billion in Europe. High technology industries must recover large investments in R&D and plant and equipment over a short product life cycle. If U.S. firms do not have access to foreign markets, they will not generate the funds they need to invest in the next generation of semiconductors. Semiconductor costs traditionally follow a "learning curve"—where cost reductions of approximately 30 percent are achieved for every doubling of cumulative output. For that reason, the continued cost competitiveness of the U.S. industry depends on access to the Japanese market. Finally, a closed home market gives foreign firms a sanctuary, which reduces the uncertainty associated with investment in new capacity. This, in turn, has often triggered over-capacity and below sales.

The issue of semiconductor market access has been on the U.S.-Japan trade agenda for at least 20 years. In the early 1970's, Japan agreed to eliminate its formal barriers, but simultaneously adopted "counter-liberation measures," which kept U.S. market share below 10 percent. In 1983, the U.S. and Japan concluded a High Technology Working Group Agreement, which also had no effect on U.S. market access. In 1986, the U.S.-Japan Semiconductor Trade Agreement was signed, which has had a significant effect, particularly after President Reagan imposed sanctions against Japan for non-compliance.

THE NEW SEMICONDUCTOR AGREEMENT

By early 1990, however, it was clear to SIA that the objectives of the 1986 U.S.-Japan Semiconductor Agreement would not be met by July 31, 1991, which was when the agreement was scheduled to expire. Although foreign market share had reached 13.1 percent by the first quarter of 1990, this was far below the 20 percent objective established by the agreement. It was also clear, however, that the agreement had produced some results. MITI was encouraging Japanese companies to purchase competitive foreign semiconductors. Furthermore, the U.S. and Japanese industries had formed a series of task forces to increase access in sectors such as HDTV, telecommunications, automotive and consumer electronics.

In March 1990, the CEOs of major American semiconductor and computer companies met to develop a common position on U.S.-Japan semiconductor trade policy. In October 3, 1990, the Computer Systems Policy Project (CSPP) and the Semiconductor Industry Association submitted their joint recommendation for a new semiconductor agreement to President Bush. SIA and CSPP had two objectives: to continue the progress that had been made in expanding access to the Japanese market; and to develop a less intrusive mechanism for deterring injurious dumping of semiconductors.

This consensus formed the basis of the U.S. negotiating position, and, after many rounds of tough negotiations, the final agreement. In the 1991 agreement, Japan reaffirmed its commitment to provide full access to its semiconductor market. Both governments agreed that foreign market share should reach at least 20 percent by the end of 1992. Long-term relationships and "design-ins" of foreign chips into Japanese electronics products will also be viewed as evidence of market-opening. Regular consultations will be held to review progress made under the agreement.

With respect to dumping, the goal of the agreement was to deter future dumping of semiconductors while minimizing the level of government intervention in the market-place. Under the new agreement, the Commerce Department will stop collecting cost and price data and issuing "foreign market values" for DRAMs and EPROMs. Instead, Japanese firms are now required to collect the data that would be necessary in a dumping investigation and to provide that data within 14 days of a U.S. request. This has the potential to cut several months from a dumping case, which is critical given the short product life cycles in the industry. There are also procedures in place in the event of dumping in third-countries.

LESSONS LEARNED

SIA and its member companies have learned a great deal about U.S.-Japan trade relations as a result of our continued efforts to gain access to the Japanese market and to combat unfair trade practices such as dumping. Some of these "lessons" are important for industry, some for the United States Government:

1. Demonstrate the ability and willingness to serve the Japanese Market

The U.S. semiconductor industry is committed to serving the Japanese market, and we have invested heavily in our ability to expand our sales in Japan. From 1986 to 1989, total personnel expenditures in Japan were up 31.7 percent, U.S. capital expenditures increased 169 percent, and total sales expenses increased 85.6 percent.

Since the 1986 Agreement was signed, U.S. companies have opened up 56 new sales offices, design centers and test/quality centers, or one every month.

2. Establish a unified industry position

The fact that the consumers and producers of semiconductors were able to agree on a semiconductor trade policy was extremely important. The majority of the SIA-CSPP recommendations were accepted by the Administration, and the alliance between CSPP and SIA enabled the U.S. Government to negotiate from a position of strength. It also eliminated the need for our government to adjudicate a complicated and potentially divisive trade issue between consumers and producers of semiconductors.

3. Once a trade agreement has been reached, industry-to-industry working groups must be formed and focused on success

SIA and its Japanese counterparts such as the Electronics Industry Association of Japan, have formed a number of industry task forces in sectors such as consumer electronics, telecommunications, high-definition systems, and automotive electronics. These working groups have been instrumental in:

- Promoting long-term relationships between U.S. chip producers and Japanese chip consumers;
- Increasing the design-in of foreign products; and
- Broadening the base of users and suppliers engaged in the market access efforts.

These initiatives have produced "success stories," both at the industry-wide and company level, that would not have occurred in their absence. Japanese companies have a better understanding of U.S. capabilities, and U.S. firms are more aware of Japanese needs. As a result, U.S. chips are being "designed-in" to Japanese electronics products. This is necessary to gain access to the higher value-added segment of the market, and to build long-term relationships. For example, Sanyo and LSI Logic are working together to develop chips for high-definition televisions, Analog Devices has developed "surround-sound" semiconductors for Japanese audio equipment, and TI chips are at the heart of Sony's CD players.

4. Remember that the goal is expanded trade, not the signing of endless agreements—results must be measured

Between 1979 and 1989, the United States and Japan have entered into fifteen trade agreements in the electronics sector alone. Despite these trade agreements, our electronics trade deficit with Japan has grown in the last decade, from $4 billion to over $18 billion.

As I noted before, the United States has been trying to open up the Japanese semiconductor market since the early 1970's, when the Nixon Administration threatened to take Japan to the GATT for maintaining import licenses for semiconductors. Because these previous agreements had failed to achieve meaningful results, the Reagan Administration decided to set a goal for the 1986 Semiconductor Trade Agreement. Both governments agreed that if the Japanese semiconductor market were truly open, foreign share would reach at least 20 percent. Setting some target or indicator of progress is essential to achieving tangible results.

5. Enforce agreements, with sanctions if necessary

According to a study by the State Department's Foreign Service Institute, Americans "see the negotiated solution as final and implementation flowing naturally therefrom," while Japanese "see the negotiated solution as one more stage and implementation as a subject for further negotiations."

SIA's experience tends to confirm this thesis. It was not until President Reagan imposed sanctions against Japan in April 1987 that Japanese government and industry officials took the semiconductor agreement seriously. In late 1987, a representative of one of the largest Japanese electronics firms told the late Robert Noyce, then of Intel, that it was too soon to expect results from the agreement, since it was only six months old. Noyce responded: "The *sanctions* are six months old, the *agreement* is a year old!" Sanctions should always be viewed as a last resort, after all other alternatives have been exhausted, but they must be employed if compliance is not forthcoming.

6. Respond to dumping quickly

Japanese companies have historically used dumping as a strategic trade tool for controlling market after market. As I noted above, between 1985-86, Japanese dumping drove six out of eight U.S. DBAM producers out of the market. Re-entry

into this important segment has proven to be very difficult. We remained in the EPROM business because dumping was halted in time. This episode dramatically illustrates the need to respond rapidly to dumping, especially for high-tech short life-cycle products.

WHAT CAN CONGRESS DO?

There are a number of steps that Congress could take which would enhance the prospects for implementation of the agreement and improve the competitiveness of the U.S. semiconductor industry:

1. Continue congressional oversight of progress under the agreement

If the Japanese government and industry are convinced that implementation of the new semiconductor agreement is a Congressional priority, it is a lot more likely to occur. Members of Congress should tell Japanese government officials that this agreement has the potential to be a success story in U.S.-Japan trade relations, but only if the objectives of the agreement are met. Also, Congress should ensure that Commerce and USTR have the resources to adequately enforce the market access and antidumping provisions of the agreement.

2. Pass the trade agreements compliance act

This legislation would enable industries to request annual reviews of compliance with bilateral trade agreements. This would put our trading partners on notice that the United States will put as much energy into enforcing agreements as it does in signing them. The Congress should enact this legislation before we negotiate another trade agreement.

3. Work with the industry to develop a comprehensive strategy for success in microelectronics

Trade policy towards Japan is only a piece of an overall strategy to ensure America's technological preeminence. Other elements are: 3-year depreciation for semiconductor manufacturing equipment; a more coherent and industry-driven technology policy; elimination of European Community semiconductor and computer parts tariffs; and U.S. re-entry into high-volume electronics markets.

Mr. Chairman, members of the Committee, that concludes my testimony. Thank you again for giving SIA the opportunity to testify. I would be happy to answer any questions you may have.

Four Years of Experience

Under the U.S.-Japan Semiconductor Agreement:

"A Deal is a Deal"

Summary

Fourth Annual Report

to the President

SIA SEMICONDUCTOR INDUSTRY ASSOCIATION

November 1990

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EXECUTIVE SUMMARY

FOUR YEARS OF EXPERIENCE UNDER THE U.S.-JAPAN SEMICONDUCTOR TRADE AGREEMENT

With less than a year until the scheduled expiration of the Semiconductor Trade Agreement, substantial progress is at last being made toward opening Japan's market and ending dumping. Still, given Japan's failure to fully comply to its commitments under the Agreement, the SIA and the Computer System Policy Project have joined in recommending adoption of a new five-year agreement to bring about the opening of Japan's market and ensure a prompt, effective dumping remedy. This second five-year agreement is needed to continue the transition to an open market in Japan and lessen the likelihood of dumping.

Origin of the Agreement

In the mid-1980s, despite fourteen years of market opening agreements, Japan's semiconductor market remained essentially closed. In 1986, the U.S. industry accounted for 66 percent of sales outside of Japan, but only 8.5 percent in Japan. Targeting, subsidies, cartel-like behavior, counter-liberalization and administrative guidance all served to keep foreign semiconductors out of Japan.

After earlier rounds of dumping and unsuccessful agreements, massive Japanese semiconductor dumping returned in the mid-1980s. In one well-documented case, U.S. distributors for a Japanese company were told to sell at any price, profits guaranteed. During this period, six out of eight U.S. manufacturers of Dynamic Random Access Memory chips (DRAM) were driven from the market. U.S. Erasable Programmable Read-Only Memory (EPROM) producers lost hundreds of millions of dollars and were driven to the brink of collapse. The Commerce Department found that Japanese semiconductor firms dumping by margins of up to 188 percent. Japanese firms lost $4 billion, but now control the critical DRAM market.

Japan and the United States agreed to the Semiconductor Agreement in order to avoid the need for trade sanctions and other penalties arising from the dumping of EPROMs and DRAMs. In return, Japan committed to stop dumping and to open its market to foreign semiconductors.

Market Access

In 1989 and 1990, market opening efforts in Japan finally began to produce results. Foreign market share is now approximately 13.3 percent, up from 8.6 percent when the Agreement was signed. The U.S. and Japanese industries are now making significant increased efforts to improve market access.

U.S. Producers' Efforts: For years, U.S. producers had sought unsuccessfully to increase sales in Japan. The clear commitments contained in the Agreement permitted U.S. firms to renew their efforts and make necessary investments. The results have been dramatic:

- 56 U.S. sales offices, design centers, test/quality centers and product failure analysis centers have opened in Japan since the signing of the Agreement;
- for the past 2 1/2 years, U.S. firms won an average of one quality award each month in Japan; and
- Expenditures for U.S. semiconductor personnel in Japan have risen 32 percent, capital expenditures are up 169 percent, and sales expenses have increased 86 percent.

Japanese Distributors' Efforts: In November, 1988, foreign semiconductor importers in Japan formed the Distributors Association of Foreign Semiconductors (DAFS). The group facilitates sales of foreign semiconductors to smaller, Japanese users from smaller foreign suppliers.

Japanese Producers'/Consumers' Efforts: For the first few years of the Agreement, progress was limited to the larger Japanese companies that both produce and consume semiconductors. After the imposition of trade measures by President Reagan in 1987 and continued U.S. efforts to improve access, other Japanese users began to seriously address foreign semiconductor market access. With the formation of the Electronic Industries Association of Japan Users Committee of Foreign Semiconductors (known as EIAJ UCOM) in 1988, 60 Japanese companies undertook concerted efforts to purchase competitive foreign semiconductors. A key component of the post-1988 success has been adoption of Market Access Plans (MAPs). In addition, late in 1988 the Japan Automotive Parts Industry Association began to explore its role in increasing foreign semiconductor purchases.

This success is clearly traceable to three factors in the Agreement:

An Explicit, Enforceable Measure of Success: Japan and the United States formally agreed that real market access was to be provided. Previous market access agreements failed because they lacked a clear measure of progress. In 1986, the U.S. and Japanese Governments agreed that if Japan effectively implemented its market access commitments foreign share in Japan would increase to at least 20 percent.

Strong Support: The Administration and Congress have provided strong bipartisan support for insisting that Japan abide by the Agreement and open its market.

A Willingness To Take Action: Faced with Japan's noncompliance, President Reagan imposed sanctions in 1987, declaring that they would remain until there is "firm and continuing evidence . . . that access to the Japanese market has improved. . . ."

By July, 1991, these efforts will have produced mixed results. There will have been progress, but also a shortfall in expected performance. It is anticipated that in the final year of the agreement U.S. sales on an annual basis will be $1.16 billion higher than they would have been absent the Agreement. Increased sales will add about $137 million

annually in new **R&D**, $130 million in **capital investment**, almost 5,500 direct semiconductor **jobs**, and over $80 million in **tax revenue**.

Full compliance, would have resulted in an additional $1.16 billion in annual sales and double the above amounts in R&D, capital investment, jobs and tax revenue. However, because of the shortfall in expected performance, only half of what was agreed to has been delivered.

Antidumping

With dumping in check, U.S. DRAM share has stabilized and there has been substantial new investment by Motorola, Texas Instruments and Micron Technology. New suppliers have been attracted to the EPROM market, and the United States has regained its EPROM world market leadership.

Concern have been expressed that the Agreement contributed to rapid increases in the prices of some semiconductors in the 1987-89 period. This assertion is not supported by the facts:

- Japanese firms were selling at prices well above Foreign Market Values (FMVs) -- prices well in excess of those required to avoid dumping accusations.
- Japanese Government production controls were instituted in violation of the Agreement and ended only at the insistence of the U.S. Government.
- The rise in DRAM prices (a market effectively controlled by Japan) was not paralleled in EPROMs, a product also subject to FMVs, because competitive U.S. EPROM suppliers remained to serve the market.

Unfortunately, the conditions for potential Japanese dumping remain: Japan's market is still restricted; anticompetitive activities continue, and excess investment is a continuing likelihood.

Recommendations

While the Agreement is beginning to bear fruit, there is a need to further open Japan's market and provide a prompt effective remedy against any renewed dumping. Thus, U.S. semiconductor manufacturers and consumers, assuming that progress under the original Agreement will continue, make the following recommendations:

- The United States and Japan should negotiate a new 5-year agreement addressing market access and dumping.
- Market access should be measured by quantifiable indicators of progress. The Government of Japan's commitment to at least a 20 percent foreign market share by July, 1991 (a benchmark of minimum acceptable progress) should be replaced

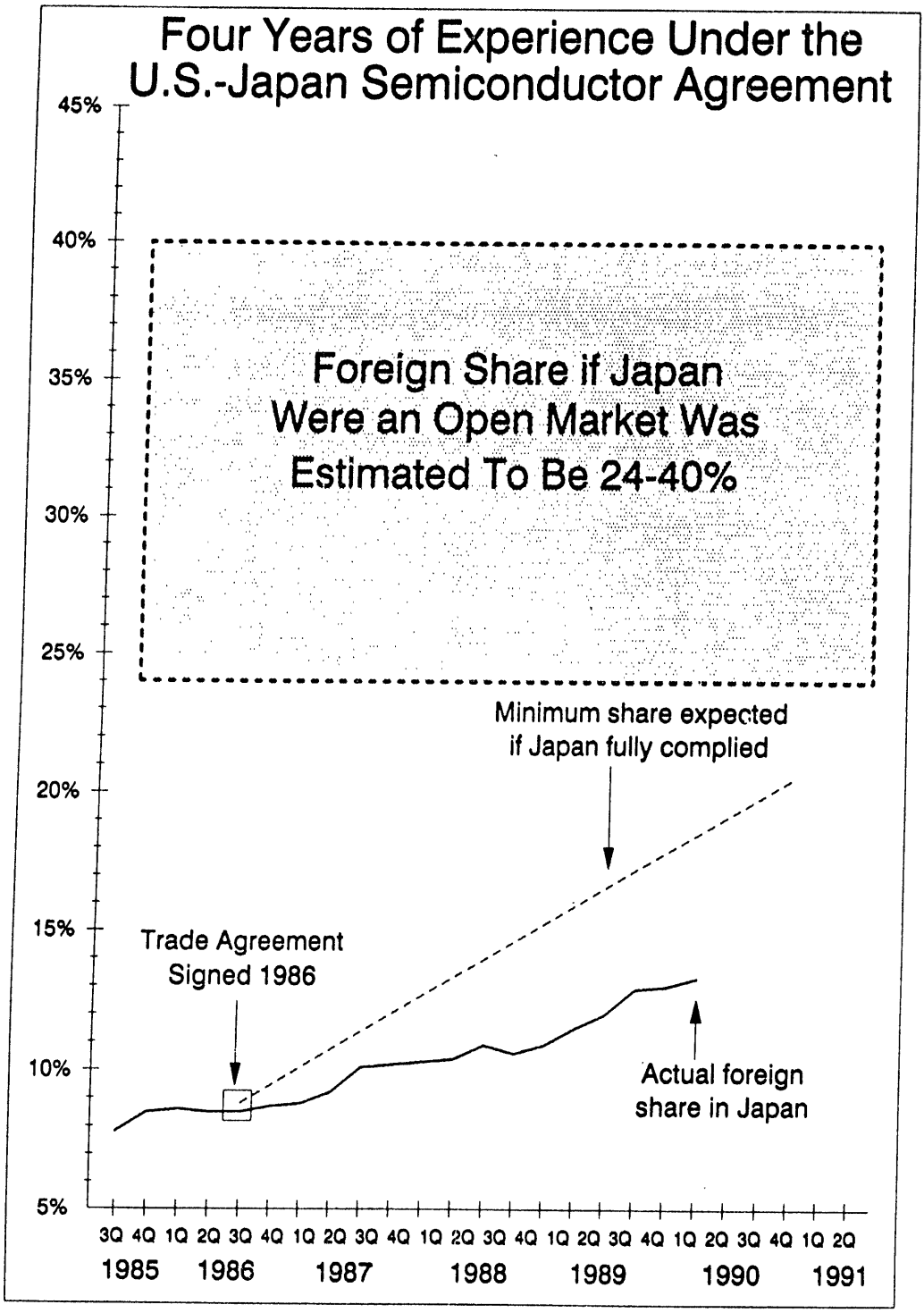
with a commitment that this level of access will be achieved by the end of 1992. An assessment should then be made to determine whether additional quantitative targets need to be set to continue momentum toward an open market.

- In light of the success of the Agreement in stopping widespread dumping of semiconductors, the antidumping measures should be revised in favor of mechanisms that lessen the degree of governmental involvement, eliminating the current FMV system.

- The U.S. Department of Commerce should no longer collect cost or price data or issue FMVs for DRAMs or EPROMs. A modified version of the EPROM suspension agreement should remain in place.

- The U.S. Department of Commerce should maintain an effective "fast track" response for investigations of semiconductor dumping.

The U.S. Government is urged to open negotiations with the Government of Japan to obtain a new trade agreement along the lines outlined in the unified industry position. The purpose is not to indefinitely extend governmental involvement but to achieve in the next five years the market-oriented objectives not fully met under the current Agreement.


Four Years of Experience Under the U.S.-Japan Semiconductor Agreement
45%
40%
35%
30%
25%
20%
15%
10%
5%
Foreign Share if Japan Were an Open Market Was Estimated To Be 24-40%
Minimum share expected if Japan fully complied
Trade Agreement Signed 1986
Actual foreign share in Japan
3Q 4Q 1Q 2Q 3Q 4Q 1Q 2Q 3Q 4Q 1Q 2Q 3Q 4Q 1Q 2Q 3Q 4Q 1Q 2Q 3Q 4Q 1Q 2Q
1985 1986 1987 1988 1989 1990 1991

U.S. - JAPAN SEMICONDUCTOR TRADE AGREEMENT

"A Deal Is A Deal"

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On July 31, 1986, the U.S. and Japanese Governments reached an agreement addressing foreign access to Japan's semiconductor market and the prevention of dumping in the U.S. and third-country markets by Japanese producers. The SIA has provided annual reports to the President describing accomplishments resulting from the Agreement as well as the commitments which had yet to be fulfilled. This, the Fourth Annual Report, is of particular importance since the Agreement, by its terms, is scheduled to expire July 31, 1991.

I. MARKET ACCESS: LAUNCHED ON THE PATH TO SUCCESS ... AT LAST!

In the 1989 Report to the President, SIA stated that "were this the first annual report on the Agreement, rather than the third, it would consist solely of a record of positive efforts. In September 1989, this record must be judged inadequate." Today, one year later and with less than one year remaining under the Agreement, this statement is still true.

Prior to 1986, free access to Japan's market was barred by the Japanese Government and industry. During the first years of the Agreement, progress was impeded by the Japanese Government's and industry's failure to make the efforts called for in the Agreement. There ensued half-hearted efforts to increase market access that were sufficient to deflect American desires for full market access. Foreign producers were still being denied participation in the Japanese market commensurate with their proven competitiveness. In 1987, the U.S. Government imposed sanctions due to a continual shortfall in Japan's performance. Thereafter, the Japanese Government and industry begin to make widespread and active efforts to comply with the Agreement. In 1988, the Electronics Industry Association of Japan (EIAJ) formed the EIAJ Users Committee of Foreign Semiconductors (EIAJ UCOM), and many smaller and medium sized Japanese users began to make significant efforts to increase their foreign procurement.

Today, the adversary is time. When the Agreement was signed in 1986, the U.S. expectation, confirmed by the Government of Japan, was that there would be five years of aggressive efforts which would lead to substantially increased market access. The agreed objective indicator that sufficient efforts were being made was that foreign market share in Japan would rise to at least 20 percent. Of course, this could not be accomplished without major efforts of both foreign sellers and Japanese companies. But a conscious effort was made, in light of a decade and a half of experience with unsuccessful market opening agreements, to avoid relying on commitments related solely to process.

However, Japan made very limited efforts for over two years. Only in the past two years has Japan put in place an aggressive market access program. Consequently, current trend lines are heading toward a 14-15 percent foreign share by the end of the Agreement, rather than the 20 percent anticipated in 1986. In short, while current efforts are praiseworthy, there is a substantial shortfall in Japanese performance under the Agreement.

A. A Significant Increase in Foreign Market Share Has Been Achieved

Conclusions concerning the relative success of the Agreement depend on whether one focuses on the progress made under the Agreement -- which has been substantial, amounting in the most recent year to $700 million in foreign sales that would not otherwise have occurred -- or whether one focuses on the shortfall in performance -- which has cost foreign producers $1.5 billion in sales in the last four years.

Since 1986, foreign market share in Japan has increased 4.7 percentage points under the Agreement, and of this amount, U.S. share has increased 3.9 points. Were the Agreement being fully implemented, however, foreign share would have increased almost 10 percentage points.

The gain in share, coupled with the growth of the market, has meant that U.S. sales in Japan have increased 150 percent in dollar terms since the signing of the Agreement. U.S. sales in Japan were $2.1 billion in 1989 compared to $875 million in 1986. While this increase is impressive, it should not obscure the fact that Japan committed to efforts which would have lead to substantially more sales than have actually been achieved, and truly open market access would have resulted in even greater foreign market penetration.

B. The Agreement Has Catalyzed Industry-Level Access Activities

Since 1988, the SIA and the EIAJ UCOM have had numerous discussions leading to a number of joint activities and initiatives at the industry level. These include:

1) increasing Japanese purchases of existing foreign products;
2) broadening the base of Japanese users and foreign suppliers engaged in the market access effort;
3) accelerating foreign participation in the consumer, HDTV, telecommunications, and automotive sectors;
4) increasing the design-in of foreign products; and
5) promoting long-term relationships between foreign producers and Japanese users.

In November 1988, Japan's semiconductor importers formed the Distributors Association of Foreign Semiconductors (DAFS), catalyzing distributors to assure the participation of smaller Japanese users and smaller foreign suppliers (who often do not have offices in Japan and must rely on distributors). That same month, the Japan Automotive Parts Industries Association (JAPIA) began to explore the role it might play in increasing market access.

By the end of 1988 the Agreement was successful in forging three crucial links at the industry level to work for market liberalization: the suppliers are represented by the SIA Japan Chapter (SIAJ), the distributors by DAFS, and the customers by EIAJ UCOM and JAPIA. These organizations offer significant leverage for industry-level activities to improve the functioning of the Japanese market. More recently, the Communications

Industries Association of Japan has agreed to support efforts to increase foreign participation in Japan's telecommunications chip market.

Among the specific activities pursued at the industry level have been the following:

- The SIA Board of Directors has held one of its quarterly meetings in Tokyo every year since the Agreement, underscoring commitment to the Japanese market.
- Eight U.S. firms participated in an executive-level Trade Mission in 1989 sponsored by the U.S. Commerce Department.
- In 1989, EIAJ/JAPIA held a purchasing mission in the United States. SIA encouraged over 50 U.S. suppliers to participate, and the associations organized over 250 individual meetings between U.S. suppliers and more than 30 Japanese users.
- The SIA, with support from the U.S. Department of Commerce, opened an office in Tokyo in 1988 to facilitate interaction between SIAJ and EIAJ semiconductor users, as well as with other organizations in Japan.

The Agreement has spawned sector specific initiatives at the industry-to-industry level in the consumer, HDTV, automotive and telecommunications areas. These initiatives include:

Consumer: In 1990, the EIAJ/SIA Consumer Electronics Task Force made a series of recommendations to increase foreign access to Japan's consumer electronics sector. As this effort coincides with a trend towards use in consumer electronics of digital technology, an area of U.S. strength, many U.S. suppliers have a unique opportunity to supply the Japanese consumer market.

HDTV: In 1989, the EIAJ and SIA formed a joint HDTV Semiconductor Cooperation Committee in Japan, which is supported by an HDTV Technical Team in the United States, to ensure that foreign semiconductors are designed in at the earliest stage of HDTV development. The Committee has held two seminars in which Japanese HDTV makers and U.S. semiconductor suppliers described their needs and capabilities.

Automotive: In the automotive sector, U.S. firms are major participants outside Japan, but had been held to less than a three percent share in Japan. Activities in this area included a Roundtable discussion in 1989 to exchange opinions on how foreign share might be improved and provision of parts lists to foreign suppliers by JAPIA. In 1990, SIA and EIAJ/JAPIA agreed to further expand their joint activities to increase foreign sales to the automotive sector.

Telecommunications: In June 1990, SIA and EIAJ agreed that semiconductor market access in the telecommunications area requires improvement. The two associations will hold seminars in telecommunication semiconductors. The Communications Industries Association of Japan will cooperate in these seminars, as will, when the occasion warrants, Nippon Telephone and Telegraph (NT&T).

C. U.S. Companies Have Aggressively Pursued the Opportunities Provided in the Japanese Market

American semiconductor suppliers have made aggressive and continual efforts to sell in the Japanese market. Since the Agreement was signed, U.S. suppliers have added 56 new sales offices, design centers, test/quality centers and failure analysis centers in Japan, an average of one facility every month. Not included in this tally are the significant floor space expansions which have occurred at many preexisting locations. Today, U.S. firms employ 64 percent more technical personnel in Japan than a year ago. In 1989, total U.S. personnel expenditures in Japan were 32 percent higher than in 1986; capital expenditures increased 169 percent, and sales expenses increased 86 percent.

In the past two and one-half years, U.S. suppliers have won an average of one quality award each month from their Japanese customers.

The numbers alone do not tell the entire story of the extraordinary efforts which U.S. companies have made in Japan. There are numerous examples of the creative initiatives which demonstrate the high degree of commitment the U.S. industry has made to serve the Japanese market. Recognizing that Japan agreed to increase foreign participation in Japan, not just U.S. participation, it is also worth noting the progress that has been made by European, Korean and Taiwanese semiconductor suppliers.

D. Japanese User and Supplier Efforts to Increase Foreign Purchases Have Accelerated Markedly Under the Agreement

In the first several years of the Agreement, market access efforts were largely limited to the ten major Japanese companies which both consume and produce semiconductors. The imposition of trade measures by the U.S. Government in 1987 brought about the realization in Japan that more needed to be done if trade tensions were to be reduced. In 1988, the Chairman of EIAJ Users Committee noted that "... Japanese users became increasingly aware of the importance of tackling the problem of [market access], not as one to be addressed only by the top 5 or top 10 users, but as one to be resolved by Japanese users at large."

One of the major developments during the past two years has been the development of market access plans (MAPs) by Japanese users. The MAPs institute a number of pro-active actions to increase foreign semiconductor purchases. Among the many MAP actions are: forming company Import Promotion Committees to implement market access programs across all divisions; compiling lists of foreign semiconductors for potential purchase; setting target objectives for share of foreign semiconductors as an internal goal comparable to internal quality objectives, and streamlining the processes for qualifying foreign products. Over time, an increasing number of Japanese user firms have reported that they have adopted these actions.

E. American Producers Have Achieved Successes Which Would Not Have Occurred Without the Agreement

Initially, U.S. producers had difficulty reaching Japanese semiconductor users directly as the large Japanese producers -- often simply different divisions of the same company -- controlled access to the users. Under the Agreement, American suppliers have more recently had opportunities to present their capabilities directly to Japanese users, and Japanese users are finding, often to their surprise, that American companies offer very competitive products. Among the many success stories are:

- Advanced Micro Devices' 40 design-ins for its Am29000 32-bit RISC microprocessor;
- Intel's one million unit shipment of 16-bit microcontrollers to Sanyo for uses such as air conditioning systems;
- Texas Instruments' advanced digital signal processor (DSP) which is at the heart of Sony's critically acclaimed CD players;
- LSI Logic's ASIC chip designed into Matsushita's camcorder and Oki's transmission equipment;
- Toyota Motors' decision to develop 23 custom ICs with U.S. suppliers;
- Nissan Motors' purchase of engine control custom ICs from Motorola; and
- Plans at Sony and Matsushita, firms where consumer electronics' needs represent over half of total chip demand, to increase foreign purchases to 20 percent.

F. Recipe for Success

The U.S.-Japan Semiconductor Agreement has the potential to be a model for a successful U.S. Government role in achieving trade liberalization in traditionally closed markets. The U.S. Government's involvement included three key factors which have finally placed the U.S. industry on a trajectory to successful market access in Japan: a clear, enforceable measure of success, strong support, and a willingness to impose trade measures.

An Explicit, Enforceable Measure of Success: Despite a succession of market-opening commitments by Japan, foreign share in Japan had long been well below the level that would have been attained had normal market forces governed semiconductor purchases. Based on U.S. market share in the rest of the world and other factors, Ambassador Hills, for example, has noted that foreign share would have been much higher if the Japanese market had been truly open. Ambassador Hills concluded: "I don't think 20% is good enough. I think it should be double or triple that." Conservatively estimated, in 1986 foreign share would have been between 24 percent and 40 percent had the Japanese market been open. In fact, in 1986, foreign share was only 8.6 percent in Japan (compared to a 66% U.S. share outside of Japan). With the failure of previous agreements clearly in mind, the U.S. Government sought to bring market forces to bear in Japan, and negotiated a "20

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percent" foreign share level as a benchmark which both sides agreed would indicate that the efforts contemplated under the Agreement had been successfully performed. See Figure 1.

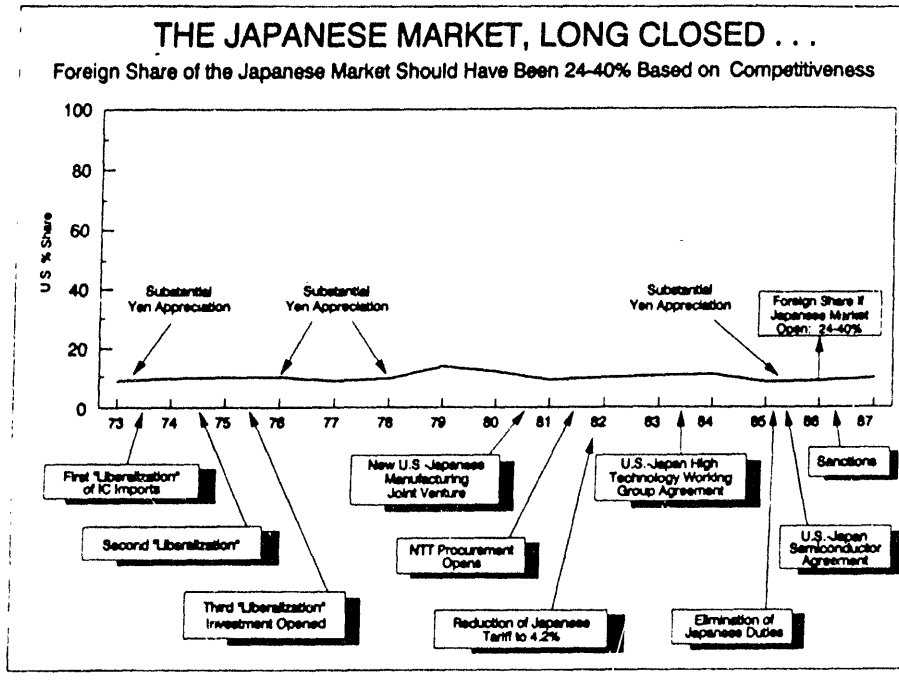


Figure 1

Strong Support: The Administration has insisted on numerous occasions that Japan abide by its commitment under the Trade Agreement and imposed sanctions in 1987 in response to Japan's failures to comply with the Agreement. Congress has provided strong bipartisan support for the Agreement, including the unanimous passage of Senate and House resolutions in 1987 and again in 1989 urging the Executive Branch to take action to enforce the Agreement.

A Willingness To Take Action: The Administration has been willing to act to achieve full compliance by Japan with its market-opening commitments. It was not until after the imposition of sanctions by the U.S. Government in 1987 that a consensus began to build in Japan that access beyond the major vertically integrated electronics companies was required if trade tensions were to be reduced. The continuation of the sanctions has made it clear that President Reagan's declaration that the sanctions would remain until there is "firm and continuing evidence . . . that access to the Japanese market has improved" was more than mere rhetoric.

The "20 percent" minimum figure has been widely misinterpreted. It was agreed that the 20 percent figure would be an indicator of Japan's compliance with its promise to open the market, a milestone towards the objective of a foreign share based on the competitive merit of the product. Then Secretary of State George Shultz, rejecting agreements based primarily on commitments to process, put it succinctly: "We want to hear the cash registers ring." The Agreement envisioned that once a 20 percent level had been achieved, foreign share would continue to rise to a level more closely reflecting the competitive merit of foreign products and government involvement could lessen. Given Japan's previous performance with market opening agreements, it is clear that the significant increase in foreign market share achieved under the Agreement would not have been possible without the "20 percent expectation" reflected in the "side letter" portion of the Agreement. See Figure 2.

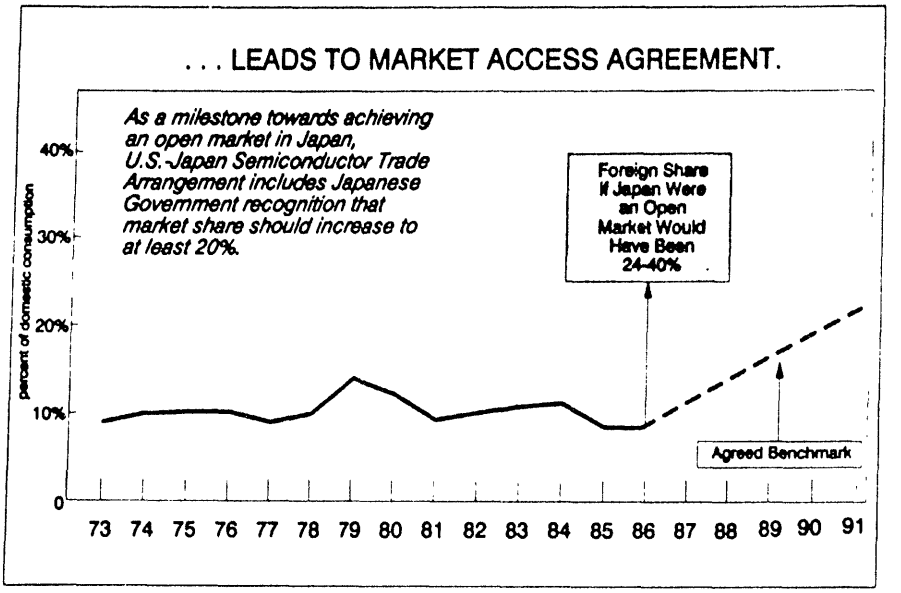


Figure 2

While it is important to recognize that the 20 percent figure is a milestone intended to ensure that market forces are allowed to operate in Japan, it is equally important to understand what the share objective is not. Critics of the Agreement have described the 20 percent figure as a "guaranteed share" in the hopes that such a characterization will erode support among free trade idealogues for Japan's fulfilling its commitments. The SIA has consistently maintained that the 20 percent figure is not a guaranteed share, and SIA

restates that position today. It is an objective indicator that the market access committed to has been achieved.

The Government of Japan's recognition of a "20 percent" expectation was necessary for three reasons.

First, the 20 percent level ensured that Japanese purchases would extend beyond commodity products to include the design-in of custom and semi-custom (ASIC) products into Japanese systems. This in turn allowed foreign suppliers to develop a close relationship of mutual interdependence with their Japanese customers.

Prior to 1986, foreign semiconductor suppliers often had to go through a Japanese semiconductor supplier division to get to its sister divisions which used semiconductors. The supplier division had every incentive to block access to the user divisions. By working closely and directly with user divisions' engineers in design-ins, foreign suppliers can now sell products directly based on their competitive merits rather than non-market factors.

Second, given the failure of past semiconductor market access agreements, including the 1983 U.S.-Japan High Technology Working Group's Recommendations on Semiconductors, something more than mere rhetoric was required to give foreign firms the confidence to make significant investments in sales support infrastructure in Japan. Despite previous trade agreements with Japan, and the competitiveness of the U.S. industry, U.S. market share in Japan had remained constant, at depressed levels. With this record of frustration, it was necessary to convince American firms that the 1986 Agreement was "real" and not another exercise in "illusory" openness. The recognition by the Japanese Government that the efforts undertaken pursuant to the Agreement would lead to a foreign share above 20 percent has been a major factor in giving U.S. producers the confidence to invest in Japan as they would in an open market.

The Japanese Government's recognition of a 20 percent benchmark for increased foreign share was also crucial to Japanese users. If a Japanese user was to design a future electronic system based on a foreign supplier's next generation part, the user had to know that the foreign supplier would also develop the sales/testing/design-center infrastructure to support the part in the future. Given that foreign share would be allowed to more than double, the user knew that the foreign supplier would invest to support its future products.

Third, the 20 percent share expectation assured that access efforts would include many segments of the Japanese market, not just the large vertically-integrated producer-user companies. Traditionally, foreign suppliers had experienced particular difficulty in penetrating the automotive and consumer markets, as well as some portions of the telecommunications equipment market. Fulfilling a 20 percent share expectation virtually required that all sectors be addressed. This breadth of market penetration is necessary if the U.S. and other foreign industries are ever to obtain the benefits of a truly open market.

G. Both the Additional Sales Due to the Agreement and the Shortfall are Important to the U.S. Industry and Economy

The Japanese Government did not exert sufficient efforts during the first two years of the Agreement (and in fact spent over a year publicly denying that a side letter between the two governments even existed). Then, in 1988, the EIAJ became a positive force in the access activities in 1988. Many of the Japanese companies now have aggressive market access plans but this has only been a very recent development.

U.S. Gains Over $1 Billion Annually from Agreement, but Japan's Breach Costs U.S. $1 Billion Annually . . .

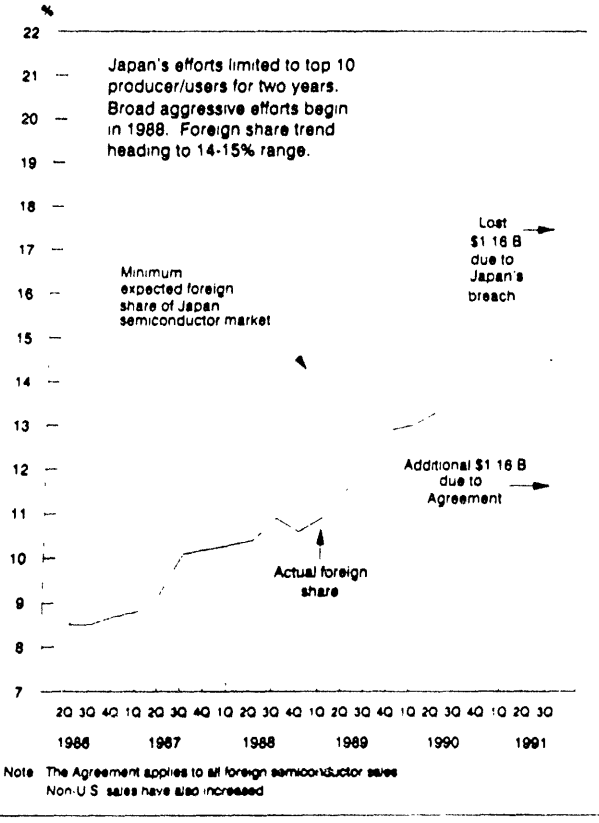


Figure 3

Thus, it is appropriate to cite the shortfall in foreign share from that expected under the Agreement as a failure by Japan to abide by its commitment under the Agreement, while recognizing that today Japan is making significant efforts to come into compliance.

If current trends continue, foreign share in Japan will be between 14 and 15 percent in July of 1991. For U.S. producers, this represents a gain under the Agreement of about 5.5 percentage points over the level which they had in 1986 (8.5 percent), but about 5.5 percentage points short of the gain which they would have if foreign share increased to above 20 percent in 1991. A 5.5 percent share of the projected $21.1 billion Japan market in 1991 is $1.16 billion. See Figure 3. As noted previously, in assessing the success of this Agreement, one can focus on the $1.16 billion in new annual sales that will be achieved due to the Agreement or the $1.16 billion shortfall due to Japan's failure to meet its obligations.

What does it mean to have gained, and lost, $1.16 billion in sales?

Research and Development: These new revenues allow expansion of research and development, the lifeblood of the semiconductor industry. The U.S. industry invests about 11.8 percent of sales on R&D. Thus, a $1.16 billion revenue gain will produce about $137 million in additional R&D by U.S.-based companies. Japan's failure to comply fully, however, will cost U.S. firms a further $137 million in R&D. See Figure 4.

Investment: For the past two years, U.S.-based companies have been investing in new plant and equipment at about 12 percent of sales. The $1.16 billion in new sales that will be achieved in 1991 under current projections is equivalent to about $130 million in additional capital investments. Again, the additional capital investment would total $260 million if Japan were abiding by its commitments.

These additional investments are critical to the continued growth and worldwide competitiveness of the U.S. semiconductor industry and to the U.S. semiconductor equipment industry. In short, reasonable access to the world's largest semiconductor market is essential to maintaining the competitiveness of the U.S. industry.

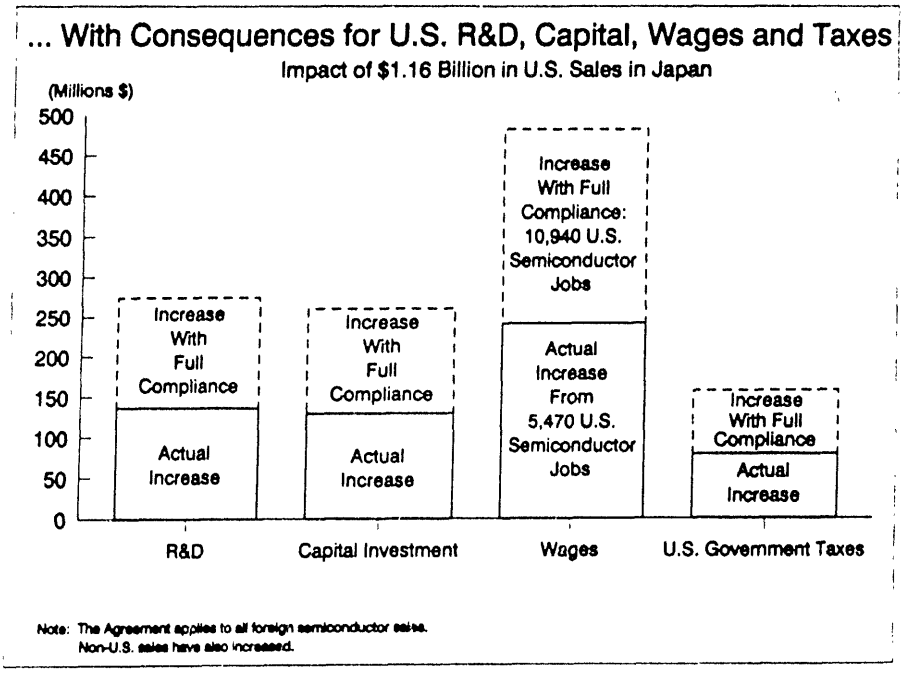


Figure 4

Jobs: A $1.16 billion sales gain in Japan represents close to an additional 5,500 semiconductor company jobs in the United States. Direct U.S. wages from $1.16 billion in Japanese

market sales are estimated to be $241 million. These figures would be more than double if Japan abided fully by its market opening commitments.

Tax Revenues: Excluding the additional tax revenues expected from corporate and personal taxes paid by U.S. semiconductor equipment and materials firms and their workers, and ignoring macroeconomic multiplier affects, an additional $1.16 billion of sales in Japan should lead to over $12 million in direct corporate tax revenues and over $67 million in personal income taxes from the wages paid to U.S. semiconductor workers. The full revenue benefits are, of course, much larger.

Another important potential benefit of fully opening Japan's market is prevention of dumping. After all, an imperfect market is a precondition of dumping, and Japanese semiconductor dumping has devastated U.S. memory chip producers. Thus, requiring Japan's market to function more like an open market will also encourage fair competition in the U.S. market.

Reaching the 20 percent market share milestone in Japan is thus extremely important from U.S. technology, capital formation, employment, and tax revenues as well as from the U.S. trade policy viewpoint.

H. Options

The current situation in Japan is improving. Substantively, neither side is calling for a change. Unfortunately, the Agreement is scheduled to expire by its terms in July, 1991. The Agreement is scheduled to expire because it is was considered a transitional measure -- to move Japan from a largely closed market to one sufficiently open that private endeavors would thereafter suffice. This, in fact, has not yet occurred. Thus, the two Governments must reach a new legal relationship.

Current U.S. policy is to press for full compliance with the terms of the Agreement. As foreign market share is very likely to fall well short of 20 percent, the United States faces a number of choices:

• Do Nothing: Allowing the government-to-government arrangement to lapse would almost certainly lead to a decline or, at best, stagnation of foreign participation in the Japanese semiconductor market, well short of what would occur were the market fully open. The ACTPN Task Force on U.S.-Japan trade policy and any number of experts on Japanese trade policy have concluded that without continuous foreign attention, significant changes in Japanese policy and behavior are unlikely. The experience of the semiconductor industry through 20 years of trade negotiations, several market opening agreements and the need to impose sanctions in 1987 confirm that conclusion.

> The momentum towards opening the Japanese market that has been built during the past two years will surely dissipate absent an Agreement. The do-nothing scenario can be compared to removing the forms from a foundation before the cement is allowed to cure -- a good deal of hard work and positive efforts will be wasted.

Were stagnation to persist for any extended period, it is likely that deterioration in U.S.-Japan relations would ensue, followed by further confrontation between the United States and Japan in this crucial product sector. Moreover, doing nothing in response to Japan's failure to abide by such an important trade agreement would result in a serious loss of credibility for U.S. trade policy. In addition, Congress would grant the Executive Branch less discretion in the formulation of trade policy.

Impose Additional Trade Measures: The United States could impose compensatory measures against Japanese exports to the United States equal to the dollar value of sales lost due to non-compliance with the Agreement. Alternatively, the United States could alter the "mix" of current sanctions so that tariffs were increased on the goods of those companies that had not made a good-faith effort to increase their purchases of foreign semiconductors. Either action could enhance the credibility of U.S. trade policy by sending America's trading partners a clear signal that the United States will enforce its rights under trade agreements. As Ambassador Hills stated last year, the U.S. Government "imposed sanctions in 1987 for non-compliance with the Agreement and is prepared to do so again, if warranted."

Japan's failure to comply fully with the Agreement's requirements was found by President Reagan in 1987 to be "unjustifiable and unreasonable and constitute a burden or restriction on U.S. commerce" within the meaning of Section 301. This finding was reaffirmed in November, 1987 when USTR lifted sanctions that had been imposed in response to Japan's failure to comply with its anti-dumping commitments, but retained market access sanctions, noting that "the access of foreign-based companies to Japan's semiconductor market has not improved, and remains unequal to that enjoyed by Japanese firms."

Today, Japan's performance has only improved to the level that it should have reached in 1988 and, even at recent trends, foreign share will be only in the 14 to 15 percent range in 1991. The magnitude of the shortfall in performance in terms of lost sales (and, thus, offsetting sanctions) is several hundred percent higher than it was in 1987.

Given recent progress, however, it would be very unfortunate for relations between U.S. semiconductor suppliers and Japanese users, and for U.S.-Japan relations generally, were it to become necessary for the U.S. Government to take additional enforcement action. Thus the SIA strongly prefers that the steps be taken to avoid sanctions becoming a necessity.

Sanctions can be avoided if the U.S. Government receives formal assurances that foreign access in Japan will continue to improve at the current rate towards (and hopefully beyond) the 20% milestone set as a threshold indicator of genuine progress toward an open market in Japan.

A Post-1991 Agreement: Underscoring the importance of improved semiconductor market access to the entire electronics industry, both U.S. semiconductor producers and consumers (the Computer Systems Policy Project) agree that Japan should continue its trade liberalization efforts to expand foreign share of its market to meet

the objectives of the current Agreement. In effect, the current rate of increase in market penetration would be preserved and the momentum maintained toward a more open market through a new agreement. Material recognition should be given to the failure to meet the agreed expectations of more than 20 percent by 1991. Thus, the new agreement would be for a full five years, with an objective indicator of the share of more than 20 percent expected in 1992 and measurable goals after 1992 as necessary to ensure continued progress. Sanctions should be considered if necessary to ensure that the Agreement achieves its objective of a truly open market in Japan where products are purchased on the basis of competitive merit. The SIA-CSPP recommendations are discussed further in Section III of this summary.

Any new agreement is only as good as our government's willingness to enforce its provisions. Thus, essential to the success of this option is the rapid passage of the Trade Agreements Compliance Act (TACA). TACA was introduced as HR 4661 by Representatives Matsui, Nancy Johnson, AuCoin, and Schulze and as S.2742 by Senators Baucus, Heinz, and Rockefeller. These bills, broadly supported by U.S. industry, would provide an oversight mechanism to monitor foreign adherence to trade agreements and can be summarized by five words: "A deal is a deal." In hearings on TACA before the Senate Finance Committee, Subcommittee on International Trade, Senator Baucus summarized the widespread sentiment in Congress, declaring that "before any other agreements are signed, this [bill] should become law."

I. Conclusion

The U.S.-Japan Semiconductor Agreement has fostered the interests of the United States and of US-Japan relations. It has been a major force for liberalization of the Japanese economy. Foreign market share in Japan's semiconductor market has increased about five percentage points, and long term relationships are beginning to be established which will allow foreign firms in the future to compete on the basis of the merit of their products and not on the basis of entrenched "inter of intra-family" relationships. Over the past five years, American firms have made monumental efforts to penetrate the Japanese market, and some key American devices are now at the heart of some high volume leading-edge Japanese consumer electronic products.

Had Japan made the aggressive efforts called for in the Agreement beginning in 1986, SIA could report today that the Japanese market was moving well toward full openness with foreign market share in Japan approaching the 20 percent level which the Government of Japan recognized as a reasonable minimum expected result of five years of mutual efforts. Unfortunately, Japan responded first with two years of limited efforts. As a result, the semiconductor sector today epitomizes many other sectors in Japan: the market is opening, but is still far from being fully open.

The market impediments which foreign semiconductor producers continue to face in Japan are similar to those which were identified throughout Japan's economy in the Structural Impediments Initiative report. In that report, the Japanese government pledged to take actions leading to "more efficient, open and competitive markets, to promote sustained

economic growth and to enhance the quality of life in both Japan and the United States." In the Semiconductor Agreement, the Japanese and U.S. governments seek to enhance "free trade in semiconductors on the basis of market principles and the competitive positions of their respective industries." Unfortunately, many of the structural barriers to semiconductor imports remain.

The U.S. semiconductor industry is united in reporting that the progress made to date would not have been possible without the U.S.-Japan Semiconductor Agreement's explicit recognition by the Government of Japan that it was reasonable to expect that mutual efforts would result in at least a 20 percent foreign share in Japan, and without the government and private unceasing efforts to obtain greater access pursuant to the Japanese commitment in the Agreement. Continued progress will require no less. Failure to maintain such efforts at this time will inevitably result in a loss of hard-won improvements in access. Thus, U.S. semiconductor producers and consumers agree that further access to Japan's market is a necessity and should be achieved through negotiation of a new five year agreement with clear, measurable goals, including a commitment to reach at least a 20 percent foreign share by the end of 1992.

II. PREVENTION OF SEMICONDUCTOR DUMPING

Largely sheltered from risk by their protected home market, Japanese producers engaged in capacity expansion races in the late 1970's and early 1980s that led to periodic export surges, culminating in massive Japanese dumping during the 1985-1986 period. These practices caused severe injury to the U.S. industry and drove Advanced Micro Devices, AT&T, Intel, Mostek, Motorola, and National Semiconductor out of the critical DRAM segment. Eprom producers lost hundreds of millions of dollars. Antidumping cases against Japanese EPROM and DRAM producers were brought in 1985; final decisions in the 64K DRAM and EPROM cases found margins of up to 188%. In 1986, all of the cases were resolved through the antidumping suspension agreements that accompanied the U.S.-Japan Semiconductor Trade Agreement. Since then, only one company, Motorola, has been able to reenter the high risk DRAM business.

While U.S. antidumping laws were unable to respond rapidly enough to prevent the DRAM debacle, the US-Japan Semiconductor Agreements has proven its value in checking the decline in U.S. DRAM market share and in sparking the resurgence of U.S. EPROM market share, although the results have not come easily. The Agreement has been successful in this regard because in addition to directly prohibiting and monitoring dumping, it formally recognized the close relationship between the problems of market access and dumping and the consequent need to address the underlying problem of a closed market as part of any long-term solution to dumping.

As the scheduled expiration of the suspension agreements and the Trade Agreement approaches, semiconductor producers are again faced with the prospect of inadequate safeguards against dumping. The experience of the industry for two decades, and the likelihood that dumping will continue to be a threat until a fully open market exists, clearly demonstrate the need for a continued prompt, effective response to semiconductor dumping.

A. Massive Japanese Dumping Caused Severe Injury to the U.S. Industry

In the early 1980s, the U.S. industry was weakened by a surge of Japanese dumping of memory devices. Concerned with the ability of the dumping law to respond promptly and adequately, the industry supported resolution of these problems in the High Tech Working Group. However, by 1985-86, the U.S. industry was again suffering from massive dumping by Japanese manufacturers. Analysis by the Department of Commerce found that Japanese firms were dumping by significant margins, pricing products with a fair value of $1 for as low as 40 cents.

As a result of the dumping, six of eight U.S. producers of DRAMs exited this critical market, probably one of the most rapid shake-outs of an established U.S. industry in history. No Japanese firms exited the DRAM market.

The damage was only slightly less severe in the case of EPROMs. While all of the major U.S. producers fought to remain in the market, they suffered enormous losses. Absent the Agreement, U.S. EPROM manufacturers eventually would have withdrawn from the market as the DRAM producers had been forced to do.

The rapid forced retreat of U.S. companies in these critical markets called into question the future of the entire U.S. electronics sector and our very national security. In 1987 the Defense Science Board concluded that:

> "the existence of a healthy U.S. semiconductor industry is critical to the national defense .... [Yet] the manufacturing capacity of the U.S. semiconductor industry is being lost to foreign competitors, principally Japan .... [with] serious implications for the nation's economy and immediate and predictable consequences for the Department of Defense."

The collapse of memory market prices led to the initiation of several antidumping investigations: an investigation of 64K DRAMs from Japan was initiated in July 1985, followed by investigations of EPROMs (initiated in October) and DRAMs of 256K and above (initiated in December). See Figure 5. The 64K DRAM investigation culminated in the issuance of an antidumping duty order. The EPROM and 256K and above DRAM investigations were suspended without imposition of duties as part of the overall settlement embodied in the Semiconductor Trade Agreement signed on September 2, 1986. (After suspension, the EPROM case did proceed to a final decision in which margins of up to 188 percent were found.) See Figure 6.

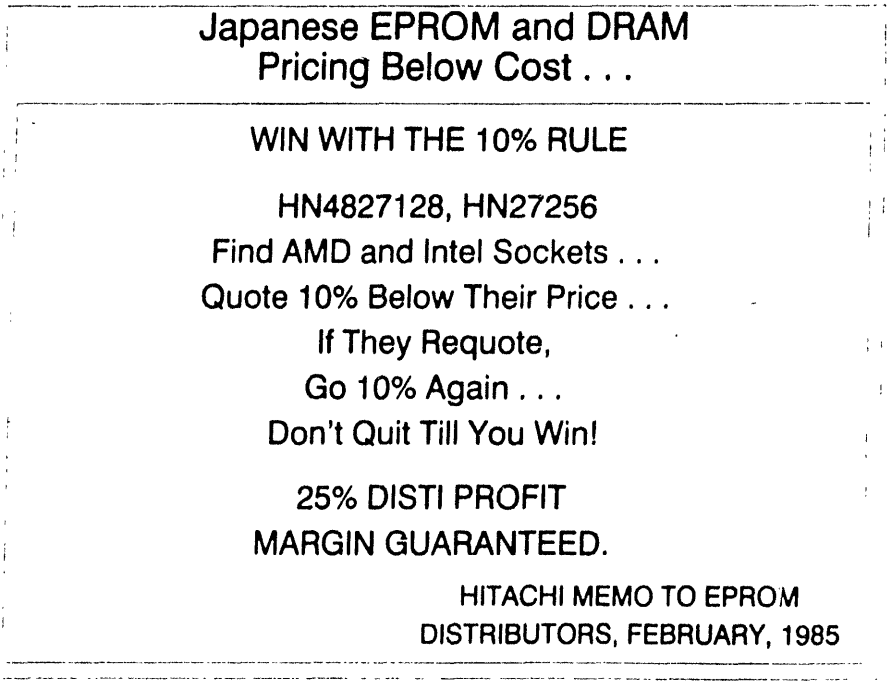
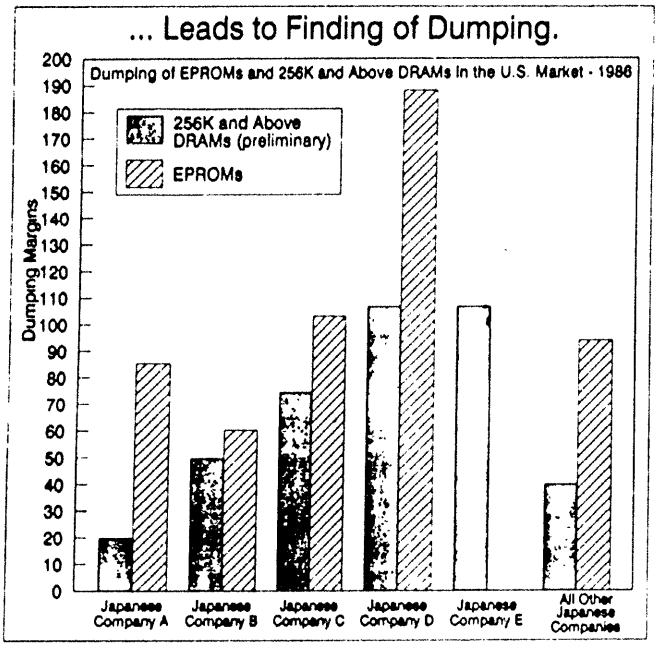


Figure 5

The separate DRAM and EPROM suspension agreements, signed by individual Japanese exporters, embodied commitments by these companies not to sell these products in the U.S. market at prices below their fair market value. Under these agreements, the U.S. Department of Commerce calculates Foreign Market Values (FMVs) based on each producer's costs to govern its U.S. sales of DRAMs and EPROMs.



In addition to the EPROM and DRAM suspension agreements, the Government of Japan made a commitment under the Agreement to monitor costs and export prices of Japanese semiconductor firms to prevent dumping in the U.S. and third-country markets. The initial list of other products to be monitored included MOS SRAMs, ECL RAMs, microprocessors, microcontrollers, ASICs, and ECL Logic. The monitoring mechanism allows a quick resolution of dumping allegations should they arise and has been effective in permitting the U.S. industry to recover from Japanese dumping.

Figure 6

B. Experience Under the Agreement

1986-1987: The Agreement's Market Oriented Solution is Ignored by the Government of Japan

Just as the Agreement's market access provisions were intended to inject market forces into Japanese purchasing behavior, the antidumping provisions of the Agreement and its companion suspension agreements were intended to bring market forces to bear in Japanese selling behavior. In normal competitive markets, success is determined by making products better, cheaper or with higher performance than a competitor. Dumping allowed success to be determined, not by who made cheaper products, but by who could afford to lose money for a longer period of time. Thus, Japanese dumping drove a number of U.S. producers -- who lacked the "deep pockets" of their Japanese competitors and had to compete for capital in an open market -- out of the market. The Agreement sought to restore market forces as the determinants of success.

The monitoring system did not establish floor prices but, rather, required each Japanese producer to sell above its individual cost of production. A floor price system, such as that adopted by the European Community in 1990, is based on the average costs of all producers. Thus, an inefficient producer is allowed to dump down to the average industry cost while an efficient producer is prevented from passing on its lower costs to its customers. The Agreement rejected this approach. See Figure 7.

Figure 7

While dumping in the United States was halted under the suspension agreements, it continued after September, 1986, in third-country markets in violation of the Semiconductor Agreement. See Figure 8. This undermined one of the critical elements of the Agreement, as neither American producers nor users wanted to force the American customer base offshore in search of cheaper parts, and U.S. chip producers viewed the loss of third-country sales as a serious consequence of Japan's dumping. Japan's initial implementation of the Agreement -- eliminating dumping in the United States, while continuing to dump outside the United States -- was precisely the result the U.S. Government had negotiated to avoid.

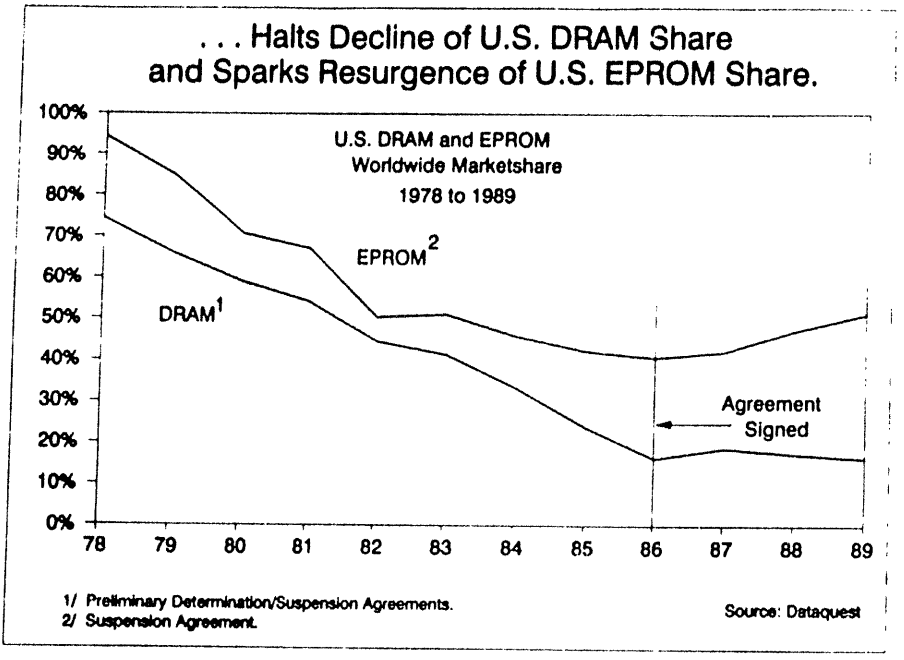


Figure 8

To force Japan to comply with its commitments, President Reagan imposed sanctions in 1987. The sanctions related to third-country dumping were based on Commerce Department analysis of Japanese pricing activity in third-country markets, which found that "Japanese produced DRAMs ... were being sold on average at 59.4 percent of the fair value, while EPROMs ... were being sold at 63.6 percent of the fair value."

Further, in 1987, the Government of Japan used the antidumping provisions as an excuse to impose uniform production controls, issuing administrative guidance to Japanese DRAM producers -- inefficient and efficient firms alike -- to reduce their output by 10 percent. There were also reports that MITI had imposed floor prices on semiconductor exports and that Japanese producers were engaging in discriminatory allocation schemes.

This was exactly the sort of "managed trade" the Agreement intended to prevent and that U.S. negotiators had specifically rejected when proposed by MITI during negotiations.

SIA opposed MITI's quantitative restrictions on semiconductors in an April 1987 press release and, in a September 1987 letter to President Reagan, urged that "sanctions against Japan should be maintained until consistent and full compliance with the Agreement has been achieved. . . . This means that . . . the Government of Japan must . . . eliminate the use of production controls and minimum floor prices so that market forces can begin to operate." A subsequent GATT panel report in 1988 criticized MITI's antidumping system,

of which the production guidelines were an integral part, as an impermissible restriction on the export of Japanese semiconductors.

In November 1987, after lengthy behind-the-scenes negotiations, MITI agreed to issue a statement that "it was imposing no quantitative or other restrictions on the production, shipment or supply of semiconductors." As a result of this agreement and the improvement in third-country dumping, President Reagan lifted those sanctions related to dumping.

The history of the first two years of the Agreement was one of persistent efforts by the U.S. Government to enforce the Agreement as it was intended and to control Japanese efforts to engage in the "managed trade" the Agreement sought to prevent.

1988-1989, Lessons of Maintaining Competition

Publicly available EPROM and DRAM pricing and cost data since the signing of the Agreement, which is more useful for ascertaining a trend than for estimating actual costs or prices at any given point in time, indicates that market prices were substantially above FMVs throughout 1987 and 1988. Contrary to assertions that the Agreement caused a run-up in price, Japanese producers kept prices well above FMV levels even though they faced no risk of dumping charges. The price increases during this period were due to the fact that six of eight U.S. firms had been driven out of the DRAM business.

High prices were not the only problem cited by DRAM users in this period. Reports of other concerns included: contract prices for 1 Megabit chips of $22 in the United States when they were only $16 in Japan, termination of a user's supply of memory chips when contract negotiations on a different matter reached an impasse, and "tie-in" deals whereby sales of scarce DRAMs were offered if the customer would also buy another type of chip.

These anticompetitive practices have been condemned by SIA and are a result of the lack of competition caused by Japan's dumping. For example, while the FMV system and MITI's production and export controls applied to both DRAMs and EPROMs, subsequent user complaints about excessive prices and shortages were made only with respect to DRAMs. Complaints were not heard in the EPROM area where the more balanced supply situation assured competition among many American, Japanese, and European suppliers.

1990 and 1991

During most of the period since the agreements were concluded in 1986, the semiconductor market has been fairly strong. During the period of strong demand and reduced DRAM supply, dumping was not an issue. Prices were so far above the public cost data, that it was reasonable to conclude that prices were also above FMVs. Today, with prices much closer to the public cost data, one cannot conclude from the imprecise publicly available data that prices are above FMVs. Both U.S. semiconductor producers and consumers agree that continued enforcement efforts are critical to prevent DRAM and EPROM dumping in the U.S. market and to permit a prompt, effective response should semiconductor dumping resume in the future.

C. Addressing U.S. Semiconductor Users' Concerns with the Agreement

Despite the fact that prices were well above publicly available information on FMVs, a number of U.S. systems companies became concerned that the FMV system was responsible for artificially high prices and shortages of DRAMs. SIA has worked continuously with semiconductor users' organizations to communicate the mutual need for strong antidumping policies and to find ways to address these user concerns. These efforts resulted in several joint recommendations to the Department of Commerce with respect to FMV procedures.

Ultimately, chip producers and users came to realize that the expansion of domestic DRAM production would allow increased competition to address many of the users' concerns. In March of 1989, a joint AEA-SIA Steering Committee explored extraordinary measures to encourage expansion of U.S. DRAM production. This led to the June 1989 effort aimed at creating U.S. Memories Inc., a cooperative venture by seven members of the SIA. U.S. Memories, which was to have manufactured 4-megabit DRAMs, was unable to obtain adequate funding and abandoned its plans in January 1990. The difficulty of forming U.S. Memories demonstrated the persistent chilling effect on potential new entrants into the DRAM business caused by the legacy of Japanese dumping of DRAMs and the continuing need for a prompt, effective response to dumping.

D. The Agreement has Encouraged Investments in Semiconductors, Including DRAMs and EPROMs

The Administration's strong stand against semiconductor dumping drew a line in the sand, and served notice to Japanese and other foreign producers that further dumping of semiconductors would not be tolerated. The Administration's unflagging position provides American firms the confidence to make necessary investments in facilities and personnel, knowing that their success will be based on their competitive merit.

Without the investment confidence that the semiconductor agreements have provided, it is likely that many more U.S. producers of commodity memories and other critical semiconductor products would have lost their enthusiasm and ability to make continued investment following the 1985-1986 dumping debacle. Instead, capital spending has rebounded significantly from the depressed levels of 1985 and 1986 when it fell sharply. U.S. merchant semiconductor firms invested almost $6 billion in plant and equipment over the past two years, a level of investment for a 24 month period that exceeds any similar period in the industry's history.

R&D spending in the industry has also continued to rise. This, in turn, has increased competition in the memory market, although Japanese dominance of the merchant DRAM market is formidable as a result of the Japanese industry's "dumping" its U.S. competition. These positive developments would not have been possible without the current level of enforcement of the antidumping law and the antidumping provisions of the Agreement.

For example, the agreements contributed to the following new investment developments in the EPROM area:

- Advanced Micro Devices investments in Austin, Texas and in its Submicron Development Center in Sunnyvale, California,

- ATMEL's investment in Colorado and its continued expansion of its EPROM product line,

- Intel's construction of a $160 million wafer fabrication facility in Santa Clara, California, and its $100 million investment in additional EPROM capacity in Albuquerque, New Mexico and Chandler, Arizona, and

- National Semiconductor's investment in West Jordan, Utah and its investment in, and technology exchange agreement with, WaferScale Integration.

Since 1986, when the price collapse caused by Japanese dumping inflicted massive losses on U.S. EPROM producers, U.S. world market share in EPROMs has increased over 10 percentage points, while Japanese share has declined by 20 percentage points. Increased Japanese purchases of American EPROMs as part of the Japanese market access effort also contribute to the gain in American share worldwide.

Investments have also been made by several U.S. DRAM producers. In the United States, the remaining DRAM producers, Texas Instruments, Motorola and Micron Technology, have significantly increased their investments in DRAMs.

The exodus of U.S. DRAM producers was reversed with Motorola's return to the market. To enter the DRAM market, Motorola has not only devoted considerable financial resources but also licensed some of its key technology to Toshiba in order to obtain from Toshiba the DRAM technology necessary for reentry. [Toshiba also made market access commitments to Motorola as part of the agreement.] Today, Motorola produces DRAMs in Arizona and Scotland and has a joint venture with Toshiba, Tohoku Semiconductor, which manufactures DRAMs in Japan.

The emergence of South Korea and Taiwan as additional sources of DRAMs can be attributed in part to increased confidence that these producers will not be faced with the costly DRAM price wars of the mid-1980s, and in part by the willingness of these governments to target their semiconductor industries. Despite these developments, however, the Japanese industry still holds most of the market, especially for new generations.

While the U.S. Government and industry had hoped that the antidumping agreement would have reversed the slide in American DRAM share, the task of regaining share from a beachhead of 16 percent is extremely difficult without the government subsidies that the Korean and Taiwanese industries have enjoyed.

The United States was able to recapture EPROM share and regain EPROM market leadership because America had a number of competitive companies which could recover lost ground once dumping was less of a threat. This lead, however, is tenuous. To sustain this lead requires continued vigilance against renewed dumping as well as further improvements in the broader industry competitive position.

There is no reason to believe that, absent the Agreement, American DRAM and EPROM producers would have been able to remain in the business, let alone reverse the history of lost sales and lost share caused by Japanese dumping. The lesson is clear: The earlier antidumping measures are taken, the better the chance that the injurious effects of dumping can be reversed.

E. Options

The current Semiconductor Arrangement is slated to expire on July 31, 1991, and the antidumping suspension agreements for DRAMs and EPROMs (along with the underlying suspended investigations) may terminate in August 1991 if the Department of Commerce determines that it is not likely that dumping of these products by Japanese producers will resume in the future. SIA has been engaged in an ongoing dialogue with U.S. semiconductor users to devise a mutually acceptable dumping prevention program to succeed the current arrangements. A basic framework has already been agreed.

In light of the history of severe dumping in this sector and the persistence of the underlying conditions that tend to cause dumping -- in particular, the fact that the Japanese home market is opening but not yet open -- both U.S. semiconductor producers and consumers agree that measures to ensure a prompt and effective response to any future semiconductor dumping problem are essential.

SIA recognizes, however, that the current measures have thus far been reasonably successful in controlling the dumping problem and that it is important that dumping prevention measures not provide a pretext for anticompetitive activities by Japanese firms or the Japanese Government in sectors, such as DRAMs, where Japan has acquired a monopoly position as a result of successful past dumping strategies. It is, therefore, appropriate -- assuming continued progress under the current system and acceptance by Japan of new market access and antidumping commitments -- to reduce the level of government involvement embodied in the current system.

Among the possible approaches to address future semiconductor dumping problems are:

- Do Nothing: The Semiconductor Agreement could simply be allowed to lapse by its terms in July of 1991. That prospect presents great uncertainty and a renewed risk of dumping, particularly for products such as ASICs and microprocessors where Japanese producers are aggressively challenging the U.S. lead. Given the history of dumping in this sector and the amount of time required to obtain relief from dumping under current U.S. law -- time that producers of short life cycle products such as semiconductors cannot afford -- the loss of the Arrangement's fast-track antidumping mechanisms and third-country dumping prevention measures is likely to result in U.S. disinvestment in semiconductor product sectors targeted by Japan.

  The fate of the DRAM and EPROM suspension agreements will be determined by the requirements of the antidumping law. Japanese semiconductor producers have petitioned the Department of Commerce to terminate the suspended EPROM and

DRAM investigations, and the Department has initiated a review to determine whether termination is appropriate. A threshold condition for termination is a finding that Japanese producers are unlikely to resume dumping; if they are found to be likely to do so, the suspension agreements will remain in effect. If the suspended investigations are terminated without effective replacement measures, any resurgence of dumping in the future will probably be met by further withdrawals by U.S. memory producers unwilling to repeat the losses of 1985-86.

- Extend the Current System in its Entirety: The current system appears to have curtailed dumping and discouraged Japanese chipmakers from engaging in a repetition of the dumping practices of 1985 and 1986. The system could be extended in its entirety, over the opposition of a united U.S. electronics industry (were the joint SIA/CSPP recommendations accepted by the governments).

- Fashion a Post-1991 Agreement: Given the history of dumping in this sector and the time required to obtain relief, termination of the suspension agreements without an effective replacement mechanism could lead to renewed dumping by Japanese producers and discourage investment in the U.S. semiconductor industry. However, extension of the current system in its entirety may not be necessary to deter future dumping. The purpose of the current agreements is to restore market forces to semiconductor pricing -- to make efficiency, not the sheer ability to absorb huge financial losses, the arbiter of marketplace success. If there is little likelihood of future dumping by Japanese firms and if progress on market access continues, it may be possible to achieve this purpose with somewhat modified mechanisms.

The final option, then, is to create a new, less intrusive, antidumping regime, based on the current system but providing for a reduced level of government intervention. SIA and CSPP recently presented a joint recommendation to President Bush outlining the possible shape of such an agreement. As part of a package of semiconductor trade policy recommendations that assumes continued progress under the current agreements and acceptance by the U.S. and Japanese Governments and Japanese industry of all elements of the package, SIA and CSPP have recommended that the current level of involvement by the U.S. and Japanese Governments in dumping prevention be lessened while still preserving sufficient dumping disciplines to make the market function efficiently.

As part of this package of market access and interchanging mechanisms, , SIA and CSPP have recommended termination of the DRAM suspension investigation and modification of the EPROM suspension agreement to eliminate quarterly cost and price data collection and issuance of FMVs by the Department of Commerce. The two groups have further recommended that the U.S. Government obtain commitments from the Japanese Government that it will refrain from issuing pricing guidance to producers, but will require Japanese producers to continue to collect cost data on EPROMs, DRAMs and other monitored products and will monitor the collection of such data so as to permit the Department of Commerce to provide an effective "fast track" response to any future dumping problem. The SIA-CSPP recommendations are discussed further in Section III.

SIA and CSPP view their agreement on these issues as an important milestone in the U.S. electronics industry and the two groups intend to continue to work together to secure the adoption of their joint recommendations.

F. Conclusion

The antidumping provisions of the Semiconductor Agreement and its companion suspension agreements have made a major contribution to the U.S. industry's continued participation in the semiconductor market. A steady decline in U.S. share in the world DRAM market has been halted and the U.S. EPROM industry has regained market share in the wake of disastrous losses in 1985-86. Today, the U.S. industry once again is the world market leader in EPROMs. Its footing, however, remains precarious: the losses of 1985-86 have not been recovered, and lost R&D and capital expenditures cannot be easily replaced in the race to remain competitive. Thus, the U.S. industry remains extremely vulnerable to the threat of renewed dumping.

The firm stand taken by the U.S. Government against DRAM and EPROM dumping, coupled with the MITI's monitoring of additional products under the Semiconductor Agreement, has sent a clear signal to Japanese semiconductor producers that dumping will not be tolerated in any semiconductor product area. During the four years under the Agreement, no additional cases have been filed against Japanese semiconductor producers for dumping semiconductors into the U.S. market.

Even with the Agreement, the cessation of dumping in the form of sales below cost did not come easily. This result occurred only after the existence of continued third-country dumping necessitated the imposition of U.S. trade measures in 1987 and after strenuous objections by the U.S. Government and SIA to anticompetitive activities such as imposition of production controls contrary to the Agreement. U.S. customers of DRAMs had very different experiences from U.S. customers of EPROMs during the past four years. This difference highlighted the anticompetitive effects flowing from the exit of six U.S. firms from DRAM production due to Japanese dumping. This situation was difficult to reverse, although the Agreement has permitted U.S. industry to preserve a 16 percent U.S. market share in the worldwide DRAM market.

As the scheduled end of the Agreement approaches, efforts must be made to ensure that Japan does not repeat its semiconductor dumping behavior. U.S. semiconductor suppliers and users have reached a broad electronics industry consensus on appropriate policies to prevent renewed semiconductor dumping through maintenance of an effective, prompt response to any new dumping and through continued progress toward the goal of a fully open Japanese semiconductor market -- ultimately, the best safeguard against dumping. We urge the U.S. Government to work with the electronics industry towards these ends.

III. INDUSTRY RECOMMENDATIONS FOR A NEW AGREEMENT

On October 4, 1990, the SIA and the Computer Systems Policy Project (CSPP) announced a unified position for developing a new five year agreement to succeed the U.S.-Japan Semiconductor Trade Agreement, which is set to expire next year.

The Computer Systems Policy Project, an affiliation of chief executive officers of American computer companies that develop, build and market information processing systems and related software and services, was formed in 1989 to develop and advocate unified public policy positions on issues critical to America's high technology industries. CSPP's members are Apple, Compaq, Control Data, Cray Research, Digital Equipment, Hewlett-Packard, IBM, NCR, Sun Microsystems, Tandem, and Unisys.

The details of the joint position were contained in a letter sent to President Bush. Highlights include the following points:

- Both groups (SIA and CSPP) are committed to open markets in the United States and Japan and are opposed to the dumping of semiconductors. Provided that progress under the current arrangement continues, the U.S. and Japan should negotiate a 5-year agreement effective August 1, 1991 addressing both issues.

- Market access should be measured by quantifiable indicators of progress. The Government of Japan's commitment to at least a 20 percent foreign market share by July, 1991 (a benchmark of minimum acceptable progress) should be replaced with a commitment that this level of access will be achieved by the end of 1992. An asses ment should then be made to determine whether additional quantitative targets need to be set to continue momentum toward an open market.

- In light of the success of the Agreement in stopping widespread dumping of semiconductors, the antidumping measures should be revised in favor of mechanisms that lessen the degree of governmental involvement, eliminating the current FMV system.

- The U.S. Department of Commerce should no longer collect cost or price data or issue FMVs for DRAMs or EPROMs. A modified version of the EPROM suspension agreement should remain in place.

- The U.S. Department of Commerce should maintain an effective "fast track" response for investigations semiconductor dumping.

The joint recommendations reflect the industry's experiences under the Agreement during the past four years. As discussed in this report, Japan engaged in aggressive market opening efforts for only two of the four years of the Agreement. Japanese dumping continued in third-country markets through much of 1987, but the Department of Commerce has not found Japan to be dumping since that time. Given this history, the SIA and CSPP Board of Directors believe that it is appropriate to recommend that a new agreement be negotiated as outlined above.

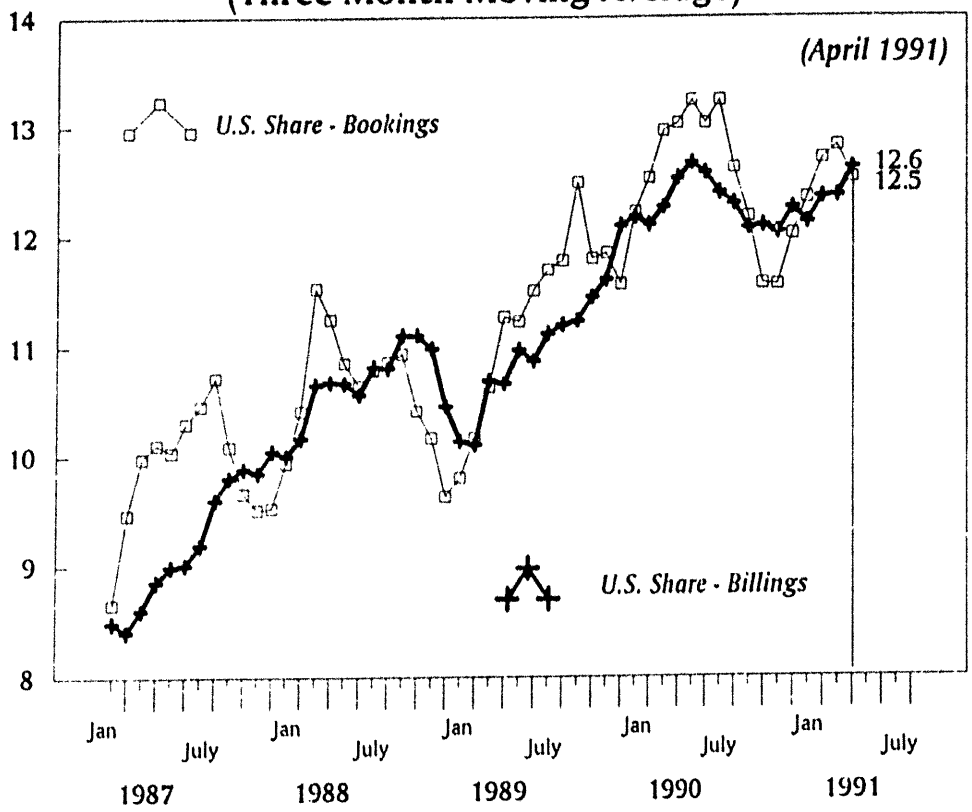
The joint SIA-CSPP position gives the U.S. Government a solid base from which to consider and negotiate policy measures that should be implemented upon the expiration of the Semiconductor Agreement. The recommendations represent a balanced approach which is in the interests of U.S. semiconductor suppliers and consumers, as well as being in their mutual interest. The SIA urges the U.S. Government to pursue a new agreement as outlined in the CSPP-SIA recommendations.

GLOSSARY OF TERMS AND ACRONYMS

ASIC	Application Specific Integrated Circuit. An integrated circuit tailored for a specific use. ASICs are often custom devices.
bipolar	One of two main types of transistors (along with MOS). Bipolar transistors were the dominant semiconductor devices of the 1950s. They operate at higher speeds than MOS devices, making them especially useful for such signal processing as radar and communications.
captive	Firms which produce semiconductors for use in their own end products.
CMOS	Complementary Metal Oxide Semiconductor; possesses n-channel (negativeconducting properties) MOS transistors and p-channel MOS transistors on the same chip; known for low power dissipation and density of elements per unit area.
DRAM	Dynamic random access memory. A type of semiconductor in which the presence or absence of a capacitive charge represents the state of a binary storage element. The charge must be periodically refreshed.
ECL RAMs	Emitter coupled logic random access memory. A high speed device used in supercomputers and mainframe cache memories.
EPROM	Erasable Programmable Read Only Memory. The contents of the device may be erased through exposure to ultraviolet light, and new information may be written to the device afterwards.
LSI	Large Scale Integration. LSI devices contain 100 to 5,000 gate equivalents or 1,000 to 16,000 bits of memory.
MOS	Metal oxide semiconductor. One of two main types of transistors (along with bipolar); consists of semiconductor body (silicon) with silicon-dioxide gate dielectric and metal gate.
RAM	Random Access Memory, stores digital information temporarily and can be changed as required. It is the basic storage element in most computers.
ROM	Read Only Memory. Permanently stores information used repeatedly -- such as microcode or characters for electronic display. Unlike RAM, ROM cannot be altered.
SRAMS	Static RAMs. A type of RAM which does not require periodic refresh cycles, as does dynamic RAM.
VLSI	Very Large Scale Integration. VLSI devices are ICs that contain 5,000 or more gate equivalents or more than 16,000 bits of memory. (Some sources designate devices with 1,000 or more gate equivalents as "VLSI".)

U.S. Bookings and Billings Share in Japan

(Three Month Moving Average)



COMMUNICATIONS

STATEMENT OF THE AMERICAN PETROLEUM INSTITUTE

Good morning, Mr. Chairman and members of the subcommittee. My name is Richard Quegan, General Manager - Marine, Texaco, Inc., and Chairman of the American Petroleum Institute's (API) Marine Transportation Committee. API is a trade association which represents over 250 companies involved in all aspects of the petroleum and natural gas industries, including transportation, refining, marketing, exploration, and production. API member companies transport large volumes of petroleum and petroleum products into the United States, as well as own and operate sizable tanker and tankbarge fleets under both U.S. and foreign registry. Consequently, API is keenly interested in efforts to eliminate foreign shipyard subsidies, and therefore H.R. 2056, "The Shipbuilding Trade Reform Act of 1991."

API strongly supports the elimination of unfair trade practices in the shipbuilding and repair industries. Unfair trade practices such as subsidies distort U.S. and international markets and create unfair commercial advantages to shipyards receiving assistance. API applauds the efforts of the U.S. Trade Representative in the current negotiations with the Organization for Economic Cooperation and Development (OECD), as well as your efforts to bring this issue under Congressional review.

During the Subcommittee on Trade hearing held on March 21, 1991, you indicated a desire to pursue domestic legislation to eliminate foreign shipyard support programs. This has resulted in the introduction of H.R. 2056. There are several points which should be considered before enacting such legislation.

H.R. 2056 Penalizes Shipowners, Not Shipyards

If Congress believes unilateral action against foreign shipyards receiving subsidies is necessary, such action should be directed at penalizing foreign shipyards or the governments that provide the subsidies. Unfortunately, H.R. 2056 punishes shipowners, not shipyards, by requiring owners to repay a prorated share of the subsidy received by the shipyard where their vessel was built. The bill imposes an onerous burden on shipowners.

From a practical standpoint, many vessel owners would avoid U.S. ports because of the inherent difficulty in demonstrating conclusively that their vessels were "subsidy free." One of the basic problems in H.R. 2056 is the requirement to provide acceptable evidence showing that a particular vessel was built without subsidies. In many cases, items which may be considered subsidies under H.R. 2056 are actually not direct subsidy payments to a shipyard but are embodied in other types of government-assistance programs (e.g. wage stabilization, steel subsidies,

research and development, or capital improvements). Foreign shipyards and governments will not feel compelled to provide the requisite information, thus leaving a shipowner without recourse in providing the necessary evidence. This leaves a shipowner with the unenviable decision to either risk entering a U.S. port and possibly paying an unknown amount of penalty, or seek trades to non-U.S. ports.

Consequently, H.R. 2056 places a shipowner in the position of enforcing an anti-subsidy policy that he is ill-equipped to perform, and may even find himself penalized after making a best effort to determine if a subsidy existed. Therefore, if the U.S. Government wishes to stop unfair subsidies, it should direct legislation against the offending governments and not place the shipowners in the position of being trade "policemen."

Adverse Effects on U.S. Foreign Trade

Depending on how the term "subsidy" is interpreted, there exists the potential for large penalties being assessed against shipowners if H.R. 2056 is adopted. It is conceivable that U.S. foreign trade would be seriously hampered if owners of new ships abstained from calling at American ports to avoid potential penalties.

To use the marine oil transportation industry as an example, almost fifty percent of America's oil supplies are imported, the majority of it by tanker. If operators of newer tankers were to avoid U.S. ports rather than be faced with paying enormous penalties, it would leave only aging ships in the maritime commerce of the United States. This, in turn, would delay implementation of the Oil Pollution Act of 1990, which mandates the gradual phase-in of double-hulled tankers. Operators would continue to trade older tonnage to U.S. ports rather than pay the increased costs of building tankers with double hulls and then remit the amounts which may be deemed to have been building subsidies. Clearly, this would be contrary to the objective of the Oil Pollution Act of 1990 to upgrade the quality of tanker tonnage trading to U.S. ports as rapidly as practicable. If shipowners instead choose to submit to the penalties, American consumers would see increases in the cost of petroleum products. In either case, the United States would be adversely affected.

U.S. Shipyards Receive Indirect Subsidies

Shipbuilding and repair yards in the United States benefit from several indirect federal government subsidies. Examples of such indirect subsidies include the "build-domestic" requirements of the Jones Act, tariffs on foreign ship repairs, restricting foreign bidding on naval shipbuilding, tax-exempt construction funds, and restricting eligibility for direct government assistance programs (e.g. cargo preference and operating subsidies). In fact, for the four years between 1987 through 1990, the United States Navy alone spent almost $65 billion in shipbuilding and repair.

These indirect subsidies are designed to assist American yards by providing incentives to utilize U.S. shipyards, reserving the U.S. coastwise shipping market for American shipbuilding facilities, limiting government cargoes to U.S. built ships, and making it extremely expensive to repair American ships in foreign yards. If the United States is to be successful in the current multinational negotiations, it cannot continue to keep these indirect subsidies off the negotiating table. The elimination of U.S. indirect subsidy programs must be addressed in the OECD negotiations and H.R. 2056 if a "level playing field" is our goal.

Precedent Setting Initiative

An unfortunate fallout of focusing on the subsidy issue within the OECD negotiations and through legislation such as H.R. 2056 is that they inevitably draw attention to the Jones Act as a type of subsidy itself. Thus, overseas pressures to eliminate the Jones Act and create a "level playing field" can be expected to grow. At the same time, API is concerned with the precedent the OECD negotiations and H.R. 2056 will set if indirect subsidies are not addressed. With the coming of a fully integrated European Community (EC) in 1992, it is widely expected that requirements similar to the Jones Act will be considered for the EC. Many API member companies operate vessels in European waters and may be harmed if a Jones Act scheme is adopted. Additionally, with the potential rise of other trading blocs in other areas worldwide, American companies may find themselves disadvantaged if the Jones Act becomes a model for similar trade restrictive measures outside of Europe.

In a letter dated September 6, 1990, API urged the U.S. Trade Representative to include the elimination of indirect subsidies, particularly the build-domestic Jones Act requirements and tariffs on foreign ship repairs, in the OECD negotiations. The U.S. Trade Representative has not responded, and Ambassador S. Linn Williams' statements during the March 21st hearing indicate that our concerns will not be addressed.

Conclusion

The elimination of restrictive measures concerning shipbuilding and repair can set a model for the world community and permit American businesses and consumers to reap more of the benefits of a competitive marketplace. While API and its member companies believe that multinational negotiations are the best method to eliminate shipyard support programs, we are prepared to work with you in developing appropriate legislative responses to create a truly level playing field in the world shipbuilding and repair industries if those negotiations fail.

Just as important, however, API and its member companies are prepared to work with you and the American shipyards to search for ways to make U.S. shipyards more competitive in the world marketplace. We believe that the goal of any shipyard legislation should be to make American shipyards more competitive and not simply to search for ways to make foreign shipyards less competitive. API and its member companies are prepared to work with you to achieve this goal.

Thank you for the opportunity to testify today. I am prepared to answer any questions you may have.

STATEMENT ON BEHALF OF THE INTERNATIONAL COUNCIL OF CRUISE LINES

The International Council of Cruise Lines (ICCL) is a non-profit trade association whose membership consists of American and foreign owned companies engaged in the overnight oceangoing passenger cruise line industry. We are opposed to S. 1361 and support the elimination of subsidies by international agreement. The subsidy problem is international in scope and cannot be effectively addressed by unilateral United States action, which would only result in injury to our suppliers, employees, and customers.

Our Membership has about 90% of the passenger cruise capacity worldwide utilizing in excess of seventy vessels which represent nearly 71,400 lower berths, and on a full-year basis, about twenty-six million passenger cruise days. As such, the owners, managers, employees, vendors, and perhaps most importantly the passengers (the majority of whom are American citizens) are vitally interested in and have a shared concern for open and unrestricted accessibility to international maritime commerce.

The punitive impact of S. 1361 would reach back 2 years and punish a shipowner who, in good faith, negotiated a capital intensive contract. Such unilateral action is inconsistent with the legitimate aspirations of not only those within our industry, but also to those whom we serve viz., our passengers. It is on their behalf as well as ours that we urge that the Bill be rejected.

This proposal will clearly not lead to the creation of a competitive passenger shipbuilding industry in the United States which does not exist today. Labor costs and efficiency are the key to a competitive industry. The Bill will penalize the millions of United States citizens who annually use our vessels for vacation and leisure purposes. Over three and one-half million Americans used our vessels last year and it is forecasted that ten million Americans will be our customers by the year 2000. Furthermore, the Bill will seriously jeopardize, and in some cases destroy, the economic benefit now enjoyed by the Ports of Miami, Everglades, Los Angeles, and other major U.S. seaports. In our industry, many jobs will be lost.

Some have stated that this and similar legislation is "about fair trade in jobs." Not in our case. Large passenger ships with a capacity for 2,600 passengers or more and a crew of 1,200, necessary to accommodate the growing market by the year 2000, are now being constructed in foreign shipyards. Similar ships are already in place. The market does not require, however, that passengers board at American ports. In this respect, we are somewhat different from the cargo industry. Cruise ship repositioning is an economic reality routine to this industry, whether resulting from weather, climate, political considerations, or adverse legislative policy. We are a mobile industry and the capital intensive investment is in the ship, not the shoreside facilities.

In summary, this legislation should be rejected because (a) it penalizes our passengers and is not directed at the heart of the problem—the development of a consensus and agreed upon solutions by governments granting the subsidies; (b) it will attract and retain older vessels to the United States passenger cruise trade at the very time our industry is energetically cooperating with the Coast Guard and the International Maritime Organization (IMO) to modernize and upgrade the fleet of passenger cruise vessels; (c) it will cause serious economic disruption to U.S. citizens now engaged in the passenger cruise industry as a sacrifice for perceived potential gains to those in a currently non-existent United States passenger ship construction industry; (d) it would result in a reactionary and regressive maritime policy of inviting retaliation by other countries by balkanizing commerce which is inconsistent with the leadership role of the United States in fostering cooperation within such agencies as the IMO, GATT, and other international agencies; (e) it further encourages the relocation of international cruise ships from Florida and elsewhere in the U.S. to non-American ports, particularly within the Caribbean, one of the largest and fastest growing cruising areas in the world; (f) it fails to recognize the economic reality that in spite of technological advancements in ship construction, labor costs and efficiency will largely determine for years to come the situs of passenger cruise ship buildings; (g) it encourages economic retaliation from any country whose flag the targeted ship may be flying, even though that country may not be engaged in ship construction subsidy practices; (h) it tarnishes the full faith and credit of the United States by making it captive to a narrow self-interest rather than by encouraging an international agreement as the only sensible way of ending subsidies; (i) it fails to recognize that passenger cruise ships are not shelf items, but on the contrary are unique customized buildings, no two ships being alike, reflecting in minute detail the owner's effort to penetrate a carefully analyzed market niche; and (j) the retroactive sanctions represent a punitive policy aimed at shipowners who negotiat-

ed contracts in good faith and fails to recognize that the subsidy issue is a matter that must be resolved by governments dealing directly with each other.

We have little quarrel with the objective of eliminating subsidized repair, conversion, and new building practices. We applaud the international concessions reportedly made so far in agreeing to that objective at the OECD talks in Europe. We also have no illusions about the difficulties which lay ahead regarding the definition of a subsidy and establishing a timetable for their elimination. We respectfully submit, however, that other nations could easily conclude that S. 1361 would represent a duplicitous policy of the United States since this country, until recently, engaged in direct shipping subsidies and continues to engage in such indirect subsidies on the national as well as local levels. Subsidies, as a general principle, result in not only over production, but in price levels that do not reflect supply and demand forces in the market place. The only sensible and effective way of eliminating them is through an international agreement. This Bill rejects that approach in favor of protectionism of narrow self-interests at the expense of the American cruise industry wage earner and consumer. Certainly one can be sympathetic with the frustrations expressed at the slow pace of the international talks to end subsidies. One cannot be sympathetic, however, with the intolerance displayed by those who would scuttle the reported progress that has been made and in the process, hold as hostage the passenger cruise industry and its American employees, suppliers, owners, ports, and millions of passengers . . . all of whom would fall victim to this unilateral action.

STATEMENT OF THE TRANSPORTATION INSTITUTE

The Transportation Institute, a research and educational organization representing over 140 U.S.-flag vessel operators engaged in all forms of waterborne commerce in both the domestic and international trades, wishes to express its strong support for ongoing negotiations to eliminate global shipbuilding subsidies, and we applaud the Administration's efforts in bringing our trading partners to the negotiation in an effort to develop a successful agreement. The Transportation Institute supports as a theoretical objective this initiative to remove shipbuilding subsidies, both direct and indirect, that characterize many major foreign shipyards. Such foreign assistance has contributed to the serious decline in the competitiveness of U.S. yards.

Therefore, we have watched with interest the progress of the ongoing shipbuilding subsidy talks being conducted under the auspices of the Organization for Economic Cooperation and Development. Consequently, we share the frustration of many within the U.S. maritime industry that the OECD talks have not reached a successful conclusion. However, there are indications that progress has been made and further discussions are underway. Like all international negotiations, successful agreements take time. It is for this reason that the Transportation Institute is deeply concerned with legislation introduced in the Senate S. 1361, the Shipbuilding and Repair Industry Free Trade Act of 1991, and similar legislation in the House of Representatives, H.R. 2056 and H.R. 2709.

Enactment of such punitive legislation is premature and, therefore, we believe these measures to be inappropriate remedies. As the subcommittee is aware, there are mechanisms in place, such as Section 301, that permit the United States to take unilateral action against an offending nation if it so chooses. In lieu of this legislation, American shipyards if dissatisfied with the OECD negotiations, should prevail upon the U.S. Trade Representative to act on their previously filed Section 301 complaint.

Like shipbuilders, ship operators have experienced a substantial decline in recent years. Both were abandoned by the Reagan Administration, which early in its first term stopped funding the Construction Differential Subsidy program, and let no new Operating Differential Subsidy contracts. Other promotional programs have been either eliminated, scaled back or placed in limbo. Sadly, the Administration has failed to offer any replacement promotional programs to bolster the U.S. industry. The various bills under discussion will only serve to further drive a wedge between two sectors of an already depressed industry essential to our Nation's security.

S. 1361 and its House counterparts take aim at the wrong target. Rather than penalizing foreign governments that persist in unfair trade practices through a vast array of subsidies, both overt and hidden, these bills assess punitive levies on vessel operators, including the U.S.-flag operators our government is supposed to be supporting for national defense purposes. These operators are in essence being asked to carry the burden of the failure of our own trade representatives to come to an acceptable agreement at the negotiating table.

At precisely the time when global competition has become the watchword for America's challenge to survive as a superpower into the next century, subsidy legislation would reduce the competitiveness of goods and services. Both exporters and importers would pay more for all types of goods subject to international trade, as punitive fines would be passed along to shippers. Such levies would be an open invitation for foreign governments to continue or even increase their discrimination against American goods in retaliation, precisely the opposite result as that desired through the OECD talks.

The Transportation Institute sympathizes with American shipbuilders in their efforts to eliminate unfair foreign subsidies. We believe that a thriving shipbuilding industry is an important component of our nation's overall maritime strategy. Nonetheless, policy should be devised on the basis of facts, not myths.

It is a myth to maintain that foreign subsidies are solely responsible for the current depressed state of American yards. Far and away, the compelling motivating factor in this business—in any business—is cost. Vessels built in the United States cost three times as much as those built elsewhere. They take three times as long to be completed—and time is money. The only market for commercial new-builds in this country is for those required by the Jones Act, a requirement which, incidentally, we support. Eliminating foreign subsidies, either through trade negotiations or through legislative fiat, will not resolve this fundamental economic problem, and the latter course will likely trigger a new trade war. Clearly, the elimination of subsidies through trade negotiations is in the Nation's best interests.

The depressed state of the U.S. maritime industry affects shipbuilders and ship operators alike. It is nothing short of madness for one sector of this vital but ailing industry to feed on the other, to scramble for its survival by throwing a new regimen of costly requirements and penalties at operators. It is also remarkably shortsighted. By helping to bleed operators dry, shipyards will be eliminating their last remaining non-military customer base. That seems rather foolhardy, given the current prospects for defense spending.

Like the U.S. shipbuilding industry and members of this subcommittee, the Transportation Institute would like to see an end put to unfair trade practices. We are hopeful that the OECD talks will afford an opportunity to level the playing field for America's shipyards. The Institute would like to work with concerned members of Congress, the shipyards and the U.S. Trade Representative to achieve this objective. However, we do not believe that committing industrial suicide, with one limb sacrificing the trunk in a futile effort to save itself, is the way to go. Therefore, the Transportation Institute strongly urges that the OECD subsidy talks be given greater opportunity to work and urges the Senate to withhold action on S. 1361.

Statement of the United Shipowners of America

The United Shipowners of America (USA) is pleased to take this opportunity to present its views on the ongoing international negotiations concerning shipbuilding subsidies as well as the legislation that has been introduced to address commercial shipbuilding subsidies.

USA is a national trade association whose members operate most of the U.S.-flag liner vessels engaged in international trade. Its members are American President Lines, Ltd., Central Gulf Lines, Inc., Crowley Maritime Corporation, Farrell Lines, Inc., Sea-Land Service, Inc., and Waterman Steamship Corporation.

USA SUPPORTS A MULTILATERAL AGREEMENT TO ELIMINATE SHIPBUILDING SUBSIDIES

USA supports the ongoing multilateral negotiations to address commercial shipbuilding subsidies and USTR's attempt to eliminate trade distorting practices in the shipbuilding sector.

We believe our Government should stay the course and persist in these negotiations. Admittedly, the talks have proven complicated and difficult. In part this is because USTR has been pursuing the objective of a meaningful agreement that would restrict subsidies for shipbuilding far more than for other industries.

But it is important to understand that substantial progress been achieved. For example, agreement has been reached on most of the text of an Agreement and a comprehensive list of proscribed subsidies ("Annex I"). In addition, the participating countries have agreed to a binding dispute settlement procedure that requires shipbuilders to repay any benefits received in violation of the Agreement. Negotiations are also in progress regarding the issue of unfair pricing (dumping) and the schedule and procedures each country will use to phase out their subsidies (each country's "Annex II").

Moreover, the talks appear to be entering their final phase. This summer national governments will address the difficult "political" questions each must face. The negotiators will convene again this fall. Yet just as the talks have moved into this crucial phase, Shipbuilders Council of America's (SCA) commitment to actually seeing an agreement reached has become questionable.

Perhaps it is because any Agreement necessarily would require the elimination of some existing U.S. laws that now provide significant benefits to domestic shipbuilders:

- the requirement that Operating Differential Subsidy may only be paid for employing U.S.-crews on U.S.-built ships;
- the requirement that tax deferred funds in the Capital Construction Fund program may be used only for U.S.-built ships; and
- the imposition of a 50% *ad valorem* duty on repairing U.S.-flag vessels in foreign yards.

U.S. commercial shipbuilders would continue to benefit from the $2.575 billion strategic shipbuilding program to expand the military's sealift capabilities, as well as the millions to be spent for refitting Ready Reserve Fleet ships and repairs to the large U.S. Navy fleet. New construction for the U.S. Navy continues at over $5 billion per year.

As U.S. negotiators have acknowledged, it is not enough to simply eliminate foreign government subsidies for commercial shipbuilding and repair: it also is necessary to eliminate U.S. government laws and policies which now benefit U.S. shipyards at the cost of serious harm to the U.S.-flag merchant marine. This requires permitting all U.S. operators in foreign trades to acquire foreign-built vessels without penalty and to repair them without penalty in the U.S. or overseas. USTR has confirmed that a multilateral agreement would of necessity have to make these changes to U.S. law in order to meet U.S. obligations under that Agreement.

USA'S OPPOSITION TO LEGISLATION SOUGHT BY DOMESTIC SHIPBUILDERS

We agree with USTR that bills introduced in the Senate (S. 1361) and House (H.R. 2056 and 2709) take the wrong approach in attempting to improve the current condition of the domestic shipbuilding industry. In brief, these bills would prohibit ships built or repaired in foreign shipyards from calling at U.S. ports if the Department of Commerce finds that work on those vessels was subsidized, unless an amount equal to the subsidy is repaid to the foreign government or paid to the U.S. Government.

USA believes that the enactment of domestic legislation would preempt the ongoing multilateral negotiations. USTR testified before the House Trade Subcommittee in March that a multilateral agreement "is the only reasonable one . . . based on a solid, rational analysis of the commercial needs of the industry." Therefore, the best chance of disciplining such subsidies worldwide would be lost.

The bills also penalize the wrong parties by imposing sanctions on vessels, vessel owners and vessel operators, including American shipowners operating U.S.-flag vessels. USA believes that the issue of foreign shipyard subsidies is best addressed through a multilateral agreement that will penalize the offenders, the subsidized foreign shipyards and their governments, not shipowners and domestic importers and exporters.

Moreover, the sanctions proposed by the various bills would disproportionately disadvantage American shipowners and operators who are likely to have a greater percentage of their fleet call at U.S. ports. Foreign lines could send "subsidy free" vessels to the U.S.—but continue to employ subsidized vessels in other trades. Example: two U.S.-flag carriers provide service on a circular route from the U.S. West Coast to several countries in Asia, and then back to the U.S. The intra-Asia trade is a major growth market. The American companies—forced to pay penalties and in turn charge more to recoup those payments—would be at a serious disadvantage vis-a-vis foreign lines that may go back and forth within Asia and never call at a U.S. port.

Not only does the legislation penalize shipowners, but it attempts to make them agents of the U.S. Government. Shipowners seek bids worldwide for shipbuilding contracts and carefully compare bottom line offers. The bills assume vessel owners are able to investigate and interrogate foreign shipbuilders as to whether they were receiving subsidies. The situation would be analogous to buying a car from Chrysler and having to certify that the company had never received financial assistance from the government.

For these reasons USTR has testified that sanctions should fall on a foreign shipbuilder receiving benefits or that foreign government, *not* on a shipowner who may

be from a different country and be unaware of the subsidy. Under the proposed multilateral agreement, sanctions *would* be imposed on foreign shipbuilders.

From a national perspective, however, the proposed legislation does far more damage than merely hurt the ship operating business. It will also harm American exporters and importers. Sanctions imposed on U.S. and foreign vessels and vessel owners would needlessly disrupt the orderly movement of millions of tons of waterborne trade through U.S. ports and elsewhere. Fewer vessels are likely to call at U.S. ports. Moreover, any fines imposed on those shipowners who are able to call at U.S. ports necessarily would be passed on to American exporters and importers as a cost of doing business. This in turn will raise the cost of goods shipped to and from the U.S., harming America's exporters and contributing to inflation. American businesses and consumers would be forced to pay for foreign subsidies!

In addition, foreign governments could well retaliate against American exports of agricultural and other goods in response to such unilateral action—justifiably so, given the continued existence of U.S. laws that significantly benefit domestic shipbuilders. Accordingly, several shipper groups have voiced concern and opposition to the legislation.

THE LACK OF COMPETITIVENESS OF U.S. SHIPBUILDERS IS NOT DUE TO FOREIGN SUBSIDIES ALONE

It has cost significantly more to build a ship in a U.S. yard than in a foreign yard for many years. Until 1981 the U.S. Government subsidized the difference in construction costs (up to 50% of the U.S. cost) for operators of U.S.-flag vessels in the international trades, who were required to build their vessels in domestic yards and could not otherwise afford to do so. Not surprisingly, since the Government terminated the ship construction subsidy program, no U.S.-flag vessels for operation in the international trades have been built in the U.S.

Indeed, as a result of lagging domestic productivity (failure to invest in new plant and equipment and learn new production processes), by 1987 it was estimated to cost more than three times as much to build a vessel in a domestic yard and to take three times as long to complete the job. While exchange rate changes, rising foreign wages, and a shortage of foreign shipyard berths have narrowed the gap somewhat, best estimates are that it still costs *almost three times as much* to build a ship in the U.S. and delivery takes *over two times as long.*

Domestic shipbuilders, represented by the SCA, have attempted to blame entirely their lack of competitiveness on the continued existence of foreign shipbuilding subsidies. SCA argues that if these foreign subsidies were eliminated, thereby creating a "level playing field," then domestic shipbuilders would be able to compete.

USA believes that even if there are foreign subsidies, it is highly questionable whether they are the reason it costs significantly more to build a vessel in a domestic yard. Rather, we believe the difference is largely the result of: lower productivity in U.S. yards because of outdated physical plant and lack of recent experience in commercial construction; higher prices in the U.S. for steel and marine equipment (if it is even available); higher labor costs (even today, after accounting for rising-reign wages and exchange rate changes); and higher construction finance costs.

CONCLUSION

Foreign shipbuilding subsidies should not be condoned, and the shipbuilders legitimately ask that they be ended. But it is unclear to what extent foreign subsidies actually are responsible for the uncompetitiveness of domestic shipyards. Moreover, the correct approach to addressing any such subsidies is through a multilateral agreement that penalizes offending foreign governments and shipbuilders, *not* shipowners and American shippers. USA supports ongoing multilateral shipbuilding subsidy negotiations and at the same time, strongly opposes any legislation which imposes sanctions against ships, shipowners or ship operators.

ISBN 0-16-037369-7