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THE USE OF "LOW-LABOR" COMPONENTS
IN THE INSULAR POSSESSIONS' WATCH
INDUSTRY

A Compilation of Written Comments Solicited by the
SUBCOMMITTEE ON INTERNATIONAL TRADE

ABRAHAM RIBICOFF, *Chairman*

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

RUSSELL B. LONG, *Chairman*



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[Press release]

August 21, 1978.

SOVIET WATCHES ASSEMBLED IN THE POSSESSIONS: SUBCOMMITTEE ON INTERNATIONAL TRADE OF THE COMMITTEE ON FINANCE SOLICITS WRITTEN COMMENTS ON THE TARIFF TREATMENT OF WATCHES AND WATCH MOVEMENTS FROM THE INSULAR POSSESSIONS ASSEMBLED FROM PARTS MANUFACTURED IN COUNTRIES NOT CURRENTLY RECEIVING NONDISCRIMINATORY (MOST-FAVORED-NATION TARIFF TREATMENT)

Hon. Abraham Ribicoff (Democrat of Connecticut), chairman of the Subcommittee on International Trade of the Committee on Finance, announced today that the subcommittee is seeking written comments on the tariff treatment of certain watches and watch movements from American Samoa, Guam, and the Virgin Islands of the United States. The particular issue which the Subcommittee is considering relates to the assembly in the Virgin Islands of watch movements from parts which are the product of the Union of Soviet Socialist Republics.

Current law

Under General Headnote 3(a) of the Tariff Schedules of the United States (19 U.S.C. 1202), watches and watch movements manufactured or produced in the insular possessions may enter the customs territory of the United States duty-free if they do not contain foreign materials to the value of more than 70 percent of their total value. The total quantity of watches and watch movements entered duty-free under Headnote 3(a) may not exceed one-ninth of the apparent U.S. consumption of watch movements during the preceding calendar year. Not more than 87.5 percent of the watches and watch movements permitted duty-free entry may come from the Virgin Islands.

Issue

It is alleged that the nature of the assembly process of Soviet parts in the Virgin Islands should not qualify the assembled movements for duty-free entry under General Headnote 3(a) of the Tariff Schedules of the United States (19 U.S.C. 1202) because the work done in the Virgin Islands is so insignificant that the purpose of Headnote 3(a), i.e., to encourage employment in the possessions, is not being achieved. It is also alleged that the Soviet parts are being imported into the insular possessions at prices which are less than their cost of production.

Comments

Any comments with respect to the issue described above must be submitted to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building not later than Wednesday, September 6, 1978.

STATEMENT OF HON. RON DE LUGO

Mr. Chairman and distinguished members of the Senate Finance Subcommittee on International Trade, I am grateful for this opportunity to provide comment on proposals for change in the tariff treatment under General Headnote 3(a) of T.S.U.S. of watches and watch movements assembled in the Virgin Islands from parts manufactured in the Soviet Union. I would also like to take this opportunity to address other legislative proposals designed to strengthen the Headnote 3(a) program, expand employment opportunities in the insular possessions, and increase protection of mainland industry.

The purpose of General Headnote 3(a), which authorizes the duty-free importation of products manufactured in the insular possessions provided that such products contain no more than 50 percent foreign materials (70 percent in the case of watches and watch movements), is to stimulate the development of light industry in the off-shore areas of the United States. Since its inception in 1954, the program has been an instrumental factor in what the Director of the Office of Territorial Affairs has called the Virgin Islands "fiscal miracle". Substantial employment, wages and tax revenues have been generated since that time, particularly in the watch industry which now employs approximately 4,000 workers. The program has gained added significance in recent years, as tremendous population growth—almost 300 percent since 1960—has given rise to serious social problems, as well as an unemployment rate higher than the national average.

It has been argued that the recent growth in the manufacture of "Russian" watches threatens the economic stability of the mainland watch industry, including the majority of watch companies in the Virgin Islands which assemble movements and parts from traditional source countries, such as Switzerland, Germany and France. I should like to emphasize that all watches manufactured in the Virgin Islands—regardless of movement or material source—are subject to the quota limitations established for the insular possessions under Public Law 89-805 to avoid injury to the domestic industry.

Under these quota provisions, Virgin Islands watch manufacturers are authorized to ship up to 87.5 percent of one-ninth of the previous year's domestic consumption. Yet, despite the ameliorative effects of Public Law 94-88 (which increased the permissible foreign material content for watches and watch movements from 50 percent to 70 percent), the Virgin Islands still experienced a quota shortfall of approximately 1.6 million units in calendar year 1977 and is projected to reach a quota shortfall of approximately 2 million units in calendar year 1978. At the present time, Russian movements account for approximately 20 percent of total V.I. shipments (846,000 units out of a total of 4.6 million units in 1977), with employment ranging from 37 to 137 workers. It is unclear whether the elimination of the Russian movements, either by a 25 part discrete component test or by a column 2 exclusion, would lead to increased employment in other Virgin Islands firms to replace the lost jobs in the Russian sector. Analysis by the Virgin Islands Department of Commerce suggests that the decline in the competitive posture of the traditional source watch sector is due less to Russian penetration than to the decline in the relative value of the dollar, the rise in sales of quartz movements and digital

watches, the higher minimum wage, and increased shipments from the Far East.

Under no circumstances can I, as Virgin Islands Delegate to Congress, support any amendment or legislative action the net effect of which would reduce employment in our third largest industry. While the numbers may seem small by mainland standards, the loss of 100 jobs would reduce industry employment by 10 percent and seriously aggravate the high unemployment problem in the Territory.

Should the Committee decide upon review of all the facts to exclude Russian watch movements from duty-free treatment under General Headnote 3(a), the jobs lost as a consequence of that action might be offset by Congressional action to authorize watch casing operations as a permissible and integral part of the watch manufacturing process. While the tariff act of 1902 created a separate tariff classification for watches (Item 715.05) and the legislative history of Public Laws 89-805 and 94-88 clearly speaks of "watches and watch movements," the U.S. Customs Service has refused to apply the foreign materials test under Headnote 3(a) against the completed watch product, but rather has applied it separately against both the watch case and the internal watch movement. The net effect of this practice of "constructive segregation," which the Customs Service justifies on the basis of "long-standing administrative practice" rather than any substantive reason, has been to prevent Virgin Islands companies from manufacturing finished watch products. The U.S. Department of Commerce, which would support watch casing as a permissible activity within the purpose of the Headnote, has estimated that a casing amendment might increase employment in the industry by as much as 200 new jobs.

I am attaching at the end of my statement a copy of an amendment which would accomplish this effect, as well as correspondence I have had with the U.S. Customs Service on this matter.

Finally, I wish to address the subject of General Headnote 3(a) reform as encompassed in H.R. 8222, legislation unanimously reported last July by the House Ways and Means Subcommittee on Trade to restore the competitive position of the other light manufacturing industries in the insular possessions. The bill does this by extending to all industrial sectors in the off-shore areas the same customs changes enacted by Congress for the benefit of the watch industry under Public Law 94-88. In brief, the subcommittee bill, which incorporates the recommendations of the House trade staff, includes the following elements:

(1) increases the permissible foreign materials content for all tariff classifications under General Headnote 3(a), exclusive of watches and watch movements, from 50 percent to 70 percent for a period of 3 years; at the end of that period, unless affirmatively renewed by Congress or otherwise changed, the Headnote formula would automatically revert back to 50 percent.

(2) provides for removal of articles from Headnote 3(a) eligibility on competitive grounds similar to those employed in the consideration of articles under the generalized system of preferences.

(3) imposes a total limit of \$25 million on the amount of any product that may enter the United States duty-free from the insular possessions taken as a whole.

(4) requires the Administration to monitor the Headnote 3(a) program and prepare a comprehensive study to aid the Congress in its determination to renew, modify or otherwise change the program at the end of the 3-year period.

The need for this legislation is dictated by the same changes in the international economic environment which adversely affected the Virgin Islands watch industry in the 1970's and which have served to diminish the real value of the General Headnote 3(a) incentives in recent years. To understand how this has happened, it is first necessary to understand how the present law works.

Under the 50 percent test for foreign materials, a Virgin Islands manufacturer must double the cost of his foreign components when the assembled product is entered into the United States in order to qualify for duty-free treatment. While the 50 percent test does not require any specific amount of value added or labor input in the Territory, the law does require that a product be "substantially transformed" from whatever foreign materials have been imported for assembly or manufacture. The substantial transformation test is rigorously enforced by the U.S. Customs Service in order to exclude industries which do not generate significant employment or merely attempt to pass a given product through the Territory to escape customs duties.

However, inflation and dollar devaluation, ever-increasing shipment costs, as well as increased competition from developing countries have caught the territorial manufacturer in a pricing squeeze where his product must now sell at prices so high under the doubling requirement that it is no longer competitive in the mainland market. The result has been that employment has declined significantly, and many companies that once operated profitably under General Headnote 3(a) have gone out of business altogether.

Recognizing these problems, Congress enacted relief for watch companies in 1975 (Public Law 94-88), incorporating the same 70 percent allowance for foreign materials that is now sought for all industries in the insular possessions. I would only like to add that, as a result of the above change in the customs formula, employment in the watch industry has returned to its peak 1972 level, climbing from a low of approximately 400 employees in late 1974 to a level approaching 1,000 in recent months. It has merely allowed the watch companies to sell at a more competitive price in order to stay in business. Under H.R. 8222, the same can reasonably be expected to occur with respect to the remainder of these Headnote 3(a) industries, where employment in the Virgin Islands alone has declined by over 42 percent in the last few years. Just since the introduction of this legislation, one factory in my District employing over 150 people has ceased operations completely. Another factory employing approximately 80 workers has laid off all but 8 persons.

I strongly believe that H.R. 8222 holds the key to long term economic growth in the Virgin Islands, as well as lessened dependence on the Federal Government. The approach embodied in the subcommittee bill is reasonable and would seem to have a number of advantages over alternative proposals. It would provide effective relief to existing companies, while its limited scope would serve to quiet imagined fears that the bill might open up a floodgate of new imports. Similarly, the article removal provision and the \$25 million product limitation would

ensure against any dislocation to import sensitive industry on the mainland. Finally, the administration would monitor the new program and its comprehensive study would generate the necessary statistics upon which any program or formula changes can be intelligently made in the future.

Thank you very much.

PROPOSED REVISION TO GENERAL HEADNOTE 3(A), TSUS

Delete the following language.—(or more than 70 percent of their total value with respect to watches and watch movements)

Substitute the following language.—(or more than 70 percent of the total value of watches, which total value shall include the value of both the movements and cases and shall be evaluated on a unitary basis, and of watch movements)

PURPOSE OF AMENDMENT

Under the present language of General Headnote 3(a), watch producers located in the insular possessions have sought to expand the scope of their operations to include, not only the assembly of watch movements, but the assembly of finished watches, that is, cased movements. The U.S. Customs Service has ruled, however, that the present language's requirement of no more than 70 percent foreign origin by value must be applied separately to the movement and case of such assembled watches. Although such watches could pass the 70 percent test if that test is applied to the total value of the assembled watches, that is, both movements and cases, it is not presently possible for watch companies in the insular possessions to produce watch cases meeting this test. Consequently, the U.S. Customs Service's restrictive interpretation of this language has frustrated the basic purpose of this provision, which was to stimulate the development of light industry in the possessions. (S. Rep. No. 1679, 89th Cong. 2d sess. 1966.)

In order to clarify congressional intent in this area and to make possible the expansion of the insular possessions' watch industry to include the casing of movements assembled there, the language of General Headnote 3(a) is revised to specify that, with respect to watches, that is, cased movements, imported from the insular possessions, the 70 percent test is not to be applied separately to the case and movement but on a unitary basis to the total value of the watch.

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., October 14, 1977.

Re request for Ruling Concerning Dutiable Status of Watches Imported from Insular Possessions.

MR. SALVATORE E. CARAMAGNO,
Director, Classifications and Valuations Division, U.S. Customs Service, 1301 Constitution Avenue, Washington, D.C.

DEAR MR. CARAMAGNO: By this letter I am asking the U.S. Customs Service to review the question of the dutiable status of watches produced in the insular possessions under the terms of General Headnote

3(a) and Headnote 6 of Subpart E, Part 2 of Schedule 7 of the Tariff Schedules of the United States ("TSUS").

Specifically, I am asking that the Customs Service rule that: (1) cases movements assembled and processed in the insular possessions are watches produced in those possession for purposes of the TSUS, (2) such watches are entitled to duty-free entry if no more than 70 percent of their total value is of foreign origin and (3) such watches may be returned to the insular possessions for repairs and reentered into the Customs territory of the United States duty-free if no more than 70 percent of their total value is then of foreign origin.

BACKGROUND

For many years, the products of U.S. insular possessions outside the Customs territory of the United States have been entitled to duty-free entry into the United States so long as any foreign materials incorporated into those products did not exceed a specified percentage of their value. (See, e.g., Public Law 83-708, § 401 (1954)), enacting what is now General Headnote 3(a) of the TSUS. The acknowledged purpose of this provision was to stimulate the development of light industry in these possessions and thereby contribute to the welfare of the inhabitants. The U.S. domestic watch industry, faced with an increasing volume of imported goods, used assembly operations in the insular possessions in an attempt to remain competitive with the imports.¹

By the mid-1960's, however, Congress concluded that the volume of components produced in the insular possessions from foreign components and imported duty-free had increased to the point where some restrictions were necessary in order to avoid damage to the remaining U.S. domestic operations. For this reason, Congress imposed a quota system on these operations which was designed to keep production in the insular possessions at a steady percentage of domestic demand and, thus, to preserve the delicate balance between watches produced in the United States, the insular possessions and foreign countries.

While reaffirming that General Headnote 3(a) "was calculated to, and in effect has, stimulated the development of light industry in the possessions," Congress decided that, to avoid adverse effects on domestic watch production, it would be necessary to impose "a quota on the number of watches and watch movements containing foreign components which may be imported duty-free from the U.S. insular possessions." (S. Rep. No. 1679, 89th Cong., 2d Sess. (1966), reprinted in 1966 U.S. Code Cong. and Ad. News at 4389-90.)

The Senate Report on the final version of this legislation observed that, "[u]nder present law, if not more than 50 percent of the total value of an article produced in the insular possessions is of foreign origin, it qualifies for duty-free treatment. . . ." *Id.* at 4392. The amendments enacted by Congress, the Committee further observed, set an upper limit on these importations by authorizing the Tariff Commission (now the International Trade Commission) to "compute and publish the number of watches and watch movements which could be

¹ In 1954, tariffs on imported watch movements were increased in order to remedy the injury suffered by the domestic industry as a result of the increased quantities of imports. (19 Federal Register 4659 (July 20, 1954).)

assembled in the possessions in each quota year for duty-free export to the United States." *Id.* at 4396.

The pertinent headnotes were again amended by Congress in 1975 in view of certain economic changes (devaluation of the U.S. dollar and inflation) which had "reduced considerably the competitiveness of watches manufactured in the possessions with those imported directly from abroad." (S. Rep. No. 94-273, 94th Cong., 1st Sess. (1975)) reprinted in 1975 U.S. Code Cong. & Ad. News at 885.) The effect of these amendments was said to be "to provide duty-free treatment to watches and watch movements manufactured in any insular possessions of the United States if foreign materials do not exceed 70 percent of the total value of such watches and movements. . . ." *Id.* at 884.

The recognition of "watches" as specific articles produced in the insular possessions and entitled to the benefit of the foregoing free entry provisions on the basis of their total value stands in contrast to the treatment accorded watches imported from foreign countries under the provisions of the TSUS. Such watches are subject to the Column 1 or Column 2 rates of duty for Item 715.05 ("Watches") which are the sum of the rates which would be applicable to the cases plus the rates which would be applicable to the movements if these two items were imported separately. TSUS, Item 715.05.

CASED MOVEMENTS ASSEMBLED AND PROCESSED IN THE INSULAR POSSESSIONS ARE WATCHES PRODUCED IN THOSE POSSESSIONS FOR PURPOSES OF THE TSUS

The TSUS recognizes "watches" as a separate and distinct category of articles, Item 715.05, and defines them as "timepieces . . . suitable for wearing or carrying on or about the person, whether or not the movement therein is within the definition of 'watch movement' in headnote 2(b) below." Headnote 2(a), Subpart E, Part 2 of Schedule 7. As already noted, the legislative history of General Headnote 3(a) and Headnote 6(b) of Subpart E, Part 2 of Schedule 7 reflects a similar recognition of watches as articles separate and distinct from watch movements. In addition, where the movement and case which compose the watch are assembled in the insular possessions and undergo significant processing there in satisfaction of the requirements of the pertinent headnotes, they are properly classified as products of those insular possessions. *See Nanco Inc. v. United States*, 40 CCR 366 (1958) (holding that the uniting of watch cases and movements into a complete watch resulted in a new article which was a product of the place of assembly).

WATCHES PRODUCED IN THE INSULAR POSSESSIONS ARE ENTITLED TO DUTY-FREE ENTRY IF NO MORE THAN 70 PERCENT OF THEIR TOTAL VALUE IS OF FOREIGN ORIGIN

The specific language of the pertinent headnotes and their legislative history show that Congress intended watches, as well as watch movements, to benefit from these duty-free entry provisions.

Headnote 6(b) of Subpart E, Part 2 of Schedule 7 permits "watches (provided for in Item 715.05) and watch movements (provided for in items 718.00 through 719.—", produced in the insular possessions,

to enter the United States free of duty “[i]f the requirements for duty-free entry set forth in general headnote 3(a) are complied with. . . .” General Headnote 3(a), in turn, states that both “watches and watch movements” produced in the insular possessions shall be exempt from duty if “not more than 70 percent of their total value” is attributable to foreign materials.

This recognition of watches as a category of articles, distinct from watch movements, the “total value” of which is entitled to be tested by the 70 percent rule, is further evidenced by the legislative histories of the 1966 and 1975 amendments to these headnotes already referred to. Thus, the Senate report on the 1966 legislation which added the quota system describes that legislation as intended to control “the number of watches and watch movements containing foreign components which may be imported duty-free from the United States insular possessions.” S. Rep. No. 1679, *supra* at 4390 (emphasis supplied). Similarly, the Senate report on the 1975 legislation indicated that under what is now General Headnote 3(a) “the permissible foreign material content of watches and watch movements entitled to duty-free treatment would be raised to 70 percent of the total value.” S. Rep. No. 94-273, *supra* at 884-885.

The relationship between the treatment of watches produced in the insular possessions under the duty-free provisions of General Headnote 3(a) and the treatment accorded watches imported from foreign countries under the normal duty rate provisions of Item 715.05 are clearly spelled out in General Headnote 3 of the TSUS, dealing with the rates of duty to be applied to imported articles. The initial subsections of this headnote identify a number of specific situations in which special duty rates (or, in the case of qualified products of the insular possessions described in subpart (a), no duties) are assessed. If an article falls within none of these special categories (as would be the case with most directly imported foreign watches), the article is “subject to the rates of duty set forth in column numbered 1 of the schedules.” TSUS, General Headnote 3(f). Accordingly, in the case of a watch imported from the insular possessions under General Headnote 3(a), there is never any need to apply the Column 1 provisions of Item 715.05, requiring the separate valuation of case and movement, and the 70 percent test is instead applied to the total value of the watch, in accordance with the language and legislative history of the pertinent footnotes.²

In sum, the headnotes and legislative history reflect a clear Congressional intent to treat a watch as a distinct category of article for purposes of General Headnote 3(a) and to apply the 70 percent limit on foreign origin value to the total value of the watch, rather than to follow the otherwise applicable provisions of Item 715.05 by separately valuing and testing the extent of foreign origin of the watch case movement. Indeed, any other interpretation of the headnotes would frustrate the clear Congressional intention to stimulate light industry in the insular possessions by permitting the duty-free entry of qualified watches and movements produced there. It has been conservatively estimated that employment in the Virgin Islands watch

² This conclusion is bolstered by the language of Headnote 6(b), Subpart E, Part 2 of Schedule 7 which, in effect, requires watches which fail to meet the test of General Headnote 3(a), to be valued on the basis of Column 1 or Column 2 rates, depending upon the origin of the foreign materials involved.

assembly industry, with which I am most familiar, would be increased by 25 percent if Customs were to confirm that watches produced in the Virgin Islands were entitled to duty-free entry in the manner outlined here and such a ruling would have an even greater multiplier effect which could be expected to raise employment and also increase government revenues, which would then be available to deal with the social effects of the remaining unemployment.

WATCHES PRODUCED IN THE INSULAR POSSESSIONS AND IMPORTED INTO THE UNITED STATES MAY BE RETURNED TO THE POSSESSIONS FOR REPAIRS AND REENTERED DUTY-FREE IF NO MORE THAN 70 PERCENT OF THEIR TOTAL VALUE IS OF FOREIGN ORIGIN

I am informed that some purchasers of watches produced in the insular possessions are considering the feasibility of locating additional facilities in those possessions and sending the imported watches there for repairs and subsequently reimporting them. Such facilities would obviously result in further benefits to the economies of the possessions and, in order to encourage this additional development, I am requesting the Customs Service to rule that the repaired watches would also be entitled to entry duty free under General Headnote 3(a) provided that 70 percent or less of the total value of the watches was of foreign origin.

It is clear that, under the pertinent laws and regulations, watches produced in the insular possessions would be treated as foreign articles at the time of their reimportation into the customs territory of the United States. See, *S. Candler Dobbs v. U.S.*, 32 CCR 470 (1954). At that time, however, the watches would again be entitled to the benefit of General Headnote 3(a) as products of the insular possessions. 19 C.F.R. § 141.2(i). Since the watches would then contain no less (indeed, presumably an even greater) component of non-foreign value than at the time of their original importation, they should again be entitled to duty-free entry.

I would appreciate your immediate attention to these important matters, and with best regards, I am

Sincerely,

RON DE LUGO,
Member of Congress.

DEPARTMENT OF THE TREASURY,
U.S. CUSTOMS SERVICE,
Washington, D.C., December 22, 1977.

Hon. RON DE LUGO,
House of Representatives,
Washington, D.C.

DEAR MR. DE LUGO: In your letters of October 14, 1977, December 6, 1977, and supplemental submissions, you requested that the Customs Service review the dutiable status of watches produced in the insular possessions of the United States. You specifically asked us to review our rulings on each of the three following issues:

I. You request a ruling that cases movements assembled and processed in the insular possessions are watches produced in those possessions for the purposes of the Tariff Schedules of the United States (TSUS).

Watches and watch movements are exempt from duty, pursuant to General Headnote 3(a) of the Tariff Schedules, if they are manufactured or produced in an insular possession, and if no more than 70 percent of the total value is of foreign origin. This exemption is accorded only if both conditions are satisfied. The issue here is whether cased movements, "assembled and processed" in the insular possessions, satisfy the "manufactured or produced" requirement of General Headnote 3(a).

We have ruled, consistently, that the mere assemblage of a watch movement into a watch case does not result in a watch which is manufactured or produced within the meaning of General Headnote 3(a). As you state in your letter, the watch components must undergo significant processing to satisfy this requirement of General Headnote 3(a). Accordingly, the question whether a watch is manufactured or produced in an insular possession depends upon the extent of the operations performed. A determination can only be made on a case by case basis.

II. You request a ruling that watches produced in the insular possessions be permitted duty free entry if no more than 70 percent of their total value is of foreign origin.

You contend that the tariff schedules require that watches be considered as articles separate and distinct from watch movements and cases. However, the statutory language cited in support of this contention, found in: General Headnote 3(a); Headnote 2(a), Subpart E, Part 2, Schedule 7; and item 715.05, TSUS, does not evidence a clear legislative intent supporting your contention. The statutory language is ambiguous and it is necessary to determine the legislative intent by reference to legislative background material. You implicitly recognize the ambiguity in the statute by making reference to the legislative history of the various amendments to the Tariff Classification Act of 1962 (the "1962 Act").

The Tariff Act of 1930 (the "1930 Act") had no provision for "watches." Watches were treated as two separate tariff entities, watch movements and cases, pursuant to paragraphs 367 and 368 of the 1930 Act. The 1962 Act amended the 1930 Act and inserted item 715.05, TSUS, for "watches." The rate of duty for these articles is dependent upon the separate appraisal of watch movements and watch cases.

It is clear from the Tariff Classification Study (the "Study") that the new statutory provisions were not intended to make any substantive changes in the treatment of watch movements and cases. The Study, in its commentary to Headnote 2(a), Subpart E, Part 2, Schedule 7, which defines "watches", states: "This definition is included to clarify the existing provision." (Tariff Classification Study, November 15, 1960, page 164, emphasis added). The Study also states that the provision which covers watches was intended to provide clarity and uniformity to the classification and dutiable rates of watches: "It is believed, in the interest of clarity and uniformity, that all watches imported should be classified according to the same principle, viz., separate rate treatment for their cases and their movements." (*Id.*, at 166.)

Since 1962, Congress has enacted two amendments to the 1962 Act which affect the treatment of watches and their components: Public

Law 89-805 (the "1966 Amendment") and Public Law 94-88 (the "1975 Amendment").

The 1966 Amendment, contained in Headnote 6(b), Subpart E, Part 2, Schedule 7, imposed a "quote on the number of watches and movements containing foreign components which may be imported duty-free from the U.S. insular possessions." (Senate Report No. 1679, 89th Cong. 2d Sess. (1966), reprinted in 1966 U.S. Code Cong. & Ad News, at 4389-90).

In your letter, you cite language from the Senate Report to the 1966 Amendment: "[u]nder present law, if not more than 50 percent of the total value of an article produced in the insular possessions is of foreign origin, it qualifies for duty-free treatment . . ." *Id.* at 4392. You contend that this language evidences a legislative intent to have watches considered as separate articles, distinct from watch movements and watch cases. However, the specific legislative intent, clearly expressed in the Senate Report was to avoid adverse effects on domestic watch production.

The 1975 Amendment, contained in General Headnote 3(a), adopted the 70 percent test with regard to watches and watch movements. It states that such products of an insular possession may be exempt from duty if the foreign content of the articles is not "more than 70 percent of their total value."

Congress indicated in the legislative history of the 1975 Amendment (Senate Report No. 94-273, 94th Cong., 1st Sess. (1975), reprinted in 1975 U.S. Code, Cong. & Ad. News) that its specific intent was to make watches manufactured in the possessions competitive with those imported directly from abroad. To do this, Congress adopted the 70 percent test and used the "total value" language which is identical to the language used in the 50 percent test in General Headnote 3(a).

The intent of both amendments was specifically stated in the legislative history of each. The language in both amendments accomplishes the stated intent. Nothing in the Congressional reports, or hearings (Hearing Before the Committee on Finance, United States Senate, 89th Congress, on H.R. 8436, June 30, 1966 (1966 Amendment); Hearings Before the Subcommittee on Trade of the House of Representatives, 94th Congress, April 23 and 24, 1975 (1975 Amendment)) requires the interpretation which you put forth.

In sum, the statutory language in the 1962 Act, the 1966 Amendment, and the 1975 Amendment did not evince a legislative intent to modify the tariff treatment of watch movements and cases. The Customs Service, relying upon a decision by the United States Court of Customs and Patent Appeals, that long established administrative practice should not be changed unless compelling reasons require it, has no justification to modify its practice with regard to watches. (See *U.S. v. Electrolux Corp.*, 46 Ct. Cust. Appls. 43 (1959)).

Congress could have easily provided, in clear and unambiguous language, for the unitary treatment of watch movements and cases as a watch rather than as individual components. Congress considered the tariff treatment of watches in adopting the 1962 Act, the 1966 Amendment and the 1975 Amendment. In each case a clear legislative intent was established in the legislative history. In each

case the statutory language reflected the legislative intent. A clear congressional intent to apply the 70 percent test to watches, rather than to watch movements and watch cases is not evident. Accordingly, the 70 percent test applicable to watches in General Headnote 3(a) must be applied to each of the watch components, movement and case, separately.

III. You request a ruling that imported watches produced in an insular possession, can be returned to the possession for repairs and re-entered duty-free if no more than 70 percent of their total value is of foreign origin.

As you know, articles returned to the United States after having been exported for repairs or alterations are subject to duty merely upon the value of the repairs or alterations, under item 806.20, TSUS.

The Customs Service has ruled that watch movements, which qualified for an exemption from duty under General Headnote 3(a) when entered into the United States, and which, upon being found defective by the original importer are sent directly back to the possession for repairs and alterations, and are then returned to the U.S. retain their duty-free status. Likewise, watches previously imported duty free, under General Headnote 3(a), and sent directly back to the possession by the importer for repairs, may be returned to the U.S. duty-free.

However, if the watches or movements are distributed to retailers after duty-free importation under General Headnote 3(a), they are no longer eligible for 3(a) treatment. In such cases, they would be subject to duty upon their return to the United States on the value of the repairs or alternations as provided in item 806.20, TSUS.

If we can be of further assistance, please do not hesitate to call on us.

Sincerely yours,

R. E. CHASEN,
Commissioner of Customs.

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., April 20, 1978.

Re Dutiable Status of Watches Assembled in the Insular Possessions.

Commissioner ROBERT E. CHASEN.

*U.S. Customs Service, 1301 Constitution Avenue NW.,
Washington, D.C.*

DEAR COMMISSIONER CHASEN: On October 14, 1977, I submitted a request for ruling concerning the dutiable status of watches imported from the insular possessions. (Attachment A) This request was supplemented by a submission, dated November 23, 1977, from Jon Paugh, Esq., on behalf of the Waltham Watch Company, which is engaged in the assembly of watches and movements in the Virgin Islands pursuant to Public Law 89-805, as amended. (Attachment B)

On December 22, 1977, you replied to my request (Attachment C), ruling that: (1) a determination as to whether the assembly and casing of watch movements in the insular possessions satisfy the "manufactured or produced" requirement of General Headnote 3(a), TSUS, would have to be made on a case by case basis; (2) that the 70 percent tests applicable to watches in General Headnote 3(a) must be applied separately to the movement and case, in view of the long-

established administrative practice to this effect and the lack of any legislative intent to change this practice.¹

I have carefully considered your letter and am asking you to reconsider that portion of your ruling which concludes that, in the circumstances described in my letter, the 70 percent test contained in General Headnote 3(a) must be applied separately to the movement and the case of a watch produced in the insular possessions. I am asking for this reconsideration because I think the requested ruling is clearly compelled by the language and legislative history of the statute.

As you are well aware, the tariff laws first recognized a watch as a distinct article in 1962, when Congress adopted the Tariff Commission's proposed definition (Headnote 2(a), Schedule 7, Part 2, Subpart E) and created a separate tariff category for watches (Item 715.05). While Congress carried forward the prior practice of assessing duties upon imported watches on the basis of their constructive segregation into cases and movements, it placed that language in the "Rates of Duty" column for Item 715.05, rather than incorporating it into the definition itself. In sum, the language of the Tariff Schedules, on its face, recognizes a "watch" as a distinct article, with an identity separate from that of its component parts.

Reading this background concerning the term "watch" into the language of General Headnote 3(a), it seems obvious that that headnote's references to the "total value" of "watches" means precisely what it says, i.e., the value ascribed to the assembled watches at the time of importation, not some value arrived at by constructive segregation of case and movement by analogy to the "Rates of Duty" language for Item 715.05.

This conclusion, so clearly supported by the language of the headnote, is further strengthened by reference to the underlying legislative purpose of General Headnote 3(a), i.e., stimulating "the development of light industry in the possessions. . . ." S. Rep. No. 1679, 89th Cong., 2d Sess. (1966) reprinted in 1966 U.S. Code Cong. & Ad News at 4389-90. Application of the 70 percent test in the manner requested would serve this fundamental statutory purpose by sanctioning additional assembly steps in the insular possessions, contributing further employment and additional stimulus to the local economies.

In rejecting the ruling request, your letter places great emphasis on a "long established administrative practice" deemed inconsistent with the requested ruling. Your letter does not cite any instances in which the ruling requested here has previously been denied, however, and, from the information available to me, there does not appear to have been a "long established administrative practice" on this point under General Headnote 3(a). Indeed, this appears to be the first time this issue has been squarely addressed by the Customs Service.

Nor is the requested ruling at odds with Customs' statutorily-mandated practice with respect to dutiable imported watches. The ruling requested here would simply require the Customs Service, as a threshold matter, to determine if the total value of the watch met the 70 percent test. If it did, and the other requirements of General Headnote 3(a) were met, no further inquiry would be required. If the

¹ You also ruled that watches produced in the insular possessions and entered into the United States duty-free can be returned to the possessions for repairs and re-entered duty-free only before they are distributed to retailers.

watch failed to meet the 70 percent test, however, the directions contained in the "Rates of Duty" column of Item 715.05 would then become applicable and duties would be assessed upon the basis of the constructive segregation of movement and case.

In sum, the ruling requested here is supported by the plain language of the statute, furthers the basic statutory purpose and is not inconsistent with existing Customs practice. For these reasons, I hope you will, after reconsidering the matter, rule that the 70 percent test of General Headnote 3(a) is to be applied to the total value of watches produced in the insular possessions.

Sincerely yours,

RON DE LUGO,
Member of Congress.

DEPARTMENT OF THE TREASURY,
U.S. CUSTOMS SERVICE,
Washington, May 12, 1978.

Hon. RON DE LUGO,
House of Representatives, Washington, D.C.

DEAR MR. DE LUGO: In your letter of April 20, 1978, you requested a reconsideration of our letter of December 22, 1977, in which we concluded that the 70 percent value test contained in General Headnote 3(a), Tariff Schedules of the United States (TSUS), must be applied separately to watch movements and watch cases.

You suggest that the ruling requested is supported by the plain language of the relevant statutes and legislative history. You also suggest that there is no long established administrative practice that precludes the unitary treatment of watches.

As you know, watch movements and cases were separately dutiable under the Tariff Act of 1930. *Concord Watch Co., Inc. v. U.S.*, C.A.D. 523 (1953); *R. F. Downing & Co., Inc. v. U.S.* 33 CCR 303, Abs 58230. See Custom's letter dated May 23, 1955, copy enclosed.

We believe that the statutory language in the Tariff Classification Act of 1962 was not intended to modify this separate tariff treatment of movements and cases. The Tariff Classification Study, which is recognized as legislative history, clearly states that the 1962 Act was merely a recodification of the 1930 Act. Also, the amendments to General Headnote 3(a), TSUS, cited by you in support of your arguments, were never intended to alter the treatment of watch movements and cases. Accordingly, the long established administrative practice, begun under the 1930 Act, requires the separate treatment of movements and cases.

We fully support the legislative policy to encourage the development of the economy of the Virgin Islands. However, we believe, for the reasons stated, that the requested change of practice cannot be justified.

If we can be of further assistance, please do not hesitate to call on us.

Sincerely yours,

R. E. CHASEN,
Commissioner of Customs.

THE VIRGIN ISLANDS OF THE UNITED STATES,
OFFICE OF THE GOVERNOR,
Charlotte Amalie, St. Thomas, August 30, 1978.

Mr. MICHAEL STERN,
Staff Director, Committee on Finance, Dirksen Senate Office Building, Washington, D.C.

DEAR Mr. STERN: We concur wholeheartedly with the objective of the Senate Subcommittee on International Trade to expand employment in the territories. Local rates of unemployment between 8 percent and 10 percent in recent years, and these probably understated, are generating severe social as well as economic problems. Despite Headnote 3(a) and our own generous industrial incentive program, the outlook for significant melioration is not promising unless even greater efforts are undertaken. We have expanded our industrial promotion staff and we have succeeded in generating new job opportunities at a higher rate. Nevertheless, the meteoric rise in population, 200 percent over the last decade and a half, now throws relatively large numbers of youths onto the labor force each year. Like the Red Queen, we must run much faster just to keep up.

Our concern is that the proposed action may fail of its meritorious objective and actually create a loss rather than a gain in jobs. The reason is that the evidence is by no means clear that jobs lost from Russian watch assembly will be more than matched by jobs gained in the remainder of the industry. The proposition would hold true if the market served by the Russian watches could be captured in large part by other Virgin Islands producers. The Russian watches have 17 jewels and retail for \$14.95 to \$19.95. Their major markets consist of very large outlets such as mail order firms, discount houses, and department stores. With a 50 percent higher movement cost, higher unit labor costs and traditionally higher markups, a serious question arises whether the gap could be filled in large part by non-Russian watches.

The competitive posture of the non-Russian segment has been severely eroded by the decline in the relative value of the dollar, the rise in sales of quartz movements, the higher minimum wage, and increasing shipments of watches from the Far East. Evidence of this is reflected in the serious shortfall of Virgin Islands shipments relative to quota, 1,600,000 units in calendar year 1977, and an estimated shortfall of 2,000,000 units for this year. Clearly, the intent of Congress to permit Virgin Islands shipments up to 87.5 percent of one-ninth of U.S. consumption is not being realized to a very significant degree. In calendar year 1977, shipments totalled 4.6 million or 74 percent of the available quota. Despite the addition of two firms, shipments for January through August this year of non-Russian movements are no higher than for the comparable period last year (see table). All indications are that shipments will reach only 69 percent of quota in 1978 compared with 74 percent of quota in 1977.

Jobs lost by elimination of the Russian movements might be offset if watch casings were to be included under Headnote 3(a). Although the legislation covers watches and watch movements, the U.S. Customs office takes the position that watch casings will not be given duty free privileges unless specifically instructed to that effect by Congress. I recommend, therefore that the Senate Subcommittee on International

Trade, add such a provision to the amendment under consideration. Several local firms have given assurance that employment in their plants would rise 25 percent to 33 percent if casing were made feasible by such legislation.

Employment by the local firms assembling Russian movements has ranged from 37 to 137. While these numbers may not appear significant by stateside standards, the loss of 100 jobs would reduce employment in the industry by more than 10 percent and would raise the number of unemployed by about 3 percent in our small community. Moreover, U.S. policy calls for special efforts to reduce the high unemployment in a predominantly black and Hispanic society such as ours. Under no circumstance can I support an amendment that may be in violation of that policy. On the other hand, the addition of watch casings to Headnote 3(a) would provide a reasonable expectation of maintaining at least the current level of employment in our most important light industry.

The inclusion of watch casings under Headnote 3(a) is consistent with the purposes of H.R. 8222, the passage of which is my paramount concern. Just as Congress found it necessary to raise permissible foreign content in the instance of watches from 50 percent to 70 percent, so experience to date dictates comparable action for all commodities. The employment created to date under the 50 percent rule has been far below expectations. The response from industries other than watch assembly has been meager even prior to the precipitate decline in the relative value of the dollar. The comparatively higher cost of foreign materials makes imperative a rise to 70 percent content if the special benefits contemplated by Headnote 3(a) are to be realized to a significant degree.

Sincerely,

HENRY A. MILLIN,
Acting Governor.

WATCH COMPANIES: SHIPMENTS—QUOTA

Companies	Jan. 1 to July 31, 1978			Jan. 1 to July 31, 1977		
	Quota (units)	Shipped through July 31, 1978	Percent of quota	Quota (units)	Shipped through July 31, 1977	Percent of quota
Antilles Industries, Inc.	450,000	240,010	53.3	400,000	114,679	28.6
Atlantic Time Products Corp.	251,379	41,390	16.4	650,000	338,101	52.0
Belair Time Corp.	505,325	232,424	46.0	500,000	219,886	44.0
Consolidated Watch Industries	150,000	51,005	34.0	175,000	66,097	37.8
Hampden Watch Co.	284,362	82,214	28.9	350,000	188,142	53.8
Master Time Co.	430,000	214,445	49.9	430,000	218,850	50.9
Micro Manufacturing Corp.	19,238	0	0	94,603	10,000	10.6
Progress Watch Co., Inc.	450,000	98,300	21.8	0	0	0
Rnza Watch Corp.	668,690	329,492	49.3	750,000	285,753	38.1
Standard Time Co.	278,599	177,509	63.7	285,753	105,273	36.9
TMX Virgin Islands, Inc.	885,000	539,000	60.9	900,000	520,357	57.8
Unitime Corp.	515,500	148,959	28.9	600,000	154,481	25.7
Waltham Watch Co.	275,000	68,720	25.0	0	0	0
Subtotal	5,163,084	2,223,387	43.1	5,134,603	2,221,619	43.3
Russian movement:						
Cornavin-VI, Inc.	339,266	139,803	41.2	696,397	181,500	26.1
Sussex Watch Corp.	101,753	86,223	84.7	150,000	65,412	43.6
Watches, Inc.	145,193	42,942	29.6	275,000	96,555	35.1
Subtotal	586,212	268,968	45.9	1,121,397	342,467	30.6
Total	5,749,296	2,492,355	43.4	6,256,000	2,565,086	41.0

Source: Virgin Islands Department of Commerce.

DEPARTMENT OF THE TREASURY,
U.S. CUSTOMS SERVICE,
Washington, September 1, 1978.

Hon. ABRAHAM RIBICOFF,
Chairman, Subcommittee on International Trade,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In your letter, dated August 22, 1978, you requested written comments on the tariff treatment of watch movements assembled from Soviet parts in the insular possessions. You enclosed a copy of a recent press release and a copy of an amendment to H.R. 8222, as proposed by Congressman Rostenkowski.

As you know, watches and watch movements from an insular possession may enter the Customs territory of the United States duty-free under General Headnote 3(a), Tariff Schedules of the United States (TSUS), if they:

- (1) are manufactured or produced in the possession;
- (2) do not contain foreign materials to the value of more than 70 percent of their total value; and,
- (3) come directly to the Customs territory of the United States from the possession.

Generally speaking, the tests for free entry applied to watches and watch movements are the same as the tests applied to other articles from the insular possessions. The only difference is that watches and watch movements may contain foreign materials valued up to 70 percent of their total value, while other articles may only contain foreign materials valued up to 50 percent of their total value.

The tests for free entry applied to watches and watch movements are not affected by the fact that the components are of Soviet origin rather than of a column 1 country. However, if watches or watch movements assembled from Soviet components do not satisfy the requirements of General Headnote 3(a), TSUS, such articles would be dutiable at the rates applicable to products of column 2 countries.

An article is "manufactured or produced" in an insular possession if the operations performed in the possession substantially transform the foreign components into a new and different article of commerce. Basically, this means that the new article must have a distinctive name, character and use different from that possessed by the original components.

In 1966, the Customs Service ruled that the assembly of "low-labor" watch movements satisfied the "manufactured or produced" requirement of General Headnote 3(a), TSUS. Typically, these "low-labor" movements are assembled in the Virgin Islands from the following parts:

1. mainplate subassembly (pre-assembled from 31 parts);
2. barrel subassembly (pre-assembled from 4 parts);
3. barrel bridge subassembly (pre-assembled from 7 parts);
4. ratchet wheel;
5. ratchet wheel screw; and,
6. barrel bridge assembly screws (3).

Although we do not collect any labor or cost statistics, we have been advised by the Department of Commerce that of the total labor input possible on the completed low-labor movements, only one-ninth is now being performed in the possession. Commerce further indicates that

the valued added in the possessions, in direct labor cost, is between 2 and 6 percent of the cost of the foreign components.

Some concern has been expressed recently concerning the duty-free status accorded to these "low-labor" watch movements from the Virgin Islands. In response to inquiries by members of Congress and the Departments of Commerce and Interior we reviewed the requirements of General Headnote 3(a), TSUS, as they concern watches and watch movements. We are preparing for publication a notice stating that we are reviewing this matter and in which we invite the public to submit written comments regarding our administrative practice in this area. If appropriate, we will change our practice and require more labor-intensive assembly operations in the possessions to meet the "manufactured or produced" requirement in General Headnote 3(a), TSUS.

We have forwarded your letter, and enclosures, to the Department of Treasury for direct response to you with comments on the proposed legislation, H.R. 8222 and the "Rostenkowski" amendment.

If we can be of further assistance, please call on us.

Sincerely yours,

LEONARD LEHMAN,
Acting Commissioner of Customs.

MEMORANDUM FROM THE U.S. INTERNATIONAL TRADE COMMISSION

BACKGROUND AND STRUCTURE OF THE INDUSTRY IN THE INSULAR POSSESSIONS

The watch movement assembly industry in the United States insular possessions developed in the last two decades under a Federal incentive program to attract outside firms and stimulate the growth of light industry in the possessions. At the present time, 16 firms in the Virgin Islands, and 2 in Guam assemble conventional watch movements from foreign parts and ship the movements to the United States mainland free of duty to be cased and distributed as watches. A watch movement assembly firm existed in American Samoa until the fall of 1977 when it ceased operations. Five of the firms that assemble watch movements in the insular possessions are subsidiaries (or affiliates) of larger watch producers in the United States, three are Swiss owned, one is affiliated with a West German watch manufacturer, and the remainder are independently owned by U.S. nationals. Although Swiss and West German parts are used principally, two firms in the Virgin Islands use Soviet-made parts. The two in Guam also use some Soviet-made parts in their watch movement assembly operations.

General headnote 3(a) of the Tariff Schedules of the United States (TSUS) provides for duty-free entry into the customs territory of the United States of watches and watch movements assembled in the insular possessions from foreign made parts, if they contain foreign materials to a value of not more than 70 percent of their total value. The duty-free treatment for watches and movements assembled in the insular possessions, however, is limited to a quota not to exceed a number equal to $\frac{1}{6}$ of the apparent U.S. consumption of watch movements during the preceding calendar year (as determined by the U.S. International Trade Commission). The Virgin Islands are allocated 87.5 percent of the quota; Guam, 8.33 percent; and American Samoa, 4.17 percent. Attachment 1 to this memorandum shows duty-free shipments of watch movements into the United States from its insular possessions for 1973-77, and January-June 1978. As can be seen, at no time in the past 5 years have the insular possessions shipped the total number of watch movements permitted under the quota.

As stated above, foreign materials cannot constitute more than 70 percent of the value of the movement (the remainder being added in the insular possession) to qualify for duty-free treatment on entry into the customs territory of the United States. Prior to midsummer 1975, the requirement was that foreign materials could not constitute more than 50 percent of the entry value. The ratio was changed by Public Law 94-98, effective August 1, 1975, in an effort to help the watch movement assembly industry in the insular possessions which are being adversely affected by the rising cost of watch parts from Europe (the principal source of such parts) as a result of inflationary

pressures and the devaluation of the dollar. In order to meet the 50 percent requirement, producers in the insular possessions had to sell the movements produced for twice the price paid for the parts, thereby pricing the movements out of their normal competitive price range in the U.S. market. The change-in-ratio requirement, which compensated for rising prices of parts produced abroad, did permit the insular possessions' assembly industry to retain a measure of its health in 1975-77. The insular possessions' industry suffered a further setback, however, particularly in the latter year, as widespread sales of inexpensive solid-state digital watches in the United States displaced sales of some inexpensive conventional watches and watch movements. (The bulk of the movements assembled in the insular possessions have consisted of conventional movements.)

USE OF SOVIET-MADE PARTS IN WATCH MOVEMENT ASSEMBLY

Although the bulk of the parts used in watch movement assembly operations in the insular possessions have been supplied principally by countries in Western Europe (attachment 2), some Soviet-made parts have been used since the early 1960's. Attachment 3 gives the value of watch movement parts imported into the Virgin Islands from the Union of Soviet Socialist Republics (U.S.S.R.) and other sources for 1962, 1967, 1973-77, and January-June 1978. As can be seen, imports of such parts from the U.S.S.R. increased sharply in 1976 and 1977, when they accounted for 12 percent of the total.

Data are not readily available on the origin or value of watch parts used in watch movement assembly operations in the other insular possessions. The two facilities on Guam are known to use some Soviet-made parts in the movements they assemble, but information on the ratio of Soviet-made parts to the total value of all parts used by the firms on Guam is not available. The only watch movement assembler on American Samoa ceased operations in 1977; it is known, however, that this firm did not utilize Soviet parts in its assembly operations.

EMPLOYMENT

Attachment 4 shows data on employment in the establishments producing watch movements in the Virgin Islands. As can be seen from these data, employment declined through 1975, but recovered somewhat before again declining in 1977. In 1977, the three firms producing watch movements using Soviet parts in the Virgin Islands had 121 employees or 12 percent of the work force employed by the watch movement assembly industry. Employment data on the Virgin Islands watch movement assembly industry is not available for the first half of 1978; however, employment is to have leveled off or increased slightly in recent months.

Employment in the Guam watch assembly industry totaled approximately 35 persons in 1977.

COMPARISON OF COST OF MOVEMENTS ASSEMBLED FROM SOVIET-MADE PARTS AND THOSE FROM OTHER SOURCES

Data obtained by the U.S. Department of Commerce on comparative costs of parts used in watch movement assembly in the insular possessions in March 1978 are shown in attachment 5. As can be seen from these data, Soviet-made parts for a 6¾ by 8 ligne movement cost \$3.32

compared with a range of \$3.80-\$6.47 for parts for a similar movement from other sources. While only a few direct comparisons can be made from the data available, it is evident that the cost of Soviet-made components is substantially below that of those from other sources.

The only readily available information on detailed comparative component costs and subsidies from the Virgin Islands is given in attachment 6, which gives a comparative breakdown of the cost elements and subsidies for 17-jewel watch movements. We understand that the subcommittee already has this information which was supplied to the U.S. Department of Commerce by the American Watch Association. As can be seen from the data presented, the cost of the European parts exceeds that of the Soviet parts by 26 percent; the movements containing Soviet-made parts must be sold at a selling price well below that of the movement made from non-Soviet parts in order not to exceed the 70 percent limitation, and the gross profit realized on the Soviet-component movement exceeds that realized on the European-component movement.

MARKET AFFECTED AND CONDITIONS OF COMPETITION

Jeweled lever watch movements assembled in the insular possessions are cased after importation into the U.S. mainland. The bulk of these watches retail in the U.S. market for \$25; watches with movements assembled from Soviet-made components retail in the range of \$12.95 to \$13.95. While some watches with insular possession movements do sell in the medium price range of between \$25 and \$50, none sell in the expensive price range of more than \$50. In the lowest price segment of the domestic retail watch market, jeweled lever watches with movements assembled in the insular possessions compete with domestic and foreign pin-lever watches, with some jeweled lever watches from Switzerland, and with inexpensive domestic and foreign solid-state digital watches. Jeweled lever watches with movements assembled in the insular possessions, selling in the medium price range, compete with more expensive jeweled lever Swiss watches and more expensive solid-state digital watches (both domestic and foreign).

Attachment 7, provided by the Department of Commerce, compares selling prices of movements assembled from Soviet parts and those made from non-Soviet parts. Here again, a direct comparison can only be made between the 6¾ by 8 ligne movements; the selling price of a finished movement of that size assembled from Soviet parts was \$4.97; while that for a movement assembled from non-Soviet parts ranged from \$5.43 to \$9.95. Again, the price range for the non-Soviet movements is explained by the existence of special features in some watches.

TECHNICAL COMMENTS

The particular issue which the subcommittee is considering relates to the assembly in the Virgin Islands of watch movements from parts which are the product of the U.S.S.R. Such parts are alleged to be imported into the Virgin Islands at prices which are less than their cost of production and to be involved in insignificant assembly operations in the Virgin Islands which do not achieve the purpose of general headnote 3(a) of the TSUS; viz., the encouragement of employment in the insular possessions.

The proposed amendment to H.R. 8222 would completely restructure general headnote 3(a) and would include therein a new requirement that to be exempt from U.S. duty thereunder, a watch or watch movement must contain "not less than 25 discrete components which have been affixed onto or otherwise added to the main plate during assembly operations within the insular possession concerned".

The amendment would also include in general headnote 3(a) an elaborate definition of the term "discrete component".

To qualify for exemption from duty under the existing requirements of general headnote 3(a), a watch or watch movement may not contain foreign material to a value of more than 70 percent of its total value, and must also be within the duty-free quota established under headnote 6(b) to subpart E, part 2, schedule of the TSUS. As a matter of substance, the apparent intent of the proposed amendment is to require that considerably more assembly operations be performed in the insular possessions than is presently required.

This new requirement, however, would fall equally on all persons utilizing the duty-free privileges of general headnote 3(a) and would in no wise affect or offset the ability of the U.S.S.R. to lay down parts of watch movements in the Virgin Islands at less than their cost of production. Also, as a matter of substance, the definition of "discrete component" seems to be used upon the assembly operations for so-called conventional-type watches (which differ significantly from those for electronic watches) and, further, is believed to be unnecessarily lengthy and unduly complex.

As a matter of placement in the TSUS, the proposed amendment should be concerned with headnote 6 of subpart E, part 2, schedule 7 of the TSUS rather than with general headnote 3(a). The special requirements for the duty-free quota applicable to imports from the insular possessions are set forth in paragraph (b) of headnote 6 and such paragraph is the provision to be appropriately amended if new requirements are to be enacted.

WATCH MOVEMENTS: DUTY-FREE SHIPMENTS INTO THE UNITED STATES FROM ITS INSULAR POSSESSIONS, 1973-77, AND JANUARY TO JUNE 1977 COMPARED WITH JANUARY TO JUNE 1978

Period	Shipments from—			Total shipments
	Virgin Islands	Guam	American Samoa	
Quantity (1,000 units)				
1973.....	4,720	366	97	5,183
1974.....	3,925	150	242	4,317
1975.....	2,900	429	85	3,414
1976.....	3,916	221	142	4,279
1977.....	4,467	265	143	4,875
January to June:				
1977.....	1,765	65	62	1,892
1978.....	2,009	94		2,103
Value (thousands of dollars)				
1973.....	38,417	1,908	2,044	42,369
1974.....	32,689	815	4,793	38,297
1975.....	26,280	2,228	1,598	30,106
1976.....	28,179	1,145	2,226	31,550
1977.....	31,042	1,413	1,946	34,401
January to June:				
1977.....	12,552	302	899	13,753
1978.....	15,506	453		15,959

Source: Compiled from official statistics of the U.S. Department of Commerce.

WATCH MOVEMENT PARTS: SHIPMENTS TO THE VIRGIN ISLANDS BY FOREIGN SOURCES, 1977

Country	Value (thousands)
Switzerland.....	\$5,367
West Germany.....	4,904
France.....	3,815
China (Taiwan).....	2,930
U.S.S.R.....	2,401
Japan.....	1,143
All other.....	23
Total.....	20,584

Note: Because of rounding, figures may not add to total shown. Value calculated from unrounded figures.

Source: Compiled from official statistics of the U.S. Department of Commerce.

WATCH MOVEMENT PARTS: IMPORTS TO THE VIRGIN ISLANDS FROM THE U.S.S.R. AND OTHER SOURCES, 1962, 1967, 1973-77, AND JANUARY TO JUNE 1977 COMPARED WITH JANUARY TO JUNE 1978

[Value in thousands of dollars]

Period	Shipments from—		Total	U.S.S.R. percent of total
	U.S.S.R.	Other sources		
1962.....	98	1,833	1,931	5
1967.....	726	9,756	10,482	7
1973.....	318	17,013	17,331	2
1974.....	210	15,418	15,628	1
1975.....	410	12,304	12,714	3
1976.....	1,670	14,735	16,405	10
1977.....	2,401	18,183	20,584	12
January to June:				
1977.....	950	9,997	10,947	9
1978.....	775	12,160	12,935	6

Source: Compiled from official statistics of the U.S. Department of Commerce.

WATCH MOVEMENTS: FULL-TIME AND PART-TIME EMPLOYMENT IN VIRGIN ISLANDS ESTABLISHMENTS ASSEMBLING WATCH MOVEMENTS, 1973-77

Year	Number of persons
1973.....	1,198
1974.....	1,000
1975.....	847
1976.....	1,007
1977.....	914

Source: Compiled from data provided by the U.S. Department of Commerce.

REPRESENTATIVE WATCH MOVEMENT PARTS COSTS, MARCH 1978

Calibre (ligne ¹) of movement	Cost of Soviet-made parts
5 ¹	\$3.25.
5 ¹	\$3.25 to \$3.32.
5 ³ / ₄	\$3.06.
6.....	\$3.04 to \$3.06.
6 ³ / ₄ x 8.....	\$3.32.
8 ³ / ₄	\$2.80 to \$3.91.
11 ¹ / ₂	\$2.79 to \$3.28.
18.....	\$5.
	Cost of parts from other sources ^{2,3}
3 ³ / ₄	\$9.56 to \$9.63.
5 ¹ / ₂	\$4.05 to \$5.63.
6 ³ / ₄ x 8.....	\$3.60 to \$6.47.
11 ¹ / ₂	\$3.26 to \$8.90.
12.....	\$8.08 to \$10.87.

¹ A ligne equals 2.255 mm.

² The value bracket used for the cost of movements using non-Soviet parts is explained by some models having self-winding mechanisms and/or calendar/date attachments which require more parts and thus add to their costs.

³ Dollar figures based on: Swiss franc equals 0.5502, French franc equals 0.2103, Deutsche mark equals 0.4980.

Source: Data provided by the U.S. Department of Commerce.

COMPARISON OF EUROPEAN AND SOVIET 17-JEWEL WATCH MOVEMENTS

	European parts	Soviet parts	
		Utilizing 6 parts ¹	Utilizing 20 parts ¹
Costs:			
Landed costs ²	\$4.10	\$3.25	\$3.25
Virgin Islands import duty (6 percent).....	.25	.20	.20
Local labor costs.....	1.00	.10	.20
Fringe benefits related to labor costs (10 percent).....	.10	.01	.02
Virgin Islands excise tax (3 percent of foreign materials costs).....	.12	.10	.10
Gross receipts tax (2 percent selling price of \$6.07 for European, \$4.64 for U.S.S.R.).....	.12	.09	.09
Total costs (excluding overhead, plant, etc., which should be same for either movement).....	5.69	3.75	3.86
Subsidies:³			
Virgin Islands duty subsidy (67.5 percent).....	.17		
Virgin Islands excise subsidy (67.5 percent).....	.08		
Virgin Islands gross receipts (exceptions) (75 percent).....	.09		
Total subsidies.....	.34	0	0
Total net costs.....	5.35	3.75	3.86
Selling price (statutory minimum).....	6.07	4.64	4.64
Gross profits before deductions for overhead, taxes, etc. (based on selling price of \$6.07 (European) and \$4.64 (U.S.S.R.).....	.72	.89	.78

¹ The U.S. International Trade Commission understands that the American Watch Association is referring to "discrete components" here which are defined in the Subcommittee Amendment to H.R. 8222 as:

"(i) any screw, part, component, or subassembly if not assembled onto the main plate of a watch, and

(ii) any bridge or subassembly of a watch not assembled together with another part or component before importation into the insular possession concerned; but does not mean any dial, dial screw, dial washer, hour wheel, watch hand, automatic mechanism and related parts, day-date or special feature device and related (sic) parts, or jewel. In applying such term, any main plate containing set jewels or shock devices, together with any part, component, or subassembly fixed to it at the time of importation into the insular possession concerned, shall be considered to be a single component."

² The landed cost for a 20-part assembled Soviet movement might vary somewhat from that for a 6-part assembled movement. The difference would be slight but it is not certain whether the cost would be lower or somewhat higher.

³ Where labor content is less than \$0.90 companies do not qualify for Virgin Islands subsidies and abatements.

Source: Attachment to American Watch Association (AWA) letter to Secretary of Commerce, Oct. 21, 1977.

REPRESENTATIVE SELLING PRICES OF SOVIET AND NON-SOVIET PARTS WATCH MOVEMENTS, ASSEMBLED IN THE VIRGIN ISLANDS, MARCH 1978 PRICES

	Finished movement selling price
Soviet calibre (ligne¹):	
51 $\frac{1}{2}$	\$4.70.
51 $\frac{1}{4}$	\$4.70 to \$4.75.
51.....	\$4.40.
6.....	\$4.40.
6 $\frac{1}{2}$ x 8.....	\$4.97.
8 $\frac{1}{2}$	\$4.22 to \$5.70.
11 $\frac{1}{2}$	\$4.05 to \$4.75.
18.....	\$7.15.
Non-Soviet² calibre (ligne):	
3 $\frac{1}{4}$	\$13.66 to \$14.82.
51 $\frac{1}{2}$	\$5.79 to \$8.66.
6 $\frac{1}{2}$ x 8.....	\$5.43 to \$9.95.
11 $\frac{1}{2}$	\$4.66 to \$13.69.
12.....	\$11.54 to \$16.72.

¹ A ligne = 2.255 mm.

² Dollar figures based on: Swiss franc equals 0.5502, French franc equals 0.2103, Deutsche mark equals 0.4980.

Source: Provided by the U.S. Department of Commerce.

GENERAL COUNSEL OF THE DEPARTMENT OF COMMERCE.

Washington, D.C., September 22, 1978.

HON. ABRAHAM RIBICOFF,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Thank you for your letter of August 22; I apologize for the delay in our response, but I understand that the Sub-

committee staff was advised prior to September 6 that the Department would not be able to meet your deadline for comments. In your letter you request the written comments of the Department on the issue of tariff treatment of watches and watch movements assembled from Soviet parts in the U.S. insular possessions. In addition, you ask the Department to respond to a series of questions related to the watch industry, to make any recommendations we might have for statutory amendments or changes in the regulations relating to General Headnote 3(a) to the Tariff Schedules of the United States, and to analyze the impact of the Rostenkowski amendment to H.R. 8222.

The Departments of Commerce and the Interior, which share responsibility under Public Law 89-805 for allocation of the watch quota to producers in the insular possessions, have had the Soviet watch situation under review since June 1977. In March of this year, we reported the results of our analysis to Representatives Charles Vanik, Chairman of the House Ways and Means Subcommittee on Trade, and Dan Rostenkowski, both of whom expressed an interest in the use of Soviet-origin movements in the insular watch industry (Enclosure A). The complexities of the issue are discussed in detail in the report.

As our report indicates, the Soviet watch situation is of concern to the Departments because the wages generated in the final assembly in insular possessions of the largely preassembled components originating in the Soviet Union do not compare favorably with wages generated in the insular possessions through the assembly of most movements sourced elsewhere. Our concern is not with the origin of the parts but with the economic benefits to the insular possessions.

On June 6 (43 F.R. 24566 (1978)) the Departments of Commerce and the Interior published in the Federal Register a notice that they were considering production incentives geared toward labor-intensive assembly operations. After evaluating all comments received on the proposal, the Departments published in the Federal Register (43 F.R. 40048 (1978)) proposed rules for allocation of watch quotas in calendar year 1979 (Enclosure B). In brief, the proposed rules placed increased emphasis on the wage factor in the allocation formula for Guam and the Virgin Islands and would allocate a portion of the respective insular annual quotas to firms assembling movements from at least 26 discrete components or averaging no less than \$.75 in wage per unit shipped. These rules are intended to provide additional incentives for all producers to engage in more significant assembly operations in the insular possessions.

In addition, in March of this year the Departments requested the Treasury Department to review the criteria for Headnote 3(a) eligibility (Enclosure C). Treasury reported on April 3 that it had begun an investigation of watches and watch movements in the insular possessions. We now understand that a formal notice is about to be filed with the Federal Register requesting comments from all interested parties on the need for more stringent 3(a) eligibility standards for watches and watch movements.

The Department of Commerce would prefer to have an opportunity for implementation and analysis of the foregoing administrative approaches to this complex problem prior to seeking legislative remedies. Moreover, the Department at present opposes any legislation directed solely at the use of Soviet movements in the insular possessions. For the reasons set forth below, such legislation would have serious adverse

effects on U.S.-Soviet trade wholly disproportionate to any possible benefits for the insular possessions.

With respect to the first issue raised in your Subcommittee's press release, the wages generated in the assembly of Soviet movements as they are now supplied to the territories are small but not "insignificant" (see data at Enclosure D) in comparison to wages generated in the assembly of most movements sourced elsewhere. The Departments' proposed allocation rules for 1979 address this issue by increasing the emphasis placed on the wage element of the allocation formula and by allocating a portion of the Virgin Islands and Guam quotas only to firms which use 26 discrete components in their movements or which contribute an average of \$.75 per movement shipped duty-free into the customs territory of the United States.

We are not in a position to evaluate whether Soviet parts are being imported into the insular possessions at prices which are less than their cost of production. Questions about the application of the antidumping statutes to products of the U.S. insular possessions should be addressed to the Treasury Department, which, together with the International Trade Commission, is responsible for investigating dumping charges.

Enclosure D contains data on the current structure of the watch industry in the insular possessions. In those instances where the provision of data on a company-by-company basis would divulge commercial or business information supplied to the Departments on a confidential basis, the data have been provided in aggregate form.

The effect on the insular possessions if watch movements assembled from Soviet parts were denied duty-free entry under Headnote 3(a) is difficult to gauge. However, the watch quota staff would expect a decline in shipments from the insular possessions of approximately 10% in calendar year 1979. The more expensive European and Japanese movements probably would not compete so effectively in the U.S. market against low-cost solid-state watches, domestically produced and imported pin lever watches, and duty-paid imports of low-cost 17 jewel movements produced in Asian countries. The recent depreciation of the dollar vis-a-vis foreign currencies (principally the Swiss Franc and German Mark) would also adversely affect the ability of insular producers using the more expensive non-Soviet movements to fill the void created by the non-availability of the low-cost Soviet movements.

Notwithstanding the expected decline in total shipments, the industry's wage contributions should remain relatively constant, at least in the Virgin Islands where most of the Headnote 3(a) watch assembly firms are located. Some sales of Soviet movements would be expected to shift to lower cost European or Japanese movements on which the labor input is two or three times that generated in the insular possessions on the largely preassembled Soviet movements. Moreover, one labor-intensive firm in the Virgin Islands, formerly a major producer but which made insignificant shipments in 1978, advises the Department that it expects to expand production substantially in 1979, a development which could give a considerable boost to wage payments in the Islands.

From the information we have on hand, Guam's two watch assembly firms, employing between 20 and 30 local residents at the present time, would probably cease operations if Soviet movements were denied duty-free treatment. Departmental efforts over the last three years

to attract new labor-intensive firms to Guam have been unsuccessful. Thus, the outright denial of duty-free entry to Soviet movements may result in the closure of the Guam watch assembly industry.

The employment reduction in the Virgin Islands would affect most severely the residents of St. Thomas, because the only two watch assembly firms operating there rely entirely on Soviet parts. Based on 1977 employment levels, 50 jobs (roughly 8 percent of the 1977 Virgin Islands industry total) would be eliminated. Unlike the situation in Guam, there has been some interest shown by potential new firms in the Virgin Islands, and it is possible that one or more new firms would be willing to locate on St. Thomas alleviating at least in part, expected employment losses there.

The denial of duty-free treatment for watches assembled in the insular possession from Soviet components would, by introducing a new barrier to Soviet imports, be inconsistent with the Administration's policy of expanding trade with the U.S.S.R. It could also provoke Soviet retaliation against our exports. Since 1972 the U.S. has run a cumulative \$8 billion trade surplus with U.S.S.R. This surplus contrasts with the approximately \$17 million in imports of Soviet watches since 1972, or about one percent of U.S. consumption. A drop in overall trade is likely to be more costly to the U.S. economy in terms of our balance of payments and insular employment than any gain which might occur by passage of this legislation.

The approach embodied in the Rostenkowski amendment to H.R. 8222 avoids discrimination against watch movement parts manufactured in countries not currently receiving most-favored-nation tariff treatment. We are concerned, however, that its effect may nonetheless be to eliminate their import because Soviet watch manufacturers may be unable or unwilling, at least initially, to make the manufacturing adjustments required by such an amendment. It may also have the effect of reducing rather than encouraging additional employment in the insular possessions. The number of components used in the assembly of watch movements may not in all instances be an accurate measure of the amount of work involved. One Virgin Islands firm, for instance, is known to have scheduled for 1979 the production of several hundred thousand movements having fewer than 25 discrete components; but because of the nature of the assembly operations it proposes this scheduled production would result in additional employment opportunities equal to or exceeding the industry average on a per unit basis. This firm has advised the Department it would have to curtail or completely suspend its Virgin Islands operation if the Rostenkowski amendment were adopted. The Departments' proposed 1979 rules take such factors into account by establishing average labor input as an alternative to the discrete-components criterion.

In summary, the Department favors our current administrative approach to the problems in the insular watch industry, and would be opposed to any legislation which would deny duty-free treatment to Soviet watch movements. If the administrative initiatives currently being pursued should prove ineffective in accomplishing the basic objective of Headnote 3(a), this Department would propose appropriate legislation to achieve the continued development of light industry in the insular possessions without adversely affecting our trade relations with other nations.

We have been advised by the Office of Management and Budget that there would be no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

C. L. HASLAM,
General Counsel.

Enclosures.

ENCLOSURE A

MARCH 6, 1978.

HON. CHARLES A. VANIK,
*U.S. House of Representatives,
Washington, D.C.*

DEAR MR. VANIK: In your letter of August 31, 1977, you asked that the Department of Commerce review the increased use of Soviet-origin, low-labor watch assemblies in the U.S. insular possessions to determine the potential impact on the viability of the insular watch industry. In my letter of September 20, 1977, I informed you that the matter was being studied and that a more detailed reply would be made later.

I am attaching for your information a report recently completed by our watch quota staff in the Bureau of Trade Regulation. It is concurred in by the Office of Territorial Affairs in the Department of the Interior, which shares responsibility with Commerce for administration of the Public Law 80-805 watch quota program.

The report gives a description of the present situation in the insular watch industry, describes actions taken to date, and briefly outlines actions the Departments would consider taking should the current initiatives prove inadequate to maintain industry's ability to provide the meaningful economic benefits intended by the Congress.

To summarize the findings of the report: (1) There has been a significant increase in the use of Soviet-origin watch components in the insular possessions in recent years. (2) The wages generated by assembly of these largely preassembled components into finished movements is small compared to the wages generated from the assembly of most movements from other countries. (3) This situation is of great concern to Commerce and Interior, for we have sought to administer the program in a manner which maximizes the contribution of the industry to the insular economies. (4) Certain changes have been made in the Departments annual allocation formula and in the codified watch quota rules to address this problem.

As the attached report points out, Commerce and the Interior do not view the problem solely in terms of the Soviet-origin components, but in terms of the increased use of preassembled watch components generally which, regardless of their origin, reduce the employment opportunities this industry affords permanent residents of the territories. We would be equally concerned if watch movement components from other countries were entering the territories in the same state of preassembly.

I appreciate your interest in the continued viability of this industry. Please feel free to call upon me if you have any further questions.

Sincerely,

FRANK A. WEIL,
Assistant Secretary for Industry and Trade.

Enclosures.

**REPORT ON THE INSULAR WATCH INDUSTRY (STATUTORY IMPORT PROGRAMS STAFF,
BUREAU OF TRADE REGULATION, FEBRUARY 1978)**

In June, 1977, the watch quota staff in the Departments of Commerce and the Interior, which share responsibility for administering the insular possession watch quota program (P.L. 80-805) initiated a review of the growing use of watch components requiring only minimal assembly activity. In letters dated August 31, 1977, and October 10, 1977, Congressman Charles A. Vanik and Dan Rostenkowski expressed concern at the effect that the increased use of "low-labor Russian movements"¹ in the insular watch industry might have on the continued viability

¹ Refers to watch parts manufactured in the Soviet Union and shipped to the U.S. territories with the majority of the assembly operations already completed. The amount of work necessary to produce the finished watch movement in the territories from the partially assembled components (sub-assemblies) is very small, therefore the designation "low-labor movement." The term "movement," as used in this report, means the unfinished movements, unless otherwise specified.

ity of the industry. In an interim response, Frank A. Weil, the Assistant Secretary for Industry and Trade (then the Domestic and International Business Administration), advised each Congressman of the Departments' review of the problem and promised a detailed report on the matter.

The following is a report on the insular watch industry. It was prepared by the watch quota staff in the Department of Commerce and concurred in by their counterparts in the Department of the Interior.

It should be emphasized that watch quota staff in the Departments do not characterize the problem in terms of "Russian" supply. While it is generally true that in recent years most of the movements which have entered the territories as subassemblies (so-called low-labor movements) have come from the Soviet Union, this has not always been the case; nor can there be any assurance that movements sourced from other countries could not cause a similar problem in the future. Indeed, one of the dangers of the availability of low-labor Soviet movements is that they could promote wider reliance on subassemblies produced in western watch producing nations or in the USSR, further reducing the benefits the possessions enjoy from the general headnote 3(a) watch assembly industry.²

This report is in three parts:

- (1) A description of the existing situation, including a brief analysis of the problem.
- (2) An account of what has been done by the Departments to date.
- (3) An account of what the Departments propose to do in the future.

(1) THE SITUATION

A. Present use

Unverified watch quota records indicate that during calendar 1977, 763,000 units of the low-labor finished movements were shipped to the United States by Virgin Island firms. This represents an increase of 201,000 units over 1976 shipments and approximately 17 percent of total 1977 shipments. (For historical perspective, see attachment 1, Purchases of USSR Movements by Insular Firms between 1967 and 1976. Purchases closely approximate shipments).

The watch assembly industry in Guam has been dominated by the low-labor movements since 1975, with annual shipments for 1975-1977 totalling 398,000, 222,000, and 318,000 units respectively. The third territory, American Samoa, has had only one firm, but it has not assembled any Russian origin movements.

B. Comparison of parts and labor costs

Based on November, 1977 data, the per unit cost to territorial assemblers of the low-labor movements in the two most popular sizes (5½ ligne and 6¾ x 8 ligne)³ was \$3.25. Competing supplies from other countries ranged from \$4.10 to \$7.00 for the 5½ ligne and from \$4.03 to \$4.50 for most 6¾ x 8 ligne.

The cost of Soviet movements is expected to rise 2 percent in 1978 to 3.32. Industry sources expect slightly higher percentage increases in the French, German, Japanese and Swiss origin movements. These cost differences will be further exacerbated if the dollar continues to decline relative to the currencies of these countries.

Because of the eligibility standards for duty-free entry under general headnote 3(a), the \$0.78 to \$3.75 cost advantage enjoyed by the low-labor movements in 1977 translates into a \$1.11 to \$5.35 advantage in the minimum price at which the finished movements can be sold to U.S. importers and/or distributors. This derives from the fact that the value of the foreign material content in an insular watch cannot exceed 70 percent of the appraised value of the finished movement when it enters the customs territory of the U.S. (This price differential is increased at each successive level of the distribution chain.)

Typically a low-labor 6¾ x 8 movement arrives in the territories as four distinct parts and components (mainplate with train and balance assembled; barrel assembled; barrel bridge assembled; and ratchet wheel) plus four screws. These components can be assembled into a finished movement by inserting the

² Territorial firms can buy subassemblies from suppliers now providing completely un-assembled components at very little additional cost (\$0.10 to \$0.20 per movement). Provided the finished movement can be sold at a competitive price in the United States, labor-intensive firms may be inclined to save the \$0.50 to \$0.70 per movement in direct labor costs by using subassemblies.

³ These are popular, women's size watches. Because the tariff is higher on women's watches than on men's, the former represent about 75 percent of the territorial production. The majority of watches assembled in the territories are the 17 jewel movements (none of which are currently manufactured in the United States).

barrel, placing the barrel bridge over the barrel, tightening three screws, inserting the ratchet wheel and tightening the ratchet wheel screw.⁴

As to the direct labor cost (excluding in-process repairs, timing, etc.) in the assembly of these movements, it is estimated that a skilled worker could finish approximately 300 units per eight-hour day, which would equate to \$0.06 labor per unit with current wage scales. With less skilled workers, the direct labor cost would range between \$0.10 and \$0.18 per movement.

In contrast to the Soviet-origin movements, most other movements now arrive in the territories in states of assembly ranging from completely unassembled to pre-assembled balance and barrel with the remainder of the movement unassembled. No watch quota firms using parts from countries other than the Soviet Union are now to assemble significant quantities of movements having fewer than 25 discrete components, and the majority use movements with from 32 to 60 components, depending largely on the nature of the movement and the supplier.

With the exception of the movement having a total of 25 components, the assembly processes on the non-Soviet merchandise include such operations as train assembly, dial side assembly, barrel bridge subassembly and balance assembly. Depending again on the nature of the specific movements, the direct labor cost of assembly would range in most cases between \$0.60 and \$0.90 per movement. The 25-component movement, which does not require the labor-intensive train assembly operation, can be produced for approximately \$0.45 per unit.

C. Competitive effects

The above parts and labor-cost differentials are undoubtedly having a growing impact on the ability of the non-Soviet supplied sector of the insular watch industry to maintain its share of the domestic watch market.⁵ Watch quota staff believe that if the low-labor movements continue to enjoy their present competitive advantages, a number of the independent producers⁶ may be forced to change to the Soviet supply or to request their non-Soviet components in a state of prior assembly approaching that of the Soviet movements. Pressure to use low-labor movements (subassemblies) is also expected to increase as a result of the rise in the minimum wage in the Virgin Islands from \$2.40 to \$2.65 per hour, effective January 1, 1978. It is said that for a very small additional cost territorial suppliers will provide subassemblies in lieu of the totally unassembled movements. This will further encourage firms to decrease their assembly activity in the territories.

However, watch quota staff do not believe that the recent growth in the use of the low-labor movement can be completely explained in terms of the cost differentials, which have always been available to Soviet-supplied producers. Other factors are involved:

(1) The growing availability of low-price watches in the domestic market (e.g., conventional watches sourced in Hong Kong, and the \$8.95 to \$9.95 Texas Instruments LED solid state movements) is thought to have disrupted the market for conventional 17 jewel watches to some extent.

(2) Firms using the inexpensive, low-labor movements allege that their watches are aimed at a different and growing segment of the U.S. market which accounts for their present success. Retailing between \$8.50 and \$12.50 (or higher if using more expensive bands and cases), these watches are said to be purchased as jewelry or fashion items. Customers may buy two or three of these inexpensive watches annually, differently styled, not expecting them to operate for more than a year or to have the timekeeping characteristics of the better quality insular or duty-paid merchandise.

(3) Much of the increase in the production of low-labor movements in the Virgin Islands since 1975 can be attributed to the emergence of a firm new to the domestic marketing of watches supplied from the Virgin Islands. This firm

⁴ The 6 $\frac{3}{4}$ x 8 ligne low-labor movement, if completely disassembled, has a total of 47 discrete components, including screws. It is estimated that approximately 1/9 of the total assembly work on these movements is performed in the insular possessions.

⁵ Total insular shipments have ranged between a low of 3.0 million units in 1967 (first year of the quota) and a high of 5.3 million units (1973). Even though the available quota increased dramatically in 1977 to 7.4 million units, shipments reached only 5.1 million units. Thus, there appears to be a demand for about 5 million units annually from the insular possessions.

⁶ By independent producers is meant firms who seek to market their movements under a variety of brand names to a variety of customers. Insular subsidiaries of major U.S. and foreign watch companies with strong brand name recognition would not be expected to use Soviet merchandise unless the quality of the movements improved (while the quality issue is debatable, most industry sources believe, in certain calibers, the Soviet movements are not comparable in quality to most other movements).

has adopted innovations and vigorous marketing techniques, including an over-the-counter replacement policy and a high-volume, lower-margin sales approach. Subtracting the sales of low-labor, Virgin Islands watches of this firm, 1970 and 1977 shipments of these movements would have been on a par with prior year sales. While this firm has undoubtedly cut into the sales of watches produced by the labor-intensive firms, it should not be assumed that the more-expensive watches supplied by these other producers would have been able to penetrate the low end of the 17 jewel conventional watch market as successfully as this new firm.

(4) A major Virgin Islands producer has made a dramatic cut in production for reasons unrelated to the availability of low-labor movements. Other labor-intensive firms have not been able to increase production sufficiently to use this excess quota, making additional quantities available for the low-labor firms.

In sum, numerous factors have contributed to the problems of the Virgin Islands watch industry, the single most important one being the great increase in cost as a result of the devaluation of the dollar of movements originating in Western countries. To illustrate, a 10 Swiss Franc movement costing \$4.00 in January, 1977 cost over \$5.00 in January, 1978, and over \$5.50 in February, 1978, due solely to currency fluctuations. While the low-labor movements added to the competitive pressures on the industry, their availability is not the root of the industry problem.

However, from the viewpoint of the territorial governments and the Federal watch quota staff, the increased use of the low-labor movements undermines the employment potential of the industry due to the small amount of local wages generated by the assembly of these movements. Their production in larger numbers is severely curtailing the economic contribution the watch assembly industry is making to the insular possessions.

(2) WHAT HAS BEEN DONE?

On September 20, 1977, the Departments requested the views of each watch quota firm in the insular possessions on the possibility of the Departments' establishing a standard which would limit eligibility for receipt of quota to firms using a specified number of discrete parts or components in their assembly process (letter requesting views at attachment 2). The purpose for such a standard would be to increase the amount of labor in the assembly process, thereby providing additional employment opportunities for territorial workers.⁷ Also, increased labor costs would reduce the profit advantage which low-labor firms presently have over labor-intensive firms.⁸ With 20 percent of the quota allocated in the Virgin Islands and Guam on the basis of tax contributions, the minimum assembly standard would blunt, to some extent, the profit incentive for using low-labor movements.

A few of the company responses to the Departments' letter proposing the minimum standard supported the illustrative 15 or 20 component minimum standard. Several others agreed with the concept but did not believe the standard would be effective unless a higher minimum number of components were established.⁹ Some firms opposed a minimum-number-of-components test and suggested a minimum-labor-input-per-unit standard as being more enforceable or preferable from an administrative viewpoint.

The American Watch Association (AWA) also commented, suggesting a number of complementary administrative actions and requesting immediate implementation in 1978. (While the AWA has some quota-firm members, it has historically represented duty-paid importer interests. For example, the Association is an advocate of tariff reductions on watches in the forthcoming multi-

⁷ Claims by low-labor firms that to increase labor costs would result in price increases in the United States and render the movements uncompetitive would appear to be exaggerated. With a \$2.25 tariff advantage over duty-paid merchandise (on 6 3/4 x 8 ligne size), a \$0.30 to \$0.60 direct labor increase per movement assembled should not affect U.S. sales of the finished movements. However, if the quality control on the Russian merchandise is as poor as some labor-intensive users allege, numerous assembly problems could arise if the minimum standard were at a sufficiently high level to require train or other more complex assembly processes.

⁸ A \$2.25 low-labor movement must be sold for no less than \$4.05 in the United States. Assuming a generous \$0.30 labor input, the low-labor firm has a \$1.09 margin between cost of parts and minimum selling price. A \$4.25 movement has a \$6.07 minimum selling price. Taking a \$0.90 labor input, the labor-intensive firm has a \$0.02 margin. Thus the potential for profit is greater for the assembly firm using the low-labor movements.

⁹ It is possible to assemble up to 25 components without engaging in the more complex, labor-intensive operations. Moreover, assembly operations can be automated so that the additional wage input resulting from assembly of 20 to 25 components instead of 8 components would not necessarily rise proportionately.

lateral trade negotiations which, if effected, would have serious ramifications on the general headnote 3(a) watch assembly industry. The AWA has also requested that the International Trade Commission modify its procedures for calculating the domestic consumption of watches in a manner which would likely reduce the size of the territorial quotas). The AWA advocated a three-part eligibility standard, consisting of (i) a minimum number of components, (ii) a minimum number of assembly steps and (iii) a minimum direct labor input.

All except one of the firms which presently rely on the Soviet movements opposed the Departments' proposal.¹⁰ All stated that they would probably be able to comply with the Departments' standard after an adequate period for adjustment. Immediate implementation in 1978, they said, could put the firms out of business since deliveries and sales quotations for 1978 were based on the current costs of parts and present labor inputs. It was also stated that parts orders are generally made at least six months in advance, and that the firms had outstanding orders which could not be cancelled or modified.

The sole supplier of Soviet-made movements did not agree with the Departments' proposed action and strongly opposed the AWA counter-proposal. Among other things, the supplier argued:

1. General headnote 3(a) makes no distinction among products sourced from different countries, and it would be inappropriate for the Departments to issue any regulation which would have the effect of modifying the law.¹¹

2. The U.S. Customs Service which determines whether a manufacturing process qualifies a product for duty-free treatment under general headnote 3(a) has held that the amount of assembly presently being done on the U.S.S.R. goods meets the Customs Service standard.¹² Accordingly, the minimum assembly standard proposed by the Departments is unnecessary and inappropriate.

3. The market for the labor-intensive movements is declining and if low-labor production is disallowed, numerous insular workers will be affected. Also, the territories will suffer economically if significant quantities of quota go unused.

After evaluating all comments and careful study of all the facts at their disposal, the Departments determined that implementation of any minimum assembly standard should await further study of the technical and administrative aspects of the problem. Also, any action effective in January, 1978, would not have allowed quota producers sufficient time to modify their operations to meet new assembly requirements without considerable hardship.

However, the Departments' 1978 allocation formula, published on February 1 (13 F.R. 4274 et seq.), differs from the 1977 formula in that the amount of quota allocated on the basis of the firms' shipments is reduced by 10 percent and an additional 5 percent each is allocated on the basis of the firms' wage and tax payments in the territories.¹³ These modifications in the allocation formula were expected to favor firms which do more assembly. Indeed, preliminary data on the Virgin Islands industry for 1977, upon which the 1978 allocation will be predicated, bear out the Departments' expectations.

Much of the uncertainty in the domestic watch market caused by the introduction of inexpensive LED solid state watches has disappeared. Most industry sources believe there will be a strong demand for the conventional 17 jewel watch for some time to come. This prognosis is supported by the quota requests for 1978 by the Virgin Islands firms engaged in the assembly of the labor-intensive movements. The strong demand, in conjunction with an anticipated decline of some 1,000,000 units in the territorial quota in 1978, is expected to reduce the amount of quota available for reallocation in 1978.¹⁴

¹⁰ The concurring firm informally advised that it was forced to use the low-labor movements for competitive reasons.

¹¹ There was public criticism of the use of Russian watch movements in the insular industry when Public Law 89-865 was enacted. Despite this criticism, Congress took no action to preclude the use of Soviet goods in the general headnote 3(a) industry.

¹² In the mid-1960's the Customs Service appears to have liberalized its general headnote 3(a) assembly standard for watches. At the time, the majority of firms using low-labor movements were relying on sources other than the Soviet Union. Subsequently, for cost reasons and due to the Departments' allocation formula, which emphasized wage contributions, the firms using movements sourced in the West began engaging in additional operations.

¹³ In 1977, the allocation factors were 35 percent shipments, 50 percent wages and 15 percent taxes. These are changed to 25 percent shipments, 55 percent wages and 20 percent taxes for 1978.

¹⁴ Firms which earn more quota under the Departments' allocation rules than they can ship relinquish their excess to the Departments which are authorized to "reallocate" or redistribute such quota to those firms able to assemble more quota than they presently have. The Departments reallocate quota among requesting firms in a manner intended to maximize the economic benefits to the territories.

In their Codified Watch Quota Rules (15 CFR 303; 42 F.R. 02007 et seq.) published in December 1977, the Departments set forth the policy that they need not reallocate quota in 1978 if the reallocation would adversely affect the viability of the industry and the economies of the territories. Since reallocations generally do not occur until July or August, the Departments have several months to evaluate further the implications of reallocations in 1978.

(3) WHAT IS PROPOSED TO BE DONE

In addition to these regulatory and administrative actions, the Departments propose to make a formal request to the U.S. Customs Service/Department of the Treasury to review the eligibility requirements for watches under headnote 3(a). The watch quota staff believe that should the Customs Service determine that the adoption of a standard requiring assembly of a minimum number of discrete components (e.g., 25) is appropriate and feasible, further action by the Departments may be unnecessary.

If these initiatives are unsuccessful or otherwise prove inadequate, the watch quota staff would recommend that the Departments give strong consideration to announcing by mid-1978 that certain minimum assembly conditions be placed on the receipt of quota beginning in 1979. The specific form of these conditions would depend on further consultations with all affected parties and on the results of additional analysis. The timing of the announcement would give all affected firms sufficient time to make the necessary operational adjustments.

The problem in the insular watch industries has also come to the attention of Soviet trade officials. The Departments intend to have informal discussions with these officials as soon as practicable.

CONCLUSION

The primary objective of the Departments is to administer Public Law 80-805 in a fashion which maintains the established character of the watch assembly industry and maximizes the economic contribution of the industry to the territories. The steps we have taken or propose to take to resolve the low-labor problem are consistent with this objective and should help preserve the long-term viability of the industry.

PURCHASES OF U.S.S.R.—ORIGIN PARTS AND COMPONENTS IN THE HEADNOTE 3(a) INSULAR WATCH INDUSTRY 1967-76

Year	Number of firms purchasing	Total units purchased	Total value of purchases	Average unit value
VIRGIN ISLANDS				
1967	5	324,100	\$688,650	\$2.12
1968	5	322,000	655,175	2.03
1969	4	231,000	498,732	2.16
1970	4	212,890	450,313	2.12
1971	4	283,320	583,952	2.08
1972	5	193,500	406,340	2.10
1973	5	134,000	302,652	2.26
1974	2	79,500	200,768	2.53
1975	3	189,200	526,237	2.78
1976	4	654,390	2,054,694	3.14
GUAM				
1967	3	73,704	155,940	2.12
1968	4	102,757	237,946	2.32
1969	2	49,500	105,328	2.13
1970	3	139,300	269,786	1.94
1971	2	140,150	268,259	1.91
1972	5	266,500	596,571	2.24
1973	3	232,600	527,721	2.27
1974	2	263,941	677,244	2.57
1975	1	327,352	843,530	2.58
1976	2	106,000	340,302	3.21

Source: Annual application form (DIB-334P) submitted by quota firms to Commerce and Interior Departments. Earlier data reflect estimates for some multiple-sourced assemblers.

U.S. DEPARTMENT OF COMMERCE,
DOMESTIC AND INTERNATIONAL BUSINESS ADMINISTRATION,
Washington, D.C.

DEAR SIR: Public Law 80-805 vests the Secretaries of Commerce and the Interior with broad discretion in formulating the basis for apportioning the quota among watch assembly firms in the Virgin Islands, Guam and American Samoa. The statute provides that allocations be made "on a fair and equitable basis."

The legislative history of the Act expresses the expectation of the Congress that "the Secretaries will act in a manner best calculated to reflect and preserve the established character of the industry in the Virgin Islands." While some additional factors are noted which might well be taken into account by the Secretaries such as "production experience" and the "cost of direct labor involved in the assembly," the broad discretion granted the Secretaries can best be summed up by the following statement of Chairman Long on the floor of the Senate:

"We do not propose to say who gets what. We merely say look at all the equities and, as far as we are concerned, we let the Secretary of Commerce and the Secretary of the Interior set up pretty much the standards they wish to set up, but they must be fair and equitable in doing it."

Since 1967 the allocation formulae employed by the Departments have contained a labor or wage factor "to foster more assembly work in the territories and thereby a greater contribution to the economy of the islands." In recent years the percentage of the total quota allocated in Guam and the Virgin Islands on the basis of wages paid to local people has been increased so that in 1977 60 percent of the Guam quota and 50 percent of the Virgin Islands quota were allocated on this basis.

Within the last three years low cost movements have been imported into both territories in increasing numbers for assembly and shipment into the customs territory of the U.S. under General Headnote 3(a), Tariff Schedules of the United States. Unfortunately, these low cost movements require minimal assembly operations which limits the contributions accruing to the territories from their assembly. Recently, in hearings on H.R. 8222, a bill which would raise the permissible foreign content of other insular products to the same 70 percent level applicable to watches and watch movements, this problem was brought to the attention of the House Subcommittee on Trade. The Subcommittee Chairman has written the Department of Commerce expressing interest in administrative measures to insure that the increased use of low-cost movements does not become a threat to the viability of the entire industry.

Under General Headnote 3(a) territorial watch movements cannot include foreign material value representing more than 70 percent of the appraised value when such movements land into the customs territory of the United States. For example, a watch movement with foreign components valued at \$3.00 can enter the U.S. at no less than \$4.29 and one containing foreign components purchased for \$4.00 can enter for no less than \$5.71 (thus at \$1.00 differential in cost results in a minimum difference of \$1.42 in U.S. selling price).

Moreover, if the direct labor payment on the lower cost movement is \$.20 versus \$.80 on the more expensive movement (due to the fact that more discrete components are involved in the assembly of the more expensive movements), the profit potential of the lower cost movement is also greater. Thus, using the examples cited above, if labor costs are subtracted from the difference between selling price and cost of the parts the respective spreads are \$1.09 on the low cost, low labor movement and \$0.91 on the more expensive, more labor intensive movement. Under the above circumstances it would appear that over a period of time firms will have a strong incentive to move either to the lower cost movements or to assembly methods involving less local labor, that is, to the ordering of parts already largely assembled at the time of import into the territory.

In either of the above cases, the territories would stand to lose because the amount of wages paid to residents is the single most important benefit accruing to the territories from the watch assembly operations. Moreover, over a period of time the established character of the industry would undoubtedly change from one engaged primarily in the complete assembly of watches to one wherein the majority of firms would engage in the minimum permissible assembly operations.

In light of the foregoing, the Departments solicit your views and comments concerning a requirement which might be proposed at some future time that

a minimum of 15 discrete components (excluding case components and hands and dials, but including screws, subassemblies, and parts for the movement) be used by a firm in all of the movements it assembles under General Headnote 3(a) in order for the firm to receive a quota allocation from the Departments of Commerce and the Interior. Your views are also solicited on a related requirement that, in order to be eligible to receive quota on reallocation, a firm would have to employ an assembly method involving no fewer than 20 discrete components.

The Departments hope through a minimum assembly operation requirement or some other related requirement to maximize the economic contributions of the watch assembly industries to the territories and to discourage the development of pass-through type operations in the Headnote 3(a) watch industries. This objective is deemed consistent with the intent of the Congress in the enactment of Public Law 89-805 and with the stated purposes of Headnote 3(a).

Your comments are requested in writing on or before October 21, 1977.

Sincerely yours,

RICHARD M. SEPPA,
Director,
Special Import Programs Division, OIP.

ENCLOSURE B

INDUSTRY AND TRADE ADMINISTRATION

BUREAU OF TRADE REGULATION PROPOSED ANNUAL RULES

Agency: Bureau of Trade Regulation, Industry and Trade Administration, Department of Commerce.

Action: Proposed annual rules.

Summary: The Departments are proposing to revise the weights assigned to the factors in the formula for allocation of calendar year 1979 watch quotas among watch assembly firms in Guam and the Virgin Islands (Public Law 89-805). They are also proposing that a portion of the quotas in the two territories be allocated among firms performing specified minimum assembly operations or making minimum headnote 3(a) wage contributions during a specified base period. The Departments published proposed production incentives applicable to calendar year 1979 allocation of duty-free watch quotas and invited comments from interested parties in the Federal Register dated June 6, 1978 (43 FR 24500 (1978)).

Date: Written comments must be received at the address shown below not later than 5 p.m., October 15, 1978. Comments should be filed in duplicate and addressed to: Statutory Import Program Staff, Bureau of Trade Regulation, room 6894, U.S. Department of Commerce, Washington, D.C. 20230.

For additional information contact: Mr. Richard M. Seppa, who can be reached by telephone on 202-377-2925.

Supplementary information: In assigning the Departments joint responsibility for allocating the quotas on a fair and equitable basis, Pub. L. 89-805 authorized them "to issue such regulations as they determine necessary to carry out their duties." The legislative history of the Act suggests that the cost of labor involved in the assembly of a watch be taken into account by the Departments in allocating quota because the labor factor "is a measure of the economic contribution being made by the assembly process, and also is an indication of the degree of assembly work being performed in the islands." (S. Rep. No. 1079, 79th Cong., 2d Sess. 8 (1966.)) The Senate report further indicated that in administering the quota law the Departments "may also take into account whatever additional factors they find are warranted."

In enacting the quota the Congress explicitly intended to prevent the duty-free privilege from becoming "little more than a convenient device for funneling foreign watches into this country."

In adhering to the intent of the Congress and the purposes of General Headnote 3(a). Tariff Schedules of the United States (stimulation of the development of light industry), the Departments have since 1967 made quota allocations under formulae which have progressively emphasized labor contributions and, in recent years, corporate income tax payments to the territorial economies.

In order further to strengthen the incentive for all producers to engage in more complete assembly operations, the Departments are proposing to revise the 1979 allocation formula by increasing the weight given the wage factor and reducing the weight given the shipment factor.

Applications from new firms would be invited for the American Samoa quota and for a portion of the Guam quota.

The Departments propose to consider new entrant applications only from firms which can meet the minimum assembly operations or minimum headnote 3(a) wage contribution provision. The Departments further propose to reallocate quota which becomes available during calendar year 1979 only among those firms which perform the minimum assembly operations or satisfy the minimum headnote 3(a) wage contribution provision.

Written comments on the Departments' notice concerning proposed production incentives which were received before the July 15 closing date for comments were considered in the development of these proposed rules. A synopsis and a staff analysis of these comments are available for public inspection and copying.

All public comments to be considered in the development of these rules will be a matter of public record and will be available for public inspection and copying. In the interest of accuracy and completeness, comments in written form are preferred. If oral comments are received, the official receiving such comments will prepare a memorandum summarizing the substance of the comments and identifying the individual making the comments as well as the person on whose behalf they are made. All such memoranda will also be a matter of public record and will be available for public review and copying.

Written public comments which are accompanied by a request that part or all of the material be treated confidentially, because of its business proprietary nature or for any other reason, will not be accepted. Such comments and materials will be returned to the submitter and will not be considered in the development of the regulations. No comments received after the close of the comment period will be accepted or considered by the Departments in the development of final rules.

The public record on these proposed rules will be maintained in the Industry and Trade Administration Freedom of Information Records Inspection Facility, Room 3012, Main Building, U.S. Department of Commerce, 14th and Constitution Avenue NW., Washington, D.C. 20230. Records in this facility, including written public comments and memoranda summarizing the substance of oral communications, may be inspected and copied in accordance with regulations published in Part 4, Title 15 of the code of Federal Regulations. Information regarding the inspection and copying of records at the facility may be obtained from Mrs. Patricia L. Mann, the Industry and Trade Administration Freedom of Information Officer, at the above address or by calling 202-377-3031.

TEXT OF PROPOSED RULES FOR CALENDAR YEAR 1979

SECTION 1. (a) That portion of the 1979 Virgin Islands quota equal to the ratio of general headnote 3(a) shipments of watches and watch movements from the territory during 1978 to the total 1978 Virgin Islands quota will be allocated on the basis of (1) the dollar amount of wages, up to a maximum of \$14,000 per person, paid by each producer during calendar year 1978 to residents of the territory and attributable to each producer's headnote 3(a) watch and watch movement assembly operations, (2) the dollar amount of income taxes paid by each producer during calendar year 1978 attributable to its headnote 3(a) watch and watch movement assembly operations (excluding penalty payments and less income tax refunds and subsidies paid by the territorial government during calendar year 1978), and (3) the number of units of watches and watch movements assembled in the territory and entered by each producer duty-free into the customs territory of the United States during calendar year 1978.

(b) In making allocations under this formula, a weight of 60 percent will be assigned to the wage factor, a weight of 20 percent will be assigned to the income tax factor, and a weight of 20 percent will be assigned to the shipment factor.

(c) The remaining portion of the 1979 Virgin Islands quota will be allocated among firms performing the minimum assembly operations or making minimum headnote 3(a) wage contributions during the base period. Eligible firms will be allocated quota in accordance with the factors and weights governing allocations under subsection 1(b). Allocations of this portion of the 1979 Virgin Islands quota will be made to firms which:

(1) Assembled all movements shipped during the base period from un-assembled movements having at least 26 discrete components; or

(2) Made headnote 3(a) wage contributions during the base period in the territory of not less than \$.75 per watch or watch movement (exclusive of

any casing operations) shipped into the customs territory of the United States.

SEC. 2. (a) That portion of the 1979 Guam quota equal to 75 percent of the ratio of calendar year 1978 general headnote 3(a) shipments of watches and watch movements from the territory to the total 1978 Guam quota will be allocated to firms on the basis of the factors and weights set forth in subsections 1 (a) and (b).

(b) Except as noted in section 3, the remaining portion of the 1979 Guam quota will be allocated among firms satisfying the criteria established in subsection 1(c) in accordance with the quota formula factors and weights specified in subsections 1 (a) and (b).

SEC. 3. Quota set aside for new firms under subsection 4(b) shall be subtracted, before allocations are made pursuant to subsection 2(b), from the respective quota amounts allocable under those provisions.

SEC. 4. Applications from new firms are invited for the calendar year 1979 American Samoa quota, because the sole recipient in the territory discontinued operations in calendar year 1977, and a new entrant was not selected under the 1978 new entrant provision (43 FR 4274; 43 FR 10718 (1978)). Due to the limited size of the American Samoa quota, the Departments will allocate that quota to the single firm which offers the best prospect of making a meaningful long-term contribution to the economy of the territory.

(b) Applications from new firms are invited for 150,000 units of the calendar year 1979 Guam quota.

(c) Applicants for new-entrant quota in Guam or American Samoa must complete applicable sections of form ITA-334P, copies of which may be obtained from the Statutory Import Programs Staff, Room 6804, U.S. Department of Commerce, Washington, D.C. 20230. Detailed instructions for completing ITA-334P will be provided by the Statutory Import Programs Staff together with copies of the application form.

(d) The Departments will consider new entrant applications only from firms able to satisfy the Departments that they can meet the minimum assembly or wage contribution criteria established in subsection 1(c). Following the Secretaries' determination that a qualifying application has been received, an announcement will be published in the Federal Register establishing a closing date for further applications. The closing date shall be 30 days from the date of such notice. In the event no qualifying application is received for the Guam new entrant quota prior to September 1, 1979, and existing Guam quota recipients were able to satisfy the criteria established in subsection 1(c) during the base period, a portion or all of the Guam quota set aside for new entrants may be reallocated to the 1979 Guam quota recipients in a manner which in the judgment of the Departments maximizes the economic contributions to the territory.

SEC. 5. Reallocation of calendar year 1979 quota which becomes available will be restricted to those firms able to satisfy the criteria established in subsection 1(c).

SEC. 6. As used in these rules, (a) "Wages" means all wages up to \$14,000 per person paid during the base period to residents of the territories employed in the firm's headnote 3(a) watch and watch movement assembly operations. Excluded, however, are wages paid to (i) accountants, lawyers, or other professional personnel who may render special services to the firm; (ii) persons assembling non-headnote 3(a) watch movements; (iii) persons engaged in casing operations; and (iv) persons engaged in the repair of nonheadnote 3(a) watches or watch movements. Wages paid to persons engaged both in headnote 3(a) and non-headnote 3(a) assembly and repair activities shall be credited proportionately to their headnote 3(a) activities provided the firm maintains production and payroll records adequate for the Departments' verification of the headnote 3(a) portion.

With respect to allocations under subsections 1(c) and 2(b) of these rules, total creditable wages will be divided by the total units entered duty-free into the customs territory of the United States during the base period to determine if the \$.75 per movement eligibility criterion is satisfied. In determining eligibility for allocations and reallocations of quota pursuant to the criteria established in subsections 1(c) and 2(b) for firms electing the base period specified in paragraph (c) (ii) below, the Departments shall give credit for wages paid up to a maximum of \$3,500 per person.

(b) "Discrete components" means screws, parts, components, and subassemblies (e.g., barrel, barrel bridge, or balance) not assembled onto the mainplate, or not assembled together with another part, component or subassembly at the

time of importation into the territory. (A mainplate containing set jewels or shock devices, together with any parts, components or subassemblies fixed to it at the time of importation, would under this definition be considered a single component.) Excluded, however, are dials; dial screws; dial washers; hour wheels; hands; automatic mechanisms and related parts; day-date or special feature devices and related parts; and jewels.

(c) "Base period" refers, in calendar year 1970, to (1) calendar year 1978, or (ii) the period January 1, 1970, through March 31, 1970, for firms so electing.

SEC. 7. All firms must, as a condition for receipt of allocations or reallocations based on subsection 1(c) or 2(b) criteria, certify to the Departments that they will not alter assembly operations during the remainder of calendar year 1970 in a manner which would result in their failure to satisfy the respective criteria.

Dated September 1, 1978.

STANLEY J. MARCUS,
*Deputy Assistant Secretary
for Trade Regulation.*

Dated September 5, 1978.

GEORGE R. MILNER,
*Director, Office of Territorial Affairs,
U.S. Department of the Interior.*

[FR Doc. 78-25262 Filed 9-5-78; 1:50 pm]

ENCLOSURE C

U.S. DEPARTMENT OF COMMERCE,
THE ASSISTANT SECRETARY FOR INDUSTRY AND TRADE,
Washington, D.C., March 9, 1978.

Mr. RICHARD DAVIS,
*Assistant Secretary for Enforcement and Operation, U.S. Department of the
Treasury, Washington, D.C.*

DEAR Mr. DAVIS: Public Law 94-805 (800 Stat. 151; 19 U.S.C.; hereafter the Act) established a quota on the number of watches and watch movements which each year could be entered free of duty into the U.S. customs territory from the insular possessions. The Act, which amended general headnote 3(a) of the Tariff Schedules of the United States (TSUS) and added headnote 6 to schedule 7, part 2, subpart E, authorized the Secretaries of Commerce and the Interior to allocate "on a fair and equitable basis" among producers of watches and watch movements located in the insular possessions the quotas for each year. The Act also specified that the Secretaries' allocations would be final and authorized the Secretaries to issue such regulations as they deem necessary to carry out their duties.

In order for watches and watch movements to qualify for the general headnote 3(a) duty exemption, there must be a finding that they (1) are manufactured or produced in the U.S. insular possessions and (2) do not contain foreign materials to the value of more than 70 percent of their value. The foreign content requirement for watches and watch movements was increased in 1975 from 50 percent by Public Law 94-88 (80 Stat. 433). Responsibility for these determinations rests with the United States Customs Service, Department of Treasury.

The legislative history of the Act (Senate Finance Committee Report No. 1070, 80th Congress, 2nd Session) provides guidance to the Secretaries of Commerce and the Interior stating the expectation that in allocating quota among producers the Secretaries (1) will act in a manner best calculated to reflect and preserve the established character of the industry and (2) take into account the cost of direct labor involved in the assembly of a watch. Labor costs were said to be "a measure of economic contribution being made by the assembly process, and also . . . an indication of the degree of assembly work being performed in the islands."

In accordance with their interpretation of the intent of the Congress, the Departments have attempted to maximize the economic contributions of the general headnote 3(a) watch assembly industry by allocating an increasing portion of the annual quota on the basis of the firms' wage payments to residents of the insular possessions. Notwithstanding this policy, there has been, within the last three years, a significant increase in the use of foreign watch movement parts and components which are entering the territories in a largely preassembled condition (so-called subassemblies).

This situation is of concern to the Departments because the low labor input associated with completing these movements severely limits the wage and employment contribution of the industry to the territorial economies. Moreover, producers using parts and components requiring a greater degree of assembly claim that their continued viability is being seriously threatened by the inexpensive "low-labor" movements which can be marketed in the U.S. for considerably lower prices with greater profit margins.

The United States Customs Service has held that the assembly processes performed on the movements produced from the subassemblies result in a product of the insular possessions eligible for duty-free entry under general headnote 3(a). We recognize that the headnote does not provide a standard to guide the Service in its determination of whether a particular operation constitutes a manufacture in the territories. It is our understanding, however, that the Service evaluates any assembly process proposed in the insular possessions in terms of the total assembly process on the article and its components, and applies a rule of reason. According to a December 5, 1966, letter from Mr. Murray Ryss of the Treasury Department to Seymour Friedman, Bureau of the Budget, the determination is based on "precedent administrative and judicial decisions" (copy attached).

In view of the economic implications of the increased use of subassemblies in the insular possessions, and the potential implications of such activity on the viability of the segment of the industry engaging in more complete assembly operations, the Departments are requesting that the Treasury Department review the Customs Service standards for determining eligibility of watches and watch movements assembled in the insular possessions for entry into the customs territory of the United States.

In your review of this matter, you may wish to consider the following facts:

1. The typical (6¾ by 8 ligne) low labor movement now enters the islands with one major subassembly (mainplate and 80 attached components), a barrel subassembly (consisting of 4 assembled components), a barrel bridge subassembly (consisting of 7 assembled components), and ratchet wheel, a ratchet wheel screw, and 3 barrel bridge screws (see attached analysis).

2. Approximately one-ninth of the total labor input possible on the completed low-labor watch movement is now being performed in the insular possessions.

3. The value added in the insular possessions on the low-labor watch movements (direct labor cost only) is between 2 and 6 percent of the cost of the foreign components (\$0.06 to \$0.18 on components costing \$3.25).

Because of the potential significance of this situation on the insular watch industries and the insular possessions, your earliest possible consideration of the matter would be appreciated. In this regard, the watch quota staffs in the Departments are available to supply any additional information you deem necessary.

Sincerely,

FRANK A. WEIL,
Assistant Secretary for Industry and Trade,
U.S. Department of Commerce.
RUTH G. VAN CLEVE,
Director, Office of Territorial Affairs,
U.S. Department of the Interior.

Enclosures.

U.S. GOVERNMENT,
December 5, 1966.

Memorandum to: Mr. Seymour Friendland, Bureau of the Budget.

From: Murray Ryss, OASIA, Treasury Department

Subject: Treasury Department response to question posed in your memorandum and discussed at interagency meeting on October 28, 1966.

In addition to the usual problems which are encountered in administering the provisions of the Tariff Schedules of the United States (TSUS), General Headnote 3(a) presents certain unique administrative difficulties which are individually discussed below. They arise primarily in connection with the entry of articles made with the use of foreign materials.

I. MANUFACTURE OR PRODUCTION DETERMINATIONS

General Headnote 3(a), TSUS, provides, in part, for an exemption from United States duties for articles which (1) are manufactured or produced in insular possession of the United States which are outside of United States

customs territory, (2) do not contain foreign materials to the value of more than 50 percent of their total value, and (3) come directly to the customs territory of the United States from the insular possession.

Before duty-free entry may be granted under the cited portion of General Headnote 3(a), an administrative determination must be made as to whether the processes which are performed in the insular possession constitute a manufacture or production, within the meaning of the headnote, of the article for which free entry is sought. This determination is based on precedent administrative and judicial decisions (primarily on the former as court cases in this area of the law are scarce).

Decisions as to what constitutes manufacture are basically found in relation to problems arising under the drawback law. In general, these decisions are not helpful in regard to the administration of General Headnote 3(a). This is in part because these decisions are not often directly in point. But even when they are in point, it must be realized that the statutes and the purposes of the statutes are by no means the same and, therefore, the precedential value of decisions under one statute are of dubious applicability under the other.

The principal difficulty in determining whether an operation constitutes a manufacture is that it has been impossible to lay down a rule of general application. Necessarily administrative precedent, not abstract logic, has governed. In essence, the problem is: What constitutes manufacture? Is mere assembly enough? If it is, how much assembly is required? Does sewing something to or on an object constitute "manufacture?" If so, how much sewing is required? Do painting, varnishing, stamping, drying, etc., etc., etc., constitute "manufacture?" If so, how much and under what circumstances?

Obviously, a rule relating to how much assembly is required before the assembly of watch parts results in the manufacture of a watch has no direct applicability to how much sewing, embroidery, etc., required before foreign fabrics have been manufactured into an article made of foreign fabric.

Further, when the Bureau of Customs rules that a certain amount of assembly does not constitute manufacture, the next question presented to the Bureau is how much more assembly would transform the operation into an acceptable manufacture. Would tightening three more screws do it? Would adding a piece of braid? If the applicant receives a negative answer, the next question is obviously: Would the addition of a further screw, or another piece of braid, push the operation over the magic border?

It will be recalled that the inherent impossibility of drawing a sensible line based on the type of operations performed in the insular possessions is what led the Treasury Department to propose a modification of General Headnote 3(a) to transform the manufacturing test into a test of value added (measured in terms of labor and insular materials added).

II. VALUE DETERMINATIONS

Section 7.8(d) of the Customs Regulations provides, in effect, that in determining whether an article manufactured or produced in an insular possession meets the 50 percent value limitation in General Headnote 3(a), a comparison shall be made between the landed cost in the possession of the foreign materials contained in the article, and the final appraised value in the United States, in accordance with section 402, Tariff Act of 1930, as amended, of the article.

In order to apply the test provided for in section 7.8(d) of the Customs Regulations, at least two value determinations are required in connection with the importation of each article into the United States. First, the landed cost of the foreign materials in the insular possession must be ascertained; second, the section 402 value of the article imported into the United States must be found. The application of the value test is further complicated by the fact that foreign components almost always arrive in more than one shipment. (If all of the components arrived together in a single shipment most finished articles would be regarded as having been imported as entireties and the finished articles for this reason would fail the manufacture test.) This factor of multiple shipments of foreign materials, of course, increases the burden involved in making the value determinations.

The appraisement in the United States of insular articles also poses unusual problems. Relationships between manufacturing firms in the insular possessions and their customers in the United States, and with insular purchasing and selling firms, are interlocking to a very high degree. This factor makes more difficult

the task of finding the proper bases of appraisement under section 402 of articles entered under General Headnote 3(a). Some examples of the interrelationship between insular and domestic firms in one industry, i.e., the assembly of watch movements, are set out below:

Parent and subsidiary

Webster Watch Company—Admiral Time Inc., Virgin Islands.
 Hamilton Watch Company—Standard Time Corp., Virgin Islands.
 Bulova Watch Company, Inc.—Atlantic Time Products Corp., Virgin Islands.
 Pan American Time Corp.—R. W. Summers Time Corp., Virgin Islands.
 Waltham Watch Co.—Hallmark Watch Co., Virgin Islands and Guam.
 Westminster Watch Co., Inc.—Westminster Time Corp., Virgin Islands and Guam.
 Belmont Watch Co., Inc.—Belmont Industries, Inc., Virgin Islands.
 Eclair Watch Corp.—Belair Time Corp., Virgin Islands.
 General Time—Antilles Industries, Inc., Virgin Islands.
 Benrus Watch Co.—Quality Products Co., Inc., Virgin Islands.
 Elgin National Watch Co.—Master Time Corp., Virgin Islands.
 Timex, Ltd.—Virgo Corp., Virgin Islands.
 Timex, Ltd.—Agama Watch Co., Inc., Guam.
 Timex, Ltd.—Oceania Corporation, Ltd., Samoa
 General Time—Trans-World Instruments, Inc., Guam.

III. IDENTIFICATION OF FOREIGN MATERIALS

When articles manufactured in an insular possession in a shipment valued over \$25 are brought into the United States for entry under the provisions of General Headnote 3(a), T.S.U.S. section 7.8(a) of the Customs Regulations requires that there be filed in connection with the entry a certificate of origin (customs Form 3220) signed by the chief customs officer in that possession or his assistant. The signature of the customs officer constitutes a verification of the statements made on the certificate by the shipper with respect to the articles being shipped to the United States and the descriptions and values of the foreign materials contained in those articles.

An insular manufacturer who produces articles for entry into the United States under General Headnote 3(a) is required to keep records which will enable customs officers to identify foreign materials used in production by the number of entry into the insular possession and the date, and to show the landed costs which have been determined to apply to those materials. Records must also be made available which will permit customs officers to trace each lot of foreign materials through the manufacturing processes into the finished article.

The customs agent in charge at St. Thomas, Virgin Islands, devotes almost full time to examining the records of manufacturing firms there, observing their operations, and otherwise ensuring that the statements made on certificates of origin with respect to the quantity, values, and descriptions of the foreign materials are accurate, and that the operations conducted by those firms conform to those which have been determined to constitute valid manufactures or productions within the meaning of General Headnote 3(a) by the Bureau of Customs or by the Treasury Department.

ANALYSIS OF LOW-LABOR MOVEMENTS, ACTUAL VERSUS POTENTIAL, IN TERMS OF SEPARATE PARTS OR COMPONENTS REQUIRING FURTHER ASSEMBLY, AND OF NUMBER OF ASSEMBLY OPERATIONS REQUIRED (6¾ x 8 ligne movement, exclusive of handling, dialing, casing)

I. ACTUAL

A. Description of parts, components (subassemblies), screws

1. Mainplate subassembly (assembled from 31 parts).
 2. Barrel subassembly (assembled from 4 parts).
 3. Barrel bridge subassembly, (assembled from 7 parts).
 4. Ratchet wheel.
 5. Ratchet wheel screw.
 6. Barrel Bridge assembly screws (3).
- Total number of discrete components: 8.

B. Description of assembly steps

1. Insert barrel subassembly.
2. Place barrel bridge subassembly over barrel.
3. Insert and turn in barrel bridge screws (3).
4. Assemble ratchet wheel and ratchet wheel screws.
5. Oil center upper jewel.

II. POTENTIAL**A. Description of parts, components, screws (so-called "A" Parts)**

1. Mainplate.
 2. Work stem and crown.
 3. Clutch wheel.
 4. Winding pinion.
 5. Clutch lever (aka yoke).
 6. Clutch lever spring (aka yoke spring).
 7. Setting wheel (aka intermediate wheel).
 8. Minute wheel.
 9. Setting cap spring (aka minute wheel bridge).
 10. Setting cap spring screws (2).
 11. Setting lever (aka detent).
 12. Setting lever hold-down spring.
 13. Setting lever hold-down screw.
 14. Center wheel.
 15. Third wheel.
 16. Fourth wheel.
 17. Escape wheel.
 18. Train bridge.
 19. Train bridge screws (2).
 20. Pallet.
 21. Pallet cock.
 22. Pallet cock screw.
 23. Cannon pinion.
 24. Balance lower shock system.¹
 25. Balance wheel complete with hairspring.¹
 26. Balance cock complete with upper shock system, stud holder and regulator.¹
 27. Balance cock screw.¹
 28. Dial screws (2).
- A parts subtotal: 31

¹ Most insular assemblers receive these components preassembled for reasons of packing and shipping economy; but they must be disassembled to permit the assembly operations shown in C.

B. Description of parts, components, screws (so-called B parts)**Barrel subassembly**

1. Barrel drug.
2. Barrel arbor.
3. Mainspring.
4. Barrel cover.

Barrel bridge subassembly

5. Barrel bridge.
6. Click.
7. Click screw.
8. Click spring.
9. Crown wheel core.
10. Crown wheel.
11. Crown wheel screw.
12. Ratchet wheel.
13. Ratchet wheel screw.
14. Barrel bridge screws (3).

B parts subtotal: 16.

Total number of discrete components: 47.

C. Description of assembly operations

1. Assemble barrel and inspect barrel arbor endshake (subassembly operation).
2. Assemble steel parts to barrel bridge (subassembly operation).

3. Remove balance and balance cock unit from mainplate.
4. Assemble winding and setting mechanism (A parts 1 through 13).
5. Assemble train (A parts 14 through 19).
6. Assemble barrel, barrel bridge and ratchet wheel.
7. Assemble pallet and pallet cock.
8. Inspection (endshake, wheel freedom, function of winding mechanisms).
9. Oil train jewels and pallet stones.
10. Fit cannon pinion and adjust tension.
11. Assemble pre-assembled balance and balance cock unit to mainplate.
12. Inspect and adjust balance endshake, overall functioning of hairspring (level, vibration, etc.).

NOTE.—The operations shown in I and II require varying degrees of precision and manual dexterity. Generally, the operations in II require greater degrees of these than that in I. Also, at least two insular producers currently perform the balance subassembly operation (see Nos. 24 to 27 in the A parts list, II), which is probably the most labor-intensive operation in watch assembly.

ENCLOSURE D

Watch assembly companies operating in the U.S. insular possessions in calendar year 1978

Virgin Islands:	1978 quota allocations
Antilles Industries, Inc.....	450,000
Atlantic Time Products Co.....	251,370
Belair Time Corporation.....	505,325
Consolidated Industries Ltd.....	150,000
Cornavin Virgin Islands, Inc. ¹	600,000
Hampden Watch Company, Inc.....	284,362
Master Time Company, Ltd.....	430,000
Micro Manufacturing Corporation.....	10,238
Progress Watch Company, Inc.....	450,000
Roza Watch Corporation.....	668,690
Standard Time Company.....	278,590
Sussex Watch Corporation ¹	150,000
TMX Virgin Islands, Inc.....	885,000
Unitime Corporation.....	515,500
Waltham Watch Company of the Virgin Islands, Inc.....	275,000
Watches, Incorporated ¹	200,000
Guam:	
Phoenix Industries Inc ¹	30,357
Jerlian Watch Co. Inc. ¹	450,648
American Samo: No companies presently operating.	

¹ Companies which relied wholly or predominantly on Soviet parts in 1977.

REPRESENTATIVE PARTS COSTS AND SELLING PRICES (MARCH 1978 PRICES)

Caliber (line)	Cost of movement parts	Finished movement selling price
Soviet:		
5¼.....	\$3.25	\$4.70
5½.....	3.25-3.32	4.70-4.75
5¾.....	3.06	4.40
6.....	3.04-3.06	4.40
6¾×8.....	3.32	4.97
8¾.....	2.80-3.91	4.22-5.70
11¾.....	2.79-3.28	4.05-4.75
18.....	5	7.15
Non-Soviet:¹		
3¾.....	9.56-9.63	13.66-14.82
5¼.....	4.05-5.63	5.79-8.66
6¾×8.....	3.80-6.47	5.43-9.95
11¾.....	3.25-8.90	4.66-13.69
12.....	8.08-10.87	11.54-16.72

¹ Dollar figures based on: Swiss franc = .5502; French franc = .2103; Deutschemark = .4980.

AGGREGATED 1977 DATA

	Companies supplied by non-Soviet suppliers	Companies supplied by Soviet Union
Virgin Islands:		
Number of units shipped.....	3,813,191	846,702
Employment provided:		
Work hours.....	1,110,528	119,691
Average number of workers.....	556	63
Headnote 3(a) wages paid.....	\$3,651,721	\$380,844
Sales.....	\$28,127,347	\$4,095,426
Guam:		
Number of unit shipped.....		357,365
Work hours.....		38,098
Average number of workers.....		22
Headnote 3(a) wages.....		\$130,761
Sales.....		\$1,714,699
American Samoa:		
No companies operating.		
All possessions:		
Units shipped.....	3,813,191	1,204,067
Work hours.....	1,110,528	157,789
Average number of workers.....	556	85
Headnote 3(a) wages.....	\$3,651,721	\$511,605
Sales.....	\$28,127,347	\$5,810,125
Averages:		
Work hours per unit shipped.....	.291	.131
Number of workers per 10,000 units.....	1.46	.71
3(a) wages per unit shipped.....	\$9.96	\$9.42
Price per unit shipped.....	\$7.38	\$4.83
1978 shipments (through June 30):		
Virgin Islands.....	1,922,663	231,368
Guam.....		95,450
Total.....	¹ 1,922,663	² 326,818

¹ 85 percent. ² 15 percent.

**VIRGIN ISLANDS WATCH COMPANIES
INDUSTRYWIDE STATISTICS CALENDAR YEARS 1972-77¹**

	Calendar year —					
	1972	1973	1974	1975	1976	1977
1. Annual quota allocation to (units).....	4,622,000	4,913,000	4,874,000	4,960,000	5,008,000	6,256,000
2. Actual units shipped to U.S. under headnote 3(a).....	4,386,521	4,634,819	4,048,876	3,046,757	4,012,810	4,659,893
3. Watch movements assembled (units).....	4,342,614	4,678,175	4,032,322	3,042,565	4,056,703	4,826,618
4. Total wages paid.....	\$3,653,935	\$3,949,015	\$3,888,797	\$3,370,560	\$3,907,010	\$4,449,222
5. Total wages credited for quota calculation purposes ²	\$3,365,053	\$3,781,956	\$3,704,051	\$3,165,259	\$3,706,076	\$4,051,193
6. Average labor per movement assembled:						
Total labor.....	.84	.84	.96	1.11	.96	.92
Quota labor.....	.77	.80	.92	1.04	.91	.84
7. Net calendar year corporate income taxes ³	\$3,086,524	\$4,342,003	\$3,177,041	⁴ \$1,856,943	\$1,029,890	\$867,464
8. Net calendar year gross receipts - customs - excise taxes paid Virgin Islands ⁵	\$81,518	\$107,885	\$152,180	\$99,821	\$1,004,857	⁶ \$1,157,053
9. Duty free watch sales—in dollars.....	\$30,283,721	\$36,228,295	\$34,006,277	\$25,489,552	\$28,964,339	\$32,260,352
10. Number of employees in Virgin Islands watch industry.....	1,104	1,193	1,000	847	1,007	⁷ 914
11. Number of companies.....	15	17	17	15	14	15

¹ Industrywide data verified by the Departments of Commerce and the Interior.

² Through 1974 the total amount of wages per person creditable for quota calculation purposes was tied to "wages subject to FICA taxes." In 1975 and 1976 the Departments limited the quota wages to \$13,200 per person, and increased the amount to \$14,000 in 1977.

³ Excludes corporate income taxes exempted by the Virgin Islands government.

⁴ Public Law 94-88, enacted in August 1975, amended general headnote 3(a) to allow foreign material to represent up to 70 percent of the appraised U.S. value. This resulted in a decline in selling prices and, accordingly, profit margins and tax payments in the insular possessions.

⁵ Through 1975 most firms enjoyed a 50 percent Customs duty exemption and 100 percent on gross receipts and excise taxes. Beginning in 1976 the percentage exemptions were reduced and the exemption given to each firm was tied to its labor input per movement shipped.

⁶ Includes: Gross receipts of \$235,136, Excise taxes of \$331,106, and Customs duties of \$590,811.

⁷ Employment as of July 1, 1977 and December 31, 1977 was 650 and 623, respectively. During the year 914 residents of the Virgin Islands received wages from the territorial firms.

GENERAL TIME CORP.,
Mesa, Ariz., September 6, 1978.

MR. MICHAEL STERN,

*Staff Director, Committee on Finance, U.S. Senate, 2227 Dirksen
 Senate Office Building, Washington, D.C.*

DEAR MR. STERN: On August 21, 1978, Chairman Ribicoff of the Subcommittee on International Trade of the Committee on Finance announced that the subcommittee would welcome written comments of interested parties with respect to the assembly in the Virgin Islands of watch movements from subassemblies which are the product of the Union of Soviet Socialist Republics.

In accordance with that statement, I am pleased to submit herewith the position of General Time Corp., a Talley Industries company, which is a major American producer of watches, clocks, and related timepieces. General Time Corp. takes the firm position that General Headnote 3(a) of the Tariff Schedules of the United States—dealing with imports from United States' insular possessions—is being used by various organizations to procure duty-free treatment for certain watches and watch movements produced in the Union of Soviet Socialist Republics. In other words, General Headnote 3(a) is being used as a "tariff loophole" in a way which evades the policies behind and undermines the purposes of the tariff laws of the United States of America. The reasons why General Time Corp. takes this position are spelled out in the attached memorandum.

Unless the Congress takes prompt action to end this abuse of General Headnote 3(a), the watch and watch movement industry in the United States and its insular possessions will suffer rapidly increasing adverse effects and there will be continued evasion of various United States statutes. In order to correct this problem, General Time Corp. strongly recommends that the Congress amend General Headnote 3(a) by adding a new subparagraph (iv) at the end as follows:

"(iv) No watch or watch movement containing any parts manufactured, assembled or otherwise processed in a country, all or some of the goods of which are subject to the rates of duty set forth in column numbered 2 of the schedules, shall be exempt from duty under this headnote 3(a), and any such watch or watch movement shall be subject to the rates of duty set forth in column numbered 2 of the schedules."

Other members of the United States watch industry, including Timex, Bulova and the membership of the American Watch Association support this proposal. The result is that the United States watch industry unanimously endorses the amendment presented above.

I am forwarding herewith twenty copies of this statement and would appreciate your distributing it to members of the subcommittee and to the staff.

Sincerely yours,

FRED CHAPMAN,
Vice President.

MEMORANDUM SUBMITTED BY GENERAL TIME CORP.—A TALLEY
INDUSTRIES COMPANY

I. INTRODUCTION

This statement is submitted by General Time Corp., a Talley Industries company, in response to the request of Chairman Abraham Ribicoff of the Senate Subcommittee on International Trade for comment on the assembly in the Virgin Islands of watch movements from subassemblies manufactured in the Union of Soviet Socialist Republics. General Time Corp., along with other interested parties, applauds the interest of this subcommittee and the Congress in this question.

General Time Corp. believes that a small group of watch importers is using General Headnote 3(a) of the Tariff Schedules of the United States, which grants duty free treatment to watches imported from the Virgin Islands on the condition that the foreign material content not to exceed seventy percent (70 percent) of value, as an unintended tariff loophole. This evasion is accomplished by importing into the United States Virgin Islands nearly complete watch movement subassemblies manufactured in the Union of Soviet Socialist Republics. Those subassemblies are then subjected to minimal assembly operations as a subterfuge to create the impression that the thirty percent (30 percent)¹ value added test is being complied with. Finally, those watches are imported into the United States under the claim that they come within General Headnote 3(a) entitling them to duty free treatment.

General Time Corp. feels strongly that the Virgin Islands assembly of Soviet manufactured watch movements and subassemblies—as outlined above—causes rapidly increasing harm to domestic and insular possession watch manufacturers, evades the purposes behind General Headnote 3(a), and frustrates the policies behind the other major congressional enactments. Accordingly, General Time Corp. submits that there is an urgent need that Congress amend General Headnote 3(a) to terminate this abuse. To that end, General Time Corp. recommends that a new subparagraph (iv) be added to General Headnote 3(a) as follows:

(iv) No watch or watch movement containing any parts manufactured, assembled or otherwise processed in a country, all or some of the goods of which are subject to the rates of duty set forth in column numbered 2 of the schedules, shall be exempt from duty under this headnote 3(a), and any such watch or watch movement shall be subject to the rates of duty set forth in column numbered 2 of the schedules.

II. BACKGROUND

General Time Corp. is a major American manufacturer of watches, clocks and other timekeeping products, with significant production facilities located in Thomaston, Conn.; Huntsville, Ala.; Athens, Ga.;

¹ 100 percent minus the 70 percent maximum for foreign content.

LaSalle, Ill.; and St. Croix in the United States Virgin Islands. General Time has a total domestic production labor force in excess of 4,600 individuals and corresponding payroll of approximately \$49.4 million. General Time products are marketed under a number of well-known brand names, including Westclox, Seth Thomas, Baby Ben, and Quartzmatic.

General Time Corp. has a substantial involvement in the U.S. wristwatch market. Although General Time once manufactured wristwatches entirely within the United States, competition from low-cost imports has forced it to abandon that program. Initially, General Time had to rely completely upon imported products. More recently, it has been able to restore a significant American content to its wristwatches by importing unassembled parts to St. Croix in the Virgin Islands, performing all assembly operations at that location, and then importing the assembled movements under the duty free provisions of General Headnote 3(a) into the United States where the casing and strapping operations are performed. General Time's facility at St. Croix makes a substantial contribution to the local economy of that insular possession. This facility has an annual local payroll of approximately 63 individuals and makes an infusion of about \$700,000 per year into the Virgin Islands economy consisting of payroll, taxes, rent, supply purchases, and other local payments. The St. Croix facility currently processes annually about 500,000 wristwatch movements, which end up in wristwatches with a wholesale value of approximately \$4,000,000. Each wristwatch processed in St. Croix is put through a complete multi-stage assembly process which starts with unassembled parts and requires the investment of approximately 12 minutes of labor per movement.

Through its ongoing presence at St. Croix and investigations in preparing these comments, General Time has been able to gather much information on the so-called assembly of Soviet watch movements within the Virgin Islands. Starting in 1964, the Russians attempted to establish a watch assembly operation in the Virgin Islands. That effort failed largely because of bad quality, acute resentment toward distribution of Soviet watches in the United States, and demonstrations at assembly points in the Antilles. Nevertheless, the Soviets achieved some level of penetration by relying upon outside assemblers. In 1974, the Russians again endeavored to create their own assembly operations. However, they experienced substantial difficulties in acquiring a building, obtaining a quota allocation, and qualifying for a tax exemption. In view of these problems, they decided to increase their reliance upon existing and newly created assemblers who would use their own quotas for importation into the United States. General Time believes that the Soviets now supply 3 assemblers. All contacts and supplies come through a company established in the Panama free trade zone. Although it is very difficult to obtain reliable information on that Panamanian company, several sources have suggested that it is Russian controlled. Although some well known names in the United States industry originally sampled Russian watch movements, they have dropped that practice because of quality problems.

General Time has been able to establish that so-called assembly of Soviet watch movements is substantially different from its own operations at St. Croix. The Russian watch movements are imported into the Virgin Islands in a nearly complete condition consisting of

three distinct subassemblies—(i) the plate, train and balance sub-assembly; (ii) the barrel bridge subassembly; and (iii) the ratchet wheel subassembly. These components are converted into a finished movement by a simple insertion process and the addition of three or four screws. The time required to complete this process is minimal—at most 2.4 minutes, according to General Time's estimate, including a very generous allowance for inspection time and defective parts.

The number of Soviet watch movements processed has grown at an astonishing rate since 1974. General Time estimates that approximately 80,000 Soviet movements were "assembled" in 1974 and approximately 800,000 in 1977. That is the equivalent of a compound growth rate of approximately 78 percent per annum.

III. ARGUMENT

The heart of General Time's opposition to the current so-called assembly of Russian-manufactured watch movements and subassemblies in the Virgin Islands is that it is a sham devised primarily to funnel Soviet watch movements into this country without the payment of any duty whatsoever. Although it is a basic premise of United States tariff laws that an importer or foreign producer may have his goods so processed as to bring them within the scope of the duty free description most favorable to him or it, this leaves open the risk that ingenious individuals will discover latent defects in the tariff structure and will exploit tariff provisions for purposes which were never intended. General Time Corp. contends that, in the sense defined above, General Headnote 3(a) is being used as a "tariff loophole" for the duty free importation into the United States of Soviet watch movements allegedly "assembled" in the Virgin Islands. Specifically General Time contends that the so-called assembly in the Virgin Islands of Soviet-manufactured watch movements evades a number of important congressional policies in that:

1. It provides a means of evading the policy underlying General Headnote 3(a) of the Tariff Schedules of the United States that Column 2 tariff rates should apply to all products of Communist countries, "whether imported directly or indirectly";

2. It discriminates against Column 1 countries, which were intended to receive most-favored-nation treatment, by allowing imports of Soviet watch movements without the payment of any duty whatsoever;

3. It does not generate the substantial employment opportunities which motivated Congress in adopting General Headnote 3(a), and jeopardizes current employment in the watch industry in the Virgin Islands; and

4. It evades the policy underlying General Headnote 3(a) of preventing harm to the domestic producers from cutthroat foreign competition.

Each of these points will be discussed in detail below.

A. *General Headnote 3(e)*

General Headnote 3(e) of the Tariff Schedules of the United States, 19 U.S.C. § 1202, says in part:

Notwithstanding any of the foregoing provisions of the headnote, the rates of duty shown in column numbered 2 shall apply to products, whether imported directly or indirectly, of the following countries * * * Union of Soviet Socialist Republics 19 U.S.C. § 1202.

General Headnote 3(e) is the direct descendant without substantive change of General Headnote 3(d) as proposed in the Tariff Classification Study of 1960 and as promulgated pursuant to the Tariff Classification Act of 1962.

(d) *Products of Certain Communist Countries Discriminating Against American Commerce.* The rates of duty shown in column numbered 2 apply only to (i) products of the Union of Soviet Socialist Republics * * * whether imported directly or indirectly therefrom * * *.

Tariff Classification Study, Text of Proposed Revised Tariff Schedules, 5 (1960).

The policy behind this provision is obvious—under all circumstances, products imported “directly or indirectly” from communist countries should pay duties at the column 2 rates. Clearly, the Soviet watches discussed here are being imported “directly or indirectly”² under this test and the policy behind General Headnote 3(e) of withholding from Communist countries the benefits of lower rates of duty is being violated. Nevertheless, the Customs Service has allowed the watches in question to enter duty-free, as products of the Virgin Islands, and thus to escape that clear congressional policy of withholding benefits from products of the Soviet Union.

The policy of withholding from Communist countries the benefits of lower rates of duty was enacted into the tariff laws in 1951, by the adoption of § 5 of the Trade Agreements Extension Act of 1951, and was affirmed by Congress most recently in Title IV of the Trade Act of 1974. Title IV is a comprehensive program governing our trade relations with Communist countries. Those countries were offered the benefits of most-favored-nation (Column 1) status, subject to certain conditions. Countries refusing to accept those conditions were expressly relegated to the higher duties found in Column 2 by § 401 of the Trade Act of 1974. The Soviet Union quite openly found those conditions unacceptable and consciously decided to remain in Column 2 status. It is incongruous that the Soviet Union, which rejected the conditions in Title IV, now pays no duty whatsoever on these exports of watch movements to the U.S., while Hungary, which recently accepted the conditions of Title IV of the Trade Act by entering into a most-favored-nation treaty, must still pay normal Column 1 duties on its exports to this country. A correction of General Headnote 3(a) is needed to prevent the Soviet Union from using the “insular possession” provision as a means of evading the Congressional policy expressed in General Headnote 3(e) and Title IV of the Trade Act of 1974.

B. Discrimination Against Column 1 Countries

One of the fundamental concepts underlying the Tariff Schedules of the United States is that the countries which have a most-favored-nation treaty with the United States, that is, the Column 1 countries—should have their products admitted to this country at lower tariff rates than the non-most-favored-nation countries—that is, Column 2 countries. The United States has agreed to uphold that concept as one of its international obligations in its many most-favored-nation bilateral treaties and in its adherence to the General Agreements on

²The U.S. Customs Court has repeatedly held that goods are “imported directly or indirectly” from a country where there is an intention that the goods ultimately enter the United States. *Dessay Enterprises, Inc. v. U.S.*, 162 F. Supp. 947, 952 (Cust. Ct. 1958); *Loblaw Groceries, Inc. v. U.S.*, 22 C.C.P.A. 479 (1935), T.D. 47481.

Tariffs and Trade. In practice, the Column 2 rates of duty are generally 70 to 100 percent higher than the Column 1 duties. Countries can be admitted to Column 1 status by entering into an appropriate treaty (as is the case for Hungary). A proposal was made in the Trade Act of 1974 to grant most-favored-nation status to the Union of Soviet Socialist Republics as a part of the Jackson-Vanik amendment. That offer was declined by the Soviets. By using General Headnote 3(a) in the manner described earlier, Soviet watch movements are circumventing the policy that Column 2 countries should pay significantly higher duties than Column 1 nations and are receiving even more favorable duty-free status. In other words, Russian watch movements are at the head of the line in terms of favorable duty treatment, when the general policy is that they should be at the rear.

The result is discrimination against Column 1 countries by putting their products at a substantial price disadvantage. This point is made dramatically clear by a brief review of the relevant TSUS categories. The bulk of the Soviet watch movements allegedly "assembled" in the Virgin Islands come within two categories—(i) 17 jewel women's watches with a width of 0.6 to 0.8 inches and (ii) 17 jewel men's watches with a width of 1.0 to 1.2 inches. If subjected to the normal duties of the Tariff Schedules of the United States ("TSUS"), those watches would come within TSUS categories 716.31 and 716.34 respectively. The following table shows the enormous savings realized by the Russian movements by circumventing both Column 2 and Column 1 duties.

Description of watch movement	Applicable TSUS category	Col. 1 duty	Col. 2 duty	Actual duty paid ¹
17 jewels, 0.6 to 0.8 in. in width.....	716.31	\$2.88	\$4.80	\$0
17 jewels, 1 to 1.2 in. in width.....	716.34	2.43	4.10	0

C. Employment in the Virgin Islands

General Time analyses show that it invests approximately 12 minutes for each watch movement which it assembles from discrete parts in the Virgin Islands. By contrast, General Time believes that the time invested in the so-called assembly of pre-assembled Soviet watch movements is at most 2.4 minutes per movement including a very generous allowance for inspection time and defective movements. In other words, General Time invests at least 5 times (12÷2.4) as much labor in the assembly of each watch movement as companies processing the Soviet movements.

The Commerce Department's studies³ show an even more dramatic contrast. That agency estimates that the direct labor cost of assembly of one Soviet watch movement in the Virgin Islands ranges from \$0.06 for a skilled worker to \$0.10 to \$0.18 for an unskilled worker.⁴ The corresponding direct labor cost of assembly on the non-Soviet merchandise is \$0.60 to \$0.90 per movement, according to that agency.⁵ In other words, the Commerce Department estimates that companies using non-Soviet movements invested anywhere from 3.33 ($\$0.60 \div \0.18) times to 15 ($\$0.90 \div \0.06) times or an average of approximately 9

³ Report on the Insular Watch Industry, Statutory Import Programs, U.S. Department of Commerce (February 1978) (hereafter cited as "Department of Commerce Report").

⁴ *Id.* at 3.

⁵ *Id.* at 4.

$(3.33 + 15) \div 2$) times as much labor per movement as users of Soviet movements.

Even using the more conservative estimate—that a preassembled Russian movement requires only one-fifth as much assembly labor as is expended by the domestic industry's plants in the Virgin Islands—it is clear that the Russian use of the General Headnote 3(a) watch assembly program does *not* generate the substantial employment opportunities which motivated the Congress in adopting that headnote. If the General Headnote 3(a) "tariff loophole" were closed to the Soviet Union (as General Time proposes), Russian watches assembled in the Virgin Islands would be subject to normal Column 2 duty rates. At those duty rates, the Russians probably would shut down the assembly operation in the Virgin Islands, thus withdrawing approximately 800,000⁶ watches annually from the marketplace. If this occurs, General Time and other producers will move rapidly to expand the scope of their Virgin Islands activities and take up the slack. Because those companies do not use pre assembled movements, their Virgin Islands operations are more labor intensive. Therefore those companies need to increase their Virgin Islands production only a small amount to make up for the jobs displaced from the assembly of Russian movements. The assembly of only 160,000 $(800,000 \div 5)$ non-Soviet movements, according to General Time's estimate, and 88,889 $(800,000 \div 9)$ non-Soviet movements, according to the Commerce Department's figures, would create the same number of assembly positions as those lost by the withdrawal of 800,000 Soviet watches, because the labor input for non-Soviet movements is so much higher.

In addition, if the Russian exploitation of General Headnote 3(a) as a tariff loophole is allowed to continue, many existing watch assembly jobs in the Virgin Islands will be jeopardized as other producers are forced to shift to Soviet movements which require substantially less labor. Any producer could reduce his assembly labor force by a factor of 5 (using General Time's estimate) or a factor of 9 (using the Commerce Department's figure) and still process the same number of movements. General Time estimates that the total watch related employment in the Virgin Islands is approximately 1,000, of which 60 jobs deal with the assembly of Soviet movements. If all current producers shifted to the low-labor "assembly" method used on Soviet movements, the total level of employment could drop to as little as 248 $(60 + (1,000 - 60) \div 5)$ or 164 $(60 + (1,000 - 60) \div 9)$ positions. Clearly, this result would contravene the Congressional intent behind General Headnote 3(a).

D. Impact Upon Domestic Manufacturers

The Virgin Islands watch assembly program received its most searching Congressional review in 1965-1966. At that time, the basic structure of the present program was approved by this Committee on the ground that "it may be appropriate to favor our insular possessions over direct imports *so long as no domestic industry is harmed by the policy.*"⁷ The same report expressed the fear that the assembly could become "a convenient device for funneling foreign watches into this country—without payment of any duty whatsoever—and this would have a substantial adverse effect on domestic production."⁸ The solution to the problem in 1966 was a quota, limiting the quantity of

⁶ *Id.* at 2.

⁷ S. Rep. 80-1070, at 1066 U.S.C.C.A.N. 4380, 4395 (emphasis added).

⁸ *Id.*

watches which could come in through the Virgin Islands. The problem today stems in large part from the artificially low import price into the Virgin Islands and the low labor input in that insular possession. The result is that the retail price in the United States of the Russian watch is generally lower than the wholesale price in the United States of a watch assembled by a U.S. manufacturer.

Quite simply, General Time cannot compete with that type of import pricing in selling to mass-merchandise retailers in the United States. Recently, General Time lost a major account with a large national retailer because it could not match the price offered on Russian watches assembled in the Virgin Islands. Just as the situation in 1966 demanded the solution legislated then, so the situation now requires the legislation propose here if irreparable harm to U.S. producers by these Russian watches is to be avoided.

IV. CONCLUSION

General Time's purpose in submitting these written comments is to request that Congress take prompt action to reaffirm and enforce the four basic policies explored above. General Time believes that the only effective remedy is to adopt the proposed amendment of General Headnote 3(a) which appears at page 46.

General Time applauds the motivations underlying Congressman Rostenkowski's proposal that watch movement imports from insular possessions be subjected to a 25 component test. That proposal will improve the employment situation in the Virgin Islands by forcing the assemblers of Soviet watch movements to a somewhat more labor intensive method of assembly. However, there is no assurance that those assemblers would shift to operations as labor intensive as those used by other companies.⁹

General Time has reason to believe that the Soviet watch movements allegedly "assembled" in the Virgin Islands are in fact totally assembled in Russia and then slightly disassembled before shipment to United States insular possessions. The only effect of the Rostenkowski amendment would be to increase slightly the amount of disassembly and re-assembly. Further, because the desire to earn hard currencies often outweighs any profit consideration in state controlled economies, the Soviets can easily drop the import price of watch movements shipped into United States insular possessions to compensate for any higher labor costs which might be incurred in the Virgin Islands under the Rostenkowski proposal.

More importantly, General Time submits that only the proposal made at page adequately responds to the other three policy considerations discussed in these comments—that is (i) withholding from the Soviet Union the benefits of rates of duty lower than Column 2, (ii) eliminating discrimination against countries with most-favored-nation status, and (iii) avoiding harm to the domestic watch industry. That is because only the proposal endorsed above will insure that Column 2 countries pay Column 2 rates, while also assuring that employment opportunities in the Virgin Islands remain at least at the present level. Accordingly, General Time strongly urges that the Congress adopt the proposal set forth at page 46.

⁹ Indeed, the Commerce Department has indicated that automation of the 25 component assembly process would reduce the employment opportunities envisioned by a 25 component test. Commerce Department Report, n. 9 at 7.

COMMENTS OF AMERICAN INSULAR MANUFACTURERS, INC., AND ITS MEMBER COMPANIES

INTRODUCTION: THE AIM COMPANIES

These comments are submitted by American Insular Manufacturers, Inc. (AIM), a nonprofit Virgin Islands Corporation acting on behalf of its three member companies.¹ The AIM companies import watch parts whose origin is the USSR into the Virgin Islands and Guam and assemble these parts into movements. The AIM companies then produce (in the Islands) complete watches using these movements, casing, affixing dials and hands after assembly of the movements.

These comments are submitted in response to Press Release No. 65, issued by the Subcommittee on International Trade of the Senate Finance Committee dated August 21, 1978. The AIM companies have a singular interest in the proceeding instituted by the subcommittee. They are the companies whose use of Soviet-origin movements precipitated the allegations which brought about the subcommittee's inquiry.

The AIM companies appreciate the opportunity to respond given them by the subcommittee.

II. THE DRAMATIS PERSONAE

The AIM companies identified above are described herein as assemblers of "specialty" watch movements because AIM watches are pre-sold (with specialty requirements) to mass retailers and do not go into manufacturers' inventory. AIM watches contain from 17 to 30 jewels and sell at less than \$30 in the U.S. retail market.

There are 11 other companies assembling Western European or "Swiss-style" watch movements in the Virgin Islands. The products of the 11 are more expensive at retail than AIM watches.²

The competitive opposition to AIM companies stems from these 11 companies and from the American Watch Association (AWA). Some of the 11 "Swiss-style" movement assemblers also belong to the AWA.³ Otherwise, the AWA is the trade association of companies producing

¹ The AIM companies are Cornavin (VI), Inc., Sussex Watch Corporation (both Virgin Islands Corporation which assemble and produce watches in the Virgin Islands using USSR-origin movements), and Jerlian Watch Co., Inc., which does so on Guam.

² Economics of Technology and Competition in Watch Production in the Virgin Islands, prepared by Brimmer and Co., Inc. (hereinafter the "Brimmer Report"), July 12, 1978, Table 13, p. 30. Copies of the complete report have been made available to the Subcommittee staff.

³ e.g., Waltham, Helbros, Master Time, and Standard Time.

and assembling watches abroad which sell in the United States at stantially higher than AIM watches.⁴

III. THE ISSUE DEFINED

The issue set out in the press release is framed in terms of allegations. The source of the allegations is not set forth but is no mystery. Major competitors seek elimination of the AIM companies from the American insular possessions, and, more important to these competitors, elimination of these AIM watches from the U.S. retail market. These competitors are (1) the 11 "Swiss-style" assemblers in the Virgin Islands, and (2) members of the AWA generally.

Two separate proceedings, each with a record of its own and each going on today, echo this intensive competitive battle commenced by these competitors and now being fought out within this industry.⁵ In each of these proceedings, disruptive events on the broader stage of U.S.-U.S.S.R. relations have been brought in as the cutting edge of the competitive effort to kill off AIM and its products.

It is clear from these proceedings that the simple issue framed by the subcommittee is really four issues, each of which is relevant to the inquiry if the subcommittee is to have a proper record before it. The first issue is as stated in the press release: an economic issue of what the AIM companies do in the Islands. The second issue is the competitive issue: who are the antagonists who have catapulted this subcommittee into a role in this industry fight, and what is the competitive goal sought by them; moreover, this issue raises the additional question of the impact on American consumers, an impact that is very relevant to the subcommittee's inquiry into what is in the public interest in this industry struggle. The fourth issue is the political definition of what is before the subcommittee. AIM companies have confronted the issue, politically defined, twice before during the summer of the Scharansky-Guinzburg prosecution. It is unrealistic to disregard this political issue, but it is also a prudent exercise in relevance to identify the economic and competitive issues herein, and contrast their real significance to the politics of these issues.

Finally, the issue of dumping has somehow found its way into this issue. Dumping has no meaning in this proceeding. If it did, another arm of government charged by statute with acting would have acted long ago.

⁴ The AWA also includes domestic producers within the United States. Its domination by foreign exporters to the United States is a matter of continuing controversy. What is undisputed is that the Association includes the major exporters of watches from Switzerland, Western Europe and Japan to the United States. The precise foreign content of AWA membership is not a matter of public record. Mr. De Lugo, Delegate from the Virgin Islands, had this to say of it in the context of AWA's complaints against the AIM companies:

"There are some companies that are using a small percentage of Russian movements in the Virgin Islands—a matter raised by the American Watch Association which, I believe, actually represents the Swiss cartel. They represent the Swiss in this, not the American watch manufacturers, as the name would lead one to believe." (Hearings before Subcommittee on Trade of House Ways and Means Committee, 95th Congress, First Session, July 19-22, 1977, p. 491). In fairness, the AWA witness stated that it was an association of "mostly United States companies engaged in manufacture and importation of watches and watch movements in the U.S. insular possessions." (Statement of Larry Heller, Vice President of Helbros, *Ibid.*, 497). The matter is best left where the AIM companies have posited it: AWA includes the major exporters of watches from Switzerland, Western Europe and Japan.

⁵ One administrative (a rulemaking proceeding under Public Law 80-805 instituted on June 6, 1978, by the Statutory Imports Program Staff of the Department of Commerce), the other legislative (action by the Subcommittee on Trade of the House Ways and Means Committee, July 17, 1978, on the Rostenkowski Amendment to H.R. 8222).

IV. THE ECONOMIC ISSUE

Jobs and payroll are the ultimate test here.

The purpose of Public Law 89-805, passed by Congress in 1966, was preservation of the Virgin Islands watch industry as a stimulus for the Islands' economy and to respond to: "the need for economic expansion and industrial development diversification of Guam and American Samoa."⁶ In absolute terms, within quota restraints, the AIM companies have contributed substantially to fulfillment of these Congress mandates, and continue to do so today.

In the proceeding instituted by the Departments of Commerce and Interior on June 6, 1978, looking toward new quota-allocation rules under Public Law 89-805, the AIM companies submitted the Brimmer Report prepared by an economic consulting firm headed by Dr. Andrew Brimmer.⁷ The Brimmer Report culminated that Company's economic investigation of the watch industry in the Virgin Islands. It reports the following facts bearing on job and labor costs in the Virgin Islands watch industry:

(A) One hundred twenty-one jobs were provided by the three AIM companies in the Virgin Islands during calendar 1977.⁸ This is more than 13 percent⁹ of the total industry figure for that year, subject to seasonal fluctuation, as are all watch industry job figures in the Virgin Islands. That percentage is slightly less than the general average of 17 percent that the Industrial Development Commission of the Islands generally ascribes to the AIM companies.¹⁰

(B) More important, the unit labor contribution of the AIM companies for 1977 was 78 cents per exported piece.¹¹ This figure includes the unit cost of casing, affixing hands, dialing, and finishing watches, activities which the three AIM companies¹² perform in the Virgin Islands, whereas their 11 competitors which utilize "Swiss-style" do not.¹³

Moreover, this labor cost figure per unit compares favorably with the unit figure of the largest single assembler of "Swiss-style" movements in the Virgin Islands—TMX Of The Virgin Islands. The 78-cent unit labor cost for AIM companies in 1977 looms favorably by contrast to TMX's figure of 65 cents per unit in 1976.¹⁴ By any comparison, 121 jobs contributing 78 cents per unit to the insular economy is a substantial contribution.

⁶ Sen. Report No. 1670, 89th Congress, p. 8.

⁷ Formerly member of the Federal Reserve Board and the faculty of the Harvard Business School.

⁸ Brimmer Report, Table 26, p. 84.

⁹ *Ibid*, Table 15, p. 45.

¹⁰ The 17 percent figure is derived from Morris Moses, Staff Director, Industrial Development Commission of the Virgin Islands; it is the figure used by the Staff to represent the average employment within the watch industry of the firms using specialty (Soviet origin) movements.

¹¹ Brimmer Report, Table 26, p. 84.

¹² In the Department of Commerce proceeding the AIM position was shared on a specifically limited basis by Watches, Inc., a Virgin Islands (St. Croix) company using "specialty movements" whose parent company also markets watches using "Swiss-style" movements. AIM figures reflect use of the specialty movements by Watches, Inc. That Company—because of its mixed operation—does not share AIM's comments herein.

¹³ Since nearly all have stateside plants performing these services which they must utilize.

¹⁴ Industrial Development Commission (Virgin Islands) figures prepared by William Quetel, Administrative Assistant, January 26, 1977; appended as Appendix II to AIM Brief (in brand volume of AIM filed exhibits) filed July 15, 1978, in the Department of Commerce proceeding.

(C) The foregoing is, however, only a snapshot in time of AIM company contribution to the insular economics. The Brimmer Report goes on to add:

Employment in these firms (the AIM companies) rose by 30 workers in 1977 over 1976, while total employment in the Virgin Islands watch industry was declining by almost 100 workers. Cornavin (VI), Inc., was responsible for all of this increased employment and its total payroll nearly doubled from 1976 to 1977. According to the AIM data, Cornavin's annual payroll per job in 1976 exceeded \$7,000.¹⁵

(D) The importance of this trend was noted by the Brimmer Report:

The average for all three "specialty movement" firms was above \$5,500 while all Headnote 3(a) watch assembly firms averaged about \$4,000 per employee worker.¹⁶

Overall, this meant that:

The three AIM members were able to increase their total payroll by more than \$100,000 in 1977—from \$306,000 in 1976 to more than \$407,000 in 1977. The increased payroll for all the firms using the "Swiss-style" movement was only about half this amount, or about \$53,000.¹⁷

(E) What this means to the Virgin Islands is critical. The Brimmer Report states that the loss of AIM company jobs cannot be disregarded: "A decline of 100 jobs in 1977 would have raised the total unemployment rate from 8.5 to 8.7 percent."¹⁸

That is, however, far from the full story. The AIM jobs are skilled jobs, higher paid than other jobs in the highly skilled labor sector of the Islands. Thus, the "snowball" impact of these jobs is far greater than number alone:

Any job multiplier resulting from the fall in primary employment in watches would add in unemployment because of jobs lost in sectors which serve the watch industry directly, as well as jobs which come from spending the wages earned in the watch industry.¹⁹

(F) There is no way that the loss of 121 jobs²⁰ can be made up elsewhere within the insular watch industry or anywhere else on the Islands. The 11 "Swiss-style" companies experienced a decline in shipments between 1977 and 1978.²¹ There is no balm there, nor is there anywhere else on the island:

Indeed, if anything, the high rates of unemployment seen in the past 3 years are much more likely to persist as the rapidly rising cost of imports (such as fuel and energy) raise the Island's prices for tourism, housing, and transportation.²²

The pathway is clear: From the payrolls of closed AIM companies—straight to the welfare rolls.

(G) This is, again, a snapshot in time. It reflects the situation as it appears today in the summer of 1978. The future for the Virgin Islands watch industry is far less promising—unless the AIM com-

¹⁵ Brimmer Report, p. 83.

¹⁶ *Ibid.*, 83, 85.

¹⁷ *Ibid.*, 86.

¹⁸ *Ibid.*, 50. It would enlarge the number of unemployed by 3 percent according to figures currently reported to the Subcommittee by the Acting Governor of the Virgin Islands.

¹⁹ *Ibid.*, 50.

²⁰ AIM companies and the Industrial Development Commission submit that the number is higher on an adjusted seasonal basis. It may presently be close to 170 exclusive of Guam's Jerlian workers. Seasonal activities make greater precision on the exact number difficult. No one, however, places the number of AIM employees in the Virgin Islands at less than 121, again seasonally adjusted.

²¹ Brimmer Report, 83.

²² *Ibid.*, 51.

panies are permitted to exist and continue their reversal of the industry decline. Reporting on May 26, 1978, to Commissioner Auguste E. Rimple, Jr., of the Virgin Islands Industrial Development Commission (VIIDC), Staff Director Morris Moses predicted a 2.2 million unit shortfall in fulfillment of the Virgin Islands statutory quota for 1978 of 6.725 million watches—unless “additional quota is made available to the low labor group.”²³

Failure to fulfill one-third of a quota provided by law to stimulate a local economy is recognition of the failure of that law. Public Law 80-805 is, indeed, in peril of failing its congressional purpose and of failing the beneficiaries of this congressional purpose, the citizens of the Virgin Islands. This failure is the result of conditions peculiar to the 11 companies who are AIM's competitors, companies whose battle with the inflated costs of Western European movements (purchased in Swiss, French, and German currency by weakened dollars) is daily being lost. Unless the AIM companies (which purchase movements in dollars and not foreign currency, and are thus impervious to the dollar's decline) can continue reversing this trend, Staff Director Moses' prediction for 1978 is simply a forerunner of worse things to come. Viewing the situation as an economist dedicated to employment on the Islands—what Public Law 80-805 is all about—Director Moses concluded:

Apparently, the only companies that could reduce the shortfall in light of the estimated shipments are precisely those that constitute the low labor group.²⁴

In the midst of declining operations by their competitors, the AIM companies represent a shot in the arm to the insular watch industry:

It is clear that had it not been for the “specialty movement” firms in the recent period the economic stimulus provided to the Virgin Islands' economy from its watch assembly operations would have been considerably blunted.²⁵

(H) Within reasonable constraints, the AIM companies desire to continue this contribution to the insular economies and to enlarge it. In papers filed in the Commerce-Interior proceeding, Cornavin seeks an expanded quota (out of the 1 to 2.2 million pieces otherwise unused in 1978 in (7), above) and, given this quota, would “presently be recruiting a total labor force of 90-100 to fulfill its production requirements.”²⁶

Cornavin's total labor cost of 78 cents per unit is significant in this projection. Sussex, a much smaller operation, has averaged 23 employees in 1977²⁷ and could minimally be expected to match this number in 1978. Watches, Inc., employing 30 workers in 1977, similarly could be expected to employ at least that number in the future.²⁸

On Guam, where endemic unemployment is as serious as in the Virgin Islands, Jerlian has—in the same proceeding—predicted em-

²³ Report of Morris Moses, Staff Director, Industrial Development Commission, to Commissioner Rimple, May 26, 1978, p. 2 (Appendix I filed by AIM July 15, 1978, in the Department of Commerce proceeding).

²⁴ *Ibid.*, n. 3. The phrase “low-labor” companies has been applied to AIM companies, partly because their unit costs are somewhat lower than the “Swiss-style” assemblers, especially when the ancillary labor performed by them in casing and dialing is excluded. This phrase had generic—and unfair—use in the years before the AIM labor cost controversy had full airing.

²⁵ Brimmer Report, 89.

²⁶ Letter of Richard Kropp, President of Cornavin, dated July 10, 1978, filed July 15, 1978, as Appendix M to the AIM Submission in the Department of Commerce proceeding.

²⁷ Brimmer Report, Table 26, p. 84.

²⁸ *Ibid.*

ployment of at least 60 workers if the company is allowed to exist and produce.²⁹

The real job figure which the subcommittee must concern itself with is, therefore, over 200 if the ordinary operations of the AIM companies are allowed to go forward. The loss of 200 skilled jobs in the midst of difficult times and widespread unemployment is a considerable sacrifice to impose on the economies of the Virgin Islands and Guam.

(I) Both of the Governors of the Virgin Islands and Guam have publicly recognized the threat. In communications to the Secretary of Commerce in the second week of July 1978, Gov. Juan Luis of the Virgin Islands and Gov. Ricardo J. Bordallo of Guam oppose the departmental proposal to restrict future AIM company operations with an "incentive reserve," a device designed to shrink gradually AIM quotas. Telling it as it is in both Islands, but speaking directly to the situation in his own, Gov. Luis identified both the job loss and the workers who would suffer from it:

With unemployment hovering between 8 percent and 10 percent in a predominantly black, Catholic, and Hispanic population, we can ill afford the loss of jobs threatened by the proposal of the statutory import program staff. A full scale review and public hearing are indicated to assure fair play to all parties concerned." (Telegram of Gov. Juan Luis to Secretary Kroeps of July 12, 1978)

That same job loss will result from any action, legislative or regulatory, which eliminates the AIM companies as employers.

V. THE COMPETITIVE ISSUE: RECOURSE TO THE CONGRESS BY FOREIGN COMPANIES UNABLE TO COMPETE

AIM's marketplace competitors are not newcomers to the halls of Congress, nor are they strangers to the regulatory process. They have come to Congress and to the regulators many times when facing difficulty in the marketplace—as they do today. Insofar as the AWA is concerned—and it is the prime mover in the present attempt to eliminate AIM and AIM products—its record is clear. AWA has little interest in the insular economies; it opposed passage of Public Law 89-805 in 1966 because its members opposed sharing the U.S. market with insular companies. Beaten then, its members made a virtue of necessity and have made considerable profits out of their own insular affiliates and subsidiaries. AWA's conduct in the summer of 1978 has nothing to do with politics of the moment; Soviet Jewry and Human Rights are merely the current catch phrases in a competitive struggle that AWA has waged for market hegemony for at least 12 years. The AWA record should be closely scrutinized in this light:

(A) In June of 1966, the chief executive of Longines-Wittnauer, Leonard B. Sadow, testified before the Senate Finance Committee. First disavowing any role as AWA spokesman, Sadow then stated his opposition to the pending legislation which was to become Public Law 89-805, expressing the hope that:

The Committee would go beyond its announced plan to set a quota of 1.5 million units annually on watch shipments from U.S. insular possessions and,

²⁹ Letter of Liang Liang Silbermel, Treasurer, Jerlan Watch Co., Inc., dated July 7, 1978, filed as Appendix O to the AIM Submission in the Department of Commerce proceeding.

instead, withdraw the unwarranted duty-free privilege entirely with respect to watches and watch movements.³⁰

But Sadow went on to explain the AWA role:

I want to emphasize that these problems have been visible to us for a long time. It was in 1960 that the immense possibilities inherent in Headnote 3(a) for avoiding the exorbitant tariffs on dutiable imports were first recognized. As soon as the first firm began shipments from the Virgin Islands, importers as a group understood that the provision for duty-free treatment of merchandise from the Virgin Islands would tempt an increasing number of companies to go into business there. We also knew that the exploitation of this loophole would come at the expense of domestic production and of dutiable imports.

The American Watch Association, which represents most of the leading U.S. importer-assembler firms, immediately took the lead in an effort to persuade Congress and the executive branch to do something promptly to prevent this situation from developing. The AWA pointed out that if the loophole was left open it would encourage the development of an uneconomic activity in the U.S. possessions which had no logical basis except for the height of the tariff on dutiable merchandise. The AWA also pointed out that the situation would become extremely serious if not handled promptly, and that postponing a solution would just make it harder in the end.

I have with me a memorandum the AWA prepared on August 25, 1960—nearly 6 years ago—which made most of the same points I am making here today.³¹

With regard to the AWA, Sadow concluded:

In short, although the AWA succeeded in interesting some members of Congress and some executive branch officials in the problem, it was unable to secure action, and the situation began to get steadily worse.

We feel that the problems created for the watch industry by the flood of duty-free merchandise cannot await a long-term solution. Action is required now.³²

The AWA and Mr. Sadow then demonstrated their solicitude for the Virgin Islands economy with this modest proposal:

While we do not like legislation singling out the watch industry for special treatment, we feel that a legislative ban on watch shipments from the territories is the best way to deal with the immediate problem.³³

This, then, is the record of the Association that comes before this subcommittee in the name of the oppressed minorities of Eastern Europe, and human rights.

(B) Since 1966, the record of the AWA and its 11 Virgin Island allies in this competitive struggle is quite consistent:

(1) In late 1974, insular allied group faced a problem of increased costs—and reacted by seeking congressional help:

The cost of the foreign components has increased tremendously because of the steep increase in the rate of foreign exchange. By reason of the 50 percent rule this has rendered the price at which the Virgin Islands watches must be sold completely noncompetitive with the price of watches imported directly into the United States from foreign countries. This is a complete reversal from prior years when the exemption of duty made it possible for Virgin Islands watches to be sold at a lesser price than those of foreign countries. This condition compounding the general recession has made it unlikely that the watch industry in the Virgin Islands will survive.³⁴

The 11 companies sought—and secured—congressional relief in the form of elevation from 50 percent to 70 percent of the foreign content limit for duty-free watches.

³⁰ Hearings before Senate Finance Committee on H.R. 8430, which was to become Public Law 805 of the 80th Congress, June 30, 1966, p. 74.

³¹ *Ibid.*, 76.

³² *Ibid.*, 77.

³³ *Ibid.*, 77.

³⁴ Statement of Harvey Lewin, dated November 24, 1974, "In support of modification of General Headnote 3(a)"; before Subcommittee on Trade of House Ways and Means Committee, Hearing on TSUS, General Headnote 3(a), p. 4-5.

(2) One year later the problem was the same, and the solution was the same. Faced with the dollar's devaluation and worldwide recession in 1973 and 1974, AIM competitors this time went before the insular Virgin Islands authorities with their tale of economic distress:

Many of the costs of operating for the watch concerns have increased sharply during the past year or so due to world economic conditions. Disadvantageous currency devaluation, cargo air freight charges, cost of utilities, bank interest charges on loans and Letters of Credit, accounting fees and insurance premiums are a few of the items which have tended to make operating the business much less profitable than heretofore.

A comparison of the 1973 figures with the projected 1975 results will show how precipitous the reduction in business will be, a decrease of quota allocations of 1,125,000 units or 23.5 percent; a decrease of shipments of 2,234,819 units or 48.5 percent; a decrease in wages paid in the Virgin Islands of 1,000,000 or 26 percent; a decrease in number of employees of 600 or 55 percent and a decrease in corporate income taxes of \$2,342,000 or 54 percent.²⁵

The purpose was local tax relief for what appeared to be a sick industry.

(3) The ills of the AIM competitors persisted into 1976. The remedy was again sought, not in the marketplace, but from the government—once again from the authorities in the Virgin Islands. Speaking for one of the AIM company competitors, the President of Atlantic Time, on February 5, 1976, stated:

I would like to point out that the reason the tax exemptions and subsidy we are requesting are necessary is not the result of mismanagement of the industry but rather due to factors beyond our control. One of the largest factors working against us is that the value of the dollar against various foreign currencies, notably the Swiss franc, has slipped disastrously in the past five years. In 1970 the Swiss franc could be exchanged for \$0.23½. Today this Swiss franc is worth \$3.39. In 1970 a movement, costing 10 Swiss francs, could be purchased for \$2.35. Today, barring inflation, the same movement costing the same 10 Swiss francs, costs \$3.89. This alone is in excess of a 50 percent rise in cost. Inflation has also contributed to cost spirals. As an actual example, a movement which cost \$2.50 in 1970 now costs \$4.96, almost double. This same dollar devaluation has also affected our costs on material purchased in Japan, France, Germany, etc.

In addition, operating costs have risen considerably. Cargo air freight charges, cost of utilities, bank interest charges on loans and letters of credit, accounting fees and insurance premiums are only a few of the items which have tended to make a business much less profitable than heretofore.²⁶

(4) In 1966, 1974, 1975 and 1976, AIM's competitors faced severe problems in the marketplace. The cost of their movements skyrocketed in direct proportion to the declining value of the dollar. Worldwide inflation cut watch purchases in major markets such as the United States, and in the United States there appeared the new single-jewel nonconventional watches, a new threat to the "Swiss-style" conventional watch movements.

In each case, the 11 companies and the AWA found remedies for their competitive difficulties by going directly to the halls of government; they combatted the dollar decline by an act of Congress enlarging the duty-free privilege they held in 1975. They remedied the forces of worldwide depression—or tried to—with local tax exemptions and they faced new products in the retail market with a combination of both forms of governmental intervention.

²⁵ Submission of Harvey M. Lewin, dated September 11, 1975, before Virgin Islands Incentive Investment Commission, p. 3-4.

²⁶ Submission of Richard Law, President of Atlantic Time Co., dated February 6, 1976, before Virgin Islands Investment Commission, p. 2.

(5) Now, in the summer of 1978, the AWA and its 11 insular allies have come to Congress again. There should be absolutely no confusion about who they are and what they are about. This is especially true because the competitive strife within the watch industry—in which this subcommittee now is asked to intervene—has been masked with so many false labels.

The AIM companies submit that the major thrust of the AWA is in protection of its members who are foreign exporters.^{36a} Stripped bare, this is a group of foreign watch companies seeking this subcommittee's help in their competitive fight in the U.S. retail market. The foreign exporters in AWA perceive that AIM watches are a threat to their U.S. sales and desire legislative action to preserve their share of this market. The device chosen by them is classic in its simplicity: elimination of the threat by an act of Congress.

These companies within the AWA have no special claim to Congressional favor. What confronts this Subcommittee insofar as these companies are concerned is a request by foreign watch manufacturers that an established Congressional policy—created to encourage American companies employing minority labor in American insular possessions—be emasculated at a time when these American companies are doing just what Congress mandated. One of the massive lobbies in the Capital desires this subcommittee to believe that the issue before it is U.S.-U.S.S.R. trade. It is not. The real issue before this subcommittee is whether Black and Hispanic workers are to be sacrificed to protect Swiss, German, French, and Japanese exporters.

(6) Insofar as AWA's domestic producers are concerned, the competitive argument favoring preservation of competition by AIM companies is just as meaningful. Some perspective must be drawn here from the real size of Soviet incursion into the American watch market, in contrast to the jeremiads of inundation flowing from the AWA.

The competitive threat that the subcommittee is asked to legislate out of business amounts to less than \$5.5 million in AIM shipments in landed value to the importer in 1977.³⁷ The total value of domestic U.S. manufacturers' shipments in 1977 amounted to over \$631 million,³⁸ and this figure is less than half of the U.S. consumption for that year, with the balance made up of direct imports.³⁹ Timex and Bulova alone control 76.4 percent of the shipments of U.S.-produced conventional watches.⁴⁰ The AIM threat is approximately $\frac{1}{10}$ of 1 percent of U.S. domestic production in 1977, and less than half of that (less than four-tenths of 1 percent) of 1977's total watch consumption in the U.S. market.

Congress is now being asked to intervene in the marketplace to protect watch producers, many of whom are foreign entities. The threat against which the foreign companies and giant U.S. producers desire protection holds a share of the market amounting to less than four-tenths of 1 percent. It certainly may be simpler to eliminate competition by passing a law rather than by competing, but passage of that kind of law in this case would be classic overkill.

^{36a} The competitive issue between AWA's domestic producers and the AIM companies is discussed below.

³⁷ Brimmer Report, Table 13, p. 39; Table 27, p. 87; Guamanian use of specialty movements in 1977 to 325,000 units with approximately the same importer price.

³⁸ Brimmer Report, Table 2, p. 14.

³⁹ *Ibid.*, Table 1, p. 12.

⁴⁰ *Ibid.*, p. 13.

VI. THE CONSUMER ISSUE

When an arm of Congress gets caught in a private competitive squabble, there is always unwanted fallout. There is here. At present the AIM companies offer lower- and middle-income Americans the only 17 to 30 jewel conventional watch in the retail market available for less than \$30. If there is any doubt that this is an attractive and reliable commodity at a price that American consumers can pay, it can be resolved by examining the sales record of retailers of AIM products. Although AIM watches have created no landslide over the past 3 years, they have proved to be a desirable and inexpensive supplement for Americans who cannot afford a multiple of \$30 for a conventional multi-jeweled watch whose durability has proved itself.

If Congress—for any reason—kills the AIM companies, American consumers will be denied a reliable 17 to 30 jewel watch for less than \$30. It is as simple as that.

VII. THE POLITICAL ISSUE

Camouflaging the competitive struggle within the watch industry brought before this subcommittee are the political issues that have erupted in U.S.-U.S.S.R. relations this summer. This is indeed the summer of the Scharansky-Guinzburg prosecutions, among other disruptions, in which the continuing plight of Soviet Jewry remains a constant problem between the two countries.

But some perspective by way of facts should be brought to the incendiary issue of U.S.-U.S.S.R. trade. The value of U.S.S.R. watch movements imported into the U.S. insular possessions approximated \$3.66 million in 1977.⁴¹ Total Soviet exports to the United States—all of which are Column II commodities against which duty-free commodities might be expected to take up an inordinately high part—were slightly more than \$421 million in 1977.⁴² Under the best of circumstances, of which duty-free watches make up less than seven-eighths of 1 percent of U.S.S.R. exports to the United States.

That is the factual leverage that the importation of Soviet watch movements provides in the political struggles now going on with the Soviets. Watch movements are surely the furuncle on a remote quarter of Soviet trade to the United States. Although Soviet reactions cannot be completely predicted, lancing this furuncle will be forgotten within 10 minutes—except for residual irritation—by precisely those Soviet authorities we seek to influence. That may also be the definition of an unfortunate act of foreign diplomacy.

But that act, in addition, will never be forgotten by a large number of suddenly unemployed American skilled workers in the Virgin Islands and on Guam.

The subcommittee's press release refers to allegations of "dumping."

Whereas the other issues require a balance of the economic, competitive, consumer and political issues present before the subcommittee, there is nothing sophisticated about the presence of dumping. It is a genuine red herring.

⁴¹ Brimmer Report, Table 13, p. 39. The prices set out there are the same approximate prices for the 325,000 specialty movements imported into Guam in 1977.

⁴² Statistics compiled by the International Trade Commission.

Section 160 of Title 19 U.S.C. deals with dumping. For dumping to be dignified as a legally cognizable issue under our law, there must first be a determination by the Secretary of the Treasury that:

A class or kind of foreign merchandise is being or is likely to be, sold in the United States or elsewhere at less than its fair value.^{42a}

No such determination has been nor could be made.⁴³

Next, the Secretary of Treasury must inform the International Trade Commission of his determination. Obviously, that has not been done.

Third, the ITC must determine (within 90 days):

Whether an industry in the United States is being or is likely to be injured, or is prevented from being established, by reason of the importation of such merchandise into the United States.^{43a}

And there is the rub. There is no such American industry that can make such a complaint. The competitive realities are set forth under section II(b) (6), *supra*. There simply is no evidence anywhere that the use of Soviet-origin movements threatens any domestic industry in the country. A market share of less than four-tenths of 1 percent threatens no one.

Certainly there is not one fact before the subcommittee that domestic watch producers are threatened. And if they were, the appropriate place for their grievance is before the Secretary of Treasury and the ITC. It is no accident that the Secretary has never acted—on these facts.

If there are aggrieved parties herein—who prefer legislation to competition—it is the foreign exporting companies among the AWA. *They* have no standing to make dumping accusations, neither under our law nor under the plain facts of this case.

VIII. CONCLUSION

The subcommittee's inquiry is not a simple one. The thrust of these comments is to establish that there are unemployment, competitive and consumer considerations which are part of this inquiry. There also is the position of the insular governments of the Virgin Islands and Guam, both opposing major changes in the customs laws applicable to their watch industries without a public hearing at which all of the facts can be reviewed in a proper record.

Present law has been on the books for 12 years. It reflects careful consideration by the Congress of the needs of the Americans in the Virgin Islands, Guam and American Samoa. Such an established policy should not be reversed without compelling evidence on a full record. That is especially true when the Governments of the insular possessions—representing the beneficiaries of the present congressional policy—oppose doing so without a full evidentiary hearing and careful consideration of the record there made.

Under any definition, full facts requires gathering of data on each of the issues that are entwined with the public interest in the matter. It goes far beyond comments offered in response to allegations based

^{42a} 19 U.S.C. 160(a).

⁴³ The source of facts concerning labor costs within the U.S.S.R. is a matter which plagues the curiosity of the observer.

^{43a} 19 U.S.C. 160(a).

on unknown facts made by parties who are insulated from confrontation, cross-examination or other assurances of reliability. Full facts are presently being gathered in a proceeding before the Departments of Commerce and Interior. If this committee finds the record inadequate, it can act on its own to secure full facts.

The interest of more than 190,000 American citizens in the insular possessions are presently before this subcommittee. After 12 years of careful encouragement of these interests, Congress should now take pains to deal with them only when it has all the facts and then, with traditional scrutiny and deliberation.

Respectfully submitted.

JOSEPH H. SHARLITT.

SUPPLEMENT TO STATEMENT OF AMERICAN INSULAR MANUFACTURERS

This supplement to the statement of American Insular Manufacturers is prompted by a proposal contained in both the statements of the Hon. Ron de Lugo of the Virgin Islands and Lt. Gov. Henry A. Millin, Acting Governor of the Virgin Islands, filed September 6, 1978, with the Committee. That proposal (as outlined by Mr. de Lugo) states:

Should the Committee decide upon review of all the facts to exclude Russian watch movements from duty-free treatment under General Headnote 3(a), the jobs lost as a consequence of that action might be offset by Congressional action to authorize watch casing operations as a permissible and integral part of the watch manufacturing process.

This proposal is an illusion for three reasons:

(1) The primary loss of jobs in the Virgin Islands (if Public Law 89-805 is modified to carve from it any U.S.S.R.-origin watch parts) will be on St. Thomas, one of the three Virgin Islands. Approximately 100 of the AIM employees are employed by the two companies operating on St. Thomas, Cornavin and Sussex. But all of the Swiss-style companies (using Western European movements) are located on St. Croix. What this proposal requires is that the 100 unemployed workers on St. Thomas move themselves and their families to St. Croix. It is a fact of life in the Islands that these families will simply not uproot themselves.

(2) The suggestion is premised on the capacity of the Swiss-style companies to expand their Virgin Islands operations. But it is precisely those companies which cannot produce to meet present quotas. It defies economic realities to expect them to face presently heightening costs and their own consequent lowered production—with expanded operations.

(3) The suggestion is further premised on the assumption that any of these companies would be willing to perform the proposed operations even if they were economically feasible. They would not for still another reason: many of them have operations on the mainland performing these precise functions, and abandoning these operations stateside creates more economic problems than it will solve.

JOSEPH H. SHARLITT.

SOVIET WATCH EXPORT TO THE U.S. VIA INSULAR POSSESSIONS

POSITION PAPER

The National Conference on Soviet Jewry has recently observed and considered the increasing import to the United States of watch movements manufactured in the U.S.S.R. and assembled in the Virgin Islands. The import is carried on under the provisions of General Headnote 3(a) of the U.S. Tariff Schedules, which allow duty-free entry.

The nature of the assembly process of these watch movements, while attempting to give the operation the appearance of complying with headnote 3(a), actually reveals a gross abuse of the license in the law. The express purpose of encouraging the Virgin Island labor market is undermined rather than augmented by the miniscule labor cost add-on. The assembled watches are sold in the United States without proper identification of origin.

In addition to the possible violations of details of the law in the import of these watches, the process by which they enter duty-free represents a circumvention of the intentions of the law itself.

The watches, for example, are artificially priced far below competitive market value, one of the reasons labor cost is so low. This low pricing threatens to have a disastrous effect on the American watch industry. The intention of headnote 3(a) centered about concern for the insular possessions, and this concern has been exploited by the Soviets in exporting a vastly unforeseen volume of watches by this method.

While the continuation of this abuse sets a precedent which is dangerous for the watch industry, and for other industries in the United States, the National Conference on Soviet Jewry is deeply concerned with this issue for reasons that go beyond the important economic concerns into the sphere of human rights. We believe that the Trade Reform Act of 1974 was, with the related amendments, a major statement on behalf of humanitarian concerns. Our nation can be proud of taking a stand on issues of human freedoms in expecting all nations, including the U.S.S.R., to respect the rights of its citizens to emigrate. By using the Virgin Islands as a port, the U.S.S.R. has shown disregard for the purposes of our laws, in manipulating loopholes of those laws. In allowing the Soviet Union to circumvent demands of the Trade Reform Act we would allow the gradual erosion of the principles the act articulated, including emigration.

Headnote 3(a), in not discriminating between column 1 and column 2 nations regarding use of the duty-free port, gives the Soviet an advantage not only over column 2 countries and even over Most Favored Nations (our trading allies), but over U.S. industry as well. It allows the U.S.S.R. to ignore with impunity basic human rights on a broad scale, and, through devious production means, to threaten

American industries without contributing to the Virgin Island's economy.

Believing that headnote 3(a) was not meant to be a springboard for cheaply dumping Soviet goods on the U.S. market, and fearful of witnessing the undermining of our nation's commitment to the principles of human rights expressed in the Trade Reform Act, The National Conference on Soviet Jewry supports efforts to amend current regulations in order to restrict insular duty-free ports to use by Most Favored Nations exclusively.

What is the National Conference on Soviet Jewry?

The National Conference on Soviet Jewry (NCSJ)*, is the major national coordinating agency for activity and policy on behalf of Jews in the Soviet Union. Thirty nine national member organizations and hundreds of affiliated local community councils, welfare federations and committees comprise its constituency, with a combined membership of over 4 million persons. The Conference reaches nearly every corner of organized Jewish life in the United States and also maintains international ties.

The Conference has two basic goals:

1. To help all Soviet Jews who wish to emigrate leave the Soviet Union for Israel and elsewhere.
2. To help Jews live in the Soviet Union with all the rights and privileges accorded other religious and ethnic cultural groups in the USSR.

NCSJ Constituent Agencies

American Federation of Jewish Fighters, Camp Inmates and Nazi Victims, Inc.	National Committee for Labor Israel
American Israel Public Affairs Committee	National Council of Jewish Women
American Jewish Committee	National Council of Young Israel
American Jewish Congress/AJ Congress Women's Division	National Jewish Community Relations Advisory Council
American Mizrahi Women	National Jewish Welfare Board
American Zionist Federation	North American Jewish Youth Council
Americans for Progressive Israel, Hashomer Hatzair	Pioneer Women
Anti-Defamation League of B'nai B'rith	Rabbinical Assembly
B'nai B'rith B'nai B'rith Women	Rabbinical Council of America
B'nai Zion	Religious Zionists of America — Mizrahi, Hapoel Hamizrachi, Women's Organization of Hapoel Hamizrachi
Brith Shalom	Student Struggle for Soviet Jewry
Central Conference of American Rabbis	Synagogue Council of America
Conference of Presidents of Major American Jewish Organizations	Union of American Hebrew Congregations
Council of Jewish Federations and Welfare Funds	Union of Orthodox Jewish Congregations of America
Free Sons of Israel	United Synagogue of America
Hadassah, Women's Zionist Organization of America	United Zionists — Revisionists of America
Jewish Labor Committee/Workmen's Circle	Women's American ORT
Jewish War Veterans of the U.S.A.	The World Zionist Organization, American Section
Labor Zionist Alliance	Zionist Organization of America

* Formerly the American Jewish Conference on Soviet Jewry, 1964, reorganized 1971.

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NATIONAL JEWISH COMMUNITY RELATIONS ADVISORY COUNCIL

The National Conference on Soviet Jewry (NCSJ), enjoys a special relationship with the National Jewish Community Relations Advisory Council (NJCRCAC). The NJCRCAC, a member of the NCSJ, acts as its channel of communication to hundreds of local communities across the United States.

Local, State, and County Agencies

- Alabama:** Jewish Community Council, Birmingham
- Arizona:** Anti-Defamation — Community Relations Committee, Tucson Jewish Community Council
- California:** Jewish Community Relations Council for Alameda and Contra Costa Counties, Jewish Community Federation, Long Beach, Community Relations Committee of the Jewish Federation-Council, Los Angeles, Sacramento Jewish Community Relations Council, Community Relations Committee of the United Jewish Federation, San Diego; Jewish Community Relations Council, San Francisco, Jewish Community Relations Council, Greater San Jose
- Connecticut:** United Jewish Council, Bridgeport; Community Relations Committee, Hartford Jewish Federation, Connecticut Jewish Community Relations Council, Jewish Federation, New Britain; New Haven Jewish Community Council; Jewish Community Council, Greater New London, Inc.; Jewish Community Council, Norwalk; United Jewish Federation, Stamford, Jewish Federation, Waterbury
- Delaware:** Jewish Federation of Delaware
- D.C.:** Jewish Community Council of Greater Washington
- Florida:** Jewish Federation of Greater Fort Lauderdale, Jewish Federation of So. Broward; Jewish Community Council, Jacksonville; Central Florida Jewish Community Council, Greater Miami Jewish Federation, Jewish Federation of Palm Beach County
- Georgia:** Atlanta Jewish Welfare Federation, Savannah Jewish Council
- Illinois:** Public Affairs Committee, Jewish United Fund of Metropolitan Chicago; Jewish Community Council, Peoria; Springfield Jewish Federation
- Indiana:** Indiana Jewish Community Relations Council, Indianapolis Jewish Community Relations Council; Jewish Community Council of St. Joseph County
- Iowa:** Jewish Welfare Federation, Des Moines
- Kansas:** (Kansas City — see Missouri)
- Kentucky:** Jewish Community Federation, Louisville
- Louisiana:** Jewish Welfare Federation, New Orleans
- Maine:** Jewish Federation-Community Council of Southern Maine
- Maryland:** Baltimore Jewish Council
- Massachusetts:** Jewish Community Council of Metropolitan Boston; Jewish Federation of the North Shore, Inc.; Jewish Federation of Greater New Bedford; Springfield Jewish Federation; Worcester Jewish Federation
- Michigan:** Jewish Community Council of Metropolitan Detroit, Jewish Community Council, Flint
- Minnesota:** Jewish Community Relations Council — Anti-Defamation League of Minnesota and the Dakotas
- Missouri:** Jewish Community Relations Bureau of Greater Kansas City; Jewish Community Relations Council, St. Louis
- Nebraska:** Jewish Community Relations Committee, Jewish Federation of Omaha
- New Jersey:** Federation of Jewish Agencies of Atlantic County; Jewish Community Relations Council, Jewish Federation of Community Services, Bergen County, Community Relations Council of the Jewish Federation of Southern N.J.; Jewish Community Federation of Metropolitan N.J.; Jewish Federation of Northern Middlesex County; Jewish Federation of Raritan Valley; Jewish Federation of North Jersey; Jewish Federation of Greater Trenton, Jewish Federation of Central New Jersey
- New York:** Jewish Community Council, Albany; Jewish Federation of Broome County; Brooklyn Jewish Community Council; United Jewish Federation, Buffalo; Jewish Community Council, Kingston; Jewish Community Federation, Rochester; Jewish Community Council, Schenectady; Syracuse Jewish Welfare Federation; Jewish Community Council, Utica
- Ohio:** Akron Jewish Community Federation; Jewish Community Federation, Canton; Jewish Community Relations Council, Cincinnati; Jewish Community Federation, Cleveland; Community Relations Committee, Columbus Jewish Federation, Community Relations Committee, Jewish Community Council, Dayton; Community Relations Committee, Jewish Welfare Federation, Toledo, Jewish Community Relations Council, Jewish Federation of Youngstown
- Oklahoma:** Tulsa Jewish Community Council
- Oregon:** Jewish Welfare Federation, Portland
- Pennsylvania:** Community Relations Council, Jewish Federation of Allentown; Jewish Community Council of Easton and Vicinity; Jewish Community Council, Erie, Jewish Community Relations Council of Greater Philadelphia, Community Relations Committee, United Jewish Federation of Pittsburgh; Scranton-Lackawanna Jewish Council; Jewish Federation of Greater Wilkes-Barre
- Rhode Island:** Community Relations Council, Jewish Federation of Rhode Island
- South Carolina:** Jewish Community Relations Committee, Charleston
- Tennessee:** Jewish Community Relations Council, Memphis; Jewish Federation of Nashville and Middle Tennessee
- Texas:** Jewish Federation of Greater Dallas; Jewish Community Relations Committee, El Paso; Jewish Federation, Fort Worth; Jewish Community Council of Metropolitan Houston; Community Relations Council, Jewish Social Service Federation, San Antonio
- Virginia:** Jewish Federation of Newport News-Hampton, Inc.; United Jewish Federation of Norfolk and Virginia Beach; Richmond Jewish Community Council
- Washington:** Jewish Federation of Greater Seattle
- Wisconsin:** Madison Jewish Community Council; Milwaukee Jewish Council

COMMENTS OF THE AMERICAN WATCH ASSOCIATION, INC.

SUMMARY

The Soviet Union is exploiting a loophole in U.S. trade law in order to funnel watch movements into the United States duty-free under the provisions of General Headnote 3(a), escaping the high tariff rates set by Congress in column 2 of the Tariff Schedules.

Soviet-made watch movements entering the United States duty-free have increased more than tenfold in the past 4 years and now account for approximately 20 percent of all watch shipments from the Virgin Islands.

Russian-made 17-jewel watches are sold in the United States for as little as \$9.88, less than any other watch made in this country or abroad, and less than the wholesale price of comparable watches imported directly from low-wage countries such as Korea and Hong Kong.

Russian watches are sold in this country without any marking on the watch, box, or enclosed literature suggesting their Russian origin. In fact, the brand names on the watches, Cornavin, Geneva, Jean Cardot, and Timetone, and the guaranty accompanying some of these watches which refers the purchaser to the American Swiss Repair Service, suggest that the Russian watches are of American or Swiss origin.

Russian watch movements sold in the United States undergo de minimis assembly operations in the Virgin Islands which add only about \$0.06 in labor to already preassembled components.

Such unrealistically low and contrived pricing, coupled with absolutely minimal assembly operations in the U.S. insular possessions, gives firms that use Russian watches an unbeatable advantage over their competition.

As a result, members of the American Watch Association and other companies in the U.S. watch industry have been pushed out of the high volume, low end of the market, are losing sales and are being forced to cut back on production in the Virgin Islands.

The cutback in the territories is by no means offset by increased Russian production, because companies employing Russian watches employ only one-ninth the workers employed by the rest of the industry. Accordingly, the Virgin Islands industry has suffered a loss of approximately 100 jobs as Russian watches have captured one-fifth of the industry there.

The problem requires a legislative solution because General Headnote 3(a) offers a duty-free loophole that subverts the repeated actions of Congress to deny most-favored-nation tariff treatment to the Soviet Union. Moreover, the problem is too complex to be resolved by an administrative remedy which cannot address the fundamental problem of watch movement valuation in any event.

Therefore, the AWA urges Congress to take action to prohibit column 2 countries from enjoying the benefits of duty-free tariff treatment under General Headnote 3(a).

I. INTRODUCTION

The comments which follow are submitted by the American Watch Association, Inc. (AWA), a trade association representing approximately 40 member and associate member U.S. firms¹ which are engaged in the manufacture, assembly or importation of watches and watch movements for sale in the U.S. and world markets. Four of our members—Hamilton Watch Co., Inc., Helbros Watches, Inc., Swiss-time Co., and Waltham Watch Co.—operate directly in the Virgin Islands. Other member companies either purchase watch movements from the insular possessions or compete directly or indirectly with companies in the Virgin Islands.

The position of the AWA is that the assembly of watches in U.S. insular possessions has an established role in the U.S. watch market, and we have no desire or intent to alter this relationship. We are concerned, however, that the relationship be maintained on a basis that is equitable to all parties concerned—to the insular possessions and the companies operating there, to U.S. watch producers and to U.S. watch importers. After several years of effort, the AWA is convinced that the only way to achieve this equity and to assure a healthy insular possessions watch assembly industry, free of unfair competition from unrealistic nonmarket pricing which injures both high-labor traditional firms in the Virgin Islands and the U.S. domestic watch industry itself, is to bar duty-free tariff treatment to watches and watch movements produced in countries ineligible for most-favored-nation (column 1) tariff treatment.

The Soviet threat to the watch industry—an overview

The Soviet Union has, in the past 3 years, embarked on a deliberate effort to capture a major share of the U.S. watch market by taking advantage of a loophole in the provisions of General Headnote 3(a) of the Tariff Schedules of the United States. Those provisions permit watches and watch movements assembled in the U.S. insular possessions to enter the customs territory of the United States duty-free if they do not contain foreign materials exceeding 70 percent of the total landed value² of the product.

¹ Members of the association include the companies which market such well-known watch brands as Audemars Piguet, Bradley, Citizen, Concord, Elgin, Fairchild, Girard-Perregaux, Hamilton, Helbros, Longines, Mido, Movado, Omega, Plaget, Pulsar, Rolex, Selko, Waltham, Wittnauer, Zenith, and many others.

² Congress undoubtedly created the 70 percent test as a bulwark against abuse of the Headnote 3(a) program. This test, however, is rendered utterly meaningless by the Russian watch industry. The Customs Service in applying the Headnote 3(a) 70 percent value test merely determines the "actual purchase price" of the foreign material in CFR 7.8(d) (1977). Accordingly, the Russian watch industry has completely circumvented the 70-percent value test by selling watch subassemblies to users in the insular possessions at any price which suits their ultimate objective.

In this regard it should be noted that the "sale" of Russian subassemblies to assemblers in the Virgin Islands may not even involve arm's-length transactions. In at least one instance, we understand that the principal seller of Russian subassemblies, a Panamanian corporation, International Ciers, S.A., owns and controls a principal assembler of Russian subassemblies, Cornavin, S.A. It is also interesting to note that in a hearing before the Virgin Islands Industrial Development Commission, officers of a company seeking to import and assemble Russian subassemblies, the Caribbean Watch Company, admitted that the company was owned and controlled by the principal officers of International Ciers, S.A. Transcript of the Testimony before the Virgin Islands Industrial Development Commission on January 27, 1976, of representatives of the Caribbean Watch Company, 46, 60.

The test of whether a watch qualifies for duty-free treatment depends entirely on the relationship between the value of the imported parts and the value of the merchandise landed in the United States. No requirement is imposed under headnote 3(a) as to the amount or percentage of value which must be added in the insular possessions. Although, under U.S. Customs regulations, a certain minimal input is necessary for any item to qualify as the product of the place in which it is assembled (instead of being treated as the product of the place in which its component parts originate), the required input is considerably less than 80 percent.

Thus the Soviets have been able to pursue their objective of penetrating the U.S. watch market by using a combination of extremely low nonmarket prices and absolutely minimal assembly in the insular possessions. Since, as a practical matter, markup from the cost of the parts to be landed value in the United States is the sole determinant of whether the merchandise qualifies for duty-free entry, it is obvious that so long as the Russian industry prices its subassemblies at below fair market values—which they do—Soviet watches will continue to undersell substantially watches assembled in the insular possessions from parts originating elsewhere. For this reason, companies which buy from the Soviet Union can undersell their insular competitors by a large margin and still reap a sizable profit.

In addition, as will be discussed below, the Russian watch industry has also been greatly aided in their penetration of the U.S. watch market through deceptive marketing techniques designed to insure that U.S. consumers of Russian watches are led to believe that they are purchasing a Swiss- or American-made product.

Thus, it is not surprising that, in a very short time, Russian-origin watches have cornered approximately one-fifth of the assembly industry in the Virgin Islands, and the majority of the industry on Guam. According to Commerce Department data, the value of Russian movements entering the U.S. duty-free from the Virgin Islands was almost \$2,500,000 in 1977, compared to \$200,768 in 1974. This represents a more than tenfold increase in shipments during that 4-year period. Other departmental statistics indicate that the volume of Russian-origin movements from the Virgin Islands jumped from 79,500 units in 1974 to 654,390 units in 1976, at the same time that total Virgin Islands watch shipments declined from 3,925,000 units to 3,916,000 units. By 1977, Russian watch shipments from the Virgin Islands had grown to 816,000 movements.

AWA members have been told by government officials and industry sources alike that this geometric growth in the use of Russian-origin watches has actually been held down somewhat because of the fear that the United States may act to restrict the duty-free entry of these watches. Most of our members have been approached by the distributors of Russian-origin movements, Metro Zona Libre, S.A. and International Ciers, S.A.³ and it is our understanding that these distributors plan a major new expansion if the threat of tighter regulation subsides.

³The two distributors of Russian watches, International Ciers, S.A. and Metro Zona Libre, S.A. (two Panamanian corporations) appear to be controlled by precisely the same management. Dun & Bradstreet International Report on International Ciers, S.A., May 20, 1976, Dun & Bradstreet International Report on Metro Zona Libre, S.A., July 10, 1976.

Proponents of Russian watch movements have argued that at least at this time Soviet watches account for only a small share of the total U.S. watch market and that they certainly pose no threat to the U.S. watch industry. This ignores the geometric growth in Russian watch imports through the insular possessions and obscures the fact that Russian watch sales are concentrated at the very lowest end of the market. In reality, Russian watches have already made substantial inroads on sales of watches that comprise an essential component of the U.S. watch industry—the domestic production of inexpensive pin-lever watches by Timex, the production of non-Russian watches by the watch assembly industries in Guam and the Virgin Islands, and the importation of inexpensive dutiable watches from countries enjoying most-favored-nation treatment.

The subcommittee should not be misled by the assertion that U.S. law restricts duty-free entry of Russian watches to a maximum of one-ninth of the total American market, assuming all insular watches were Russian. Based on 1978 apparent consumption figures, the ceiling on sales of such duty-free shipments would be 7.7 million units; concentrated at the very low end of the market, such a volume of sales could well put Timex and other important U.S. watch companies out of business in the low end of the market.

II. SOVIET WATCHES ARE SOLD AT UNREALISTICALLY LOW NONMARKET PRICES

The market for inexpensive watches

Industry sources estimate that U.S. consumers purchased approximately 54 million watches in 1977, making the American market the largest and most attractive in the world. The great bulk of the watches sold in this country are inexpensive products. Halsey Stuart, a prominent New York investment banking firm that surveys the watch industry, estimates that 75 percent of these sales involve watches priced at \$30 or less, and that another 15 percent fall within the \$30 to \$50 price range. Plainly, the majority of watch sales occurs at the low end of the market.

At the low end of the market in particular, watches compete with one another primarily in terms of price. This includes all types of inexpensive watches: imported 17-jewel watches, jewel-lever movements containing a lesser number of jewels, domestic and imported pin-lever movements, domestic and imported solid-state watches, and duty-free merchandise entering from the Virgin Islands and Guam.

Soviet watch prices

The U.S. market is especially attractive to the Soviet watch industry which ranks second in the world, after Switzerland, in volume of production. The International Trade Commission (ITC) has estimated that annual production of watches and watch movements in the Soviet Union amounted to 60 million units in 1976—21 percent of total world production. Switzerland had a production of 75 million units (26 percent) but was declining whereas Soviet production has been increasing rapidly. Japan, with production of 34 million (12 percent), and the United States, with production of 31 million (11 percent), were far behind.

The Soviet Union has not in the past shipped many watches or watch movements directly to this country (i) in part because of the

column 2 tariff rates which the United States levies against Soviet products and (ii) in part no doubt because it would be more difficult to evade Federal watch-marking requirements as discussed below. In 1976, the only Soviet direct watch exports to the United States were 1,000 watch movements that entered under TSUS Item No. 716.11 (zero to one jewel) at a value of \$3,265 or \$3.27 a unit. (It may be indicative of Soviet pricing policies that the average value of watch movements imported from all countries in 1976 under TSUS Item No. 716.11 was \$9.04 a unit.)⁴

The Soviet Union has found in the duty-free provisions of General Headnote 3(a) a convenient means of entry into the U.S. market and has just begun to exploit it in a substantial manner. Seventeen-jewel, steel-cased Russian watches, assembled in the Virgin Islands, are being sold in the United States through such national discount retail chains as Zayre and K-Mart at prices as low as \$9.88.⁵ The only comparable watches being sold today at that price level are low-quality digital electronic watches cased in the least expensive plastic case with non-leather strap. AWA members have been unable to purchase comparable 17-jewel ladies' mechanical watches for less than \$26.

The least expensive Timex watch (a pin-lever watch in a less expensive case than the cheapest Russian watch) retails for \$12.95. The least expensive 17-jewel Timex watch—which is assembled in the Virgin Islands—retails for \$29.95, although the bulk of Timex 17-jewel watches sell for approximately \$40.

Perhaps even more startling is the following information: the Soviet Union—a country with a per capita income of \$2,760, above that of the developing countries such as Hong Kong (\$2,110), Taiwan (\$1,070), South Korea (\$670) and Singapore (\$2,700)⁶—is able to export its 17-jewel watches into the United States and sell them at prices much lower than the least expensive 17-jewel watch available from such low-wage countries.

Seventeen-jewel Russian watches are on sale in the United States at retail for as low as \$9.88. Commerce Department watch-import statistics show that such watches sell for dramatically less than any 17-jewel watch produced in any free-world country. The chart below, created from these statistics, sets forth the average cost of all 8- to 17-jewel watches imported during 1977 from Hong Kong, Taiwan, South Korea, Singapore and Japan. As the chart points out, in all but one case (and this case may well involve a watch movement with less than 17 jewels) the Russian 17-jewel watch retails for less than the wholesale price of comparable 17-jewel watches from low-wage developing countries. (When these wholesale watch prices of the watches from low-wage developing countries are converted to their retail equivalents, the differences between the sales prices of the Russian watch and its free-world competition is staggering.) The data which follow should be compared to Russian 17-jewel watches assembled in the Virgin Islands retailing for \$9.88.

⁴ In contrast, the Soviet Union has exported great volumes of watches and watch movements to countries such as Great Britain and Canada which confer most-favored-nation treatment to Soviet products. Sold under the brand name of Cardinal in Canada and Sekonda in Great Britain, the Soviet watches have established a permanent and rapidly growing presence in these two countries.

⁵ The AWA will be happy, upon request, to submit to the Senate Subcommittee on International Trade specimens of Russian watches on sale for prices as low as \$9.88.

⁶ The per capita income statistics used in this presentation have been obtained from the World Bank Atlas (1977).

AVERAGE WHOLESALE (IMPORT) PRICES FOR ALL 8-17 JEWELLED WATCHES REPORTED IN 1977 FROM THE COUNTRIES SPECIFIED

TSUS watch category	Hong Kong	Taiwan	South Korea	Singapore	Japan
7150514.....	11.29	10.15			\$21.28
7150518.....	10.48			35.62	15.00
7150519.....	8.91	19.18			28.62
7150520.....	12.57	16.76			33.00
7150524.....	13.41				22.19
7150528.....	10.20				13.85
7150534.....	19.36				22.73
7150538.....	17.85		19.48		23.89

Source: U.S. Commerce Department.

Price advantages for Russian watches

Russian-made watch movements enjoy a series of price advantages, all stemming from the fact that Russian-origin movements are sold into the Virgin Islands at unrealistically low prices which are well below the prices of movements that can be obtained from any other U.S. or foreign supplier. This initial price advantage currently ranges from \$1.68 for a popular 6¾x8 ligne ladies regular-wind, 17-jewel watch movement (\$5 for a non-Soviet movement vs. \$3.32 for a Russian movement) to \$3.50 for a 11½ ligne maus automatic 17-jewel watch movement (\$0.10 vs. \$5.51).¹

The table below traces a typical Russian and non-Russian watch movement through its assembly in the Virgin Islands and its final assembly into a finished watch in the United States.

COMPARISON OF 6¾ BY 8 LIGNE LADIES REGULAR-WIND RUSSIAN AND NON-RUSSIAN 17-JEWEL WATCH MOVEMENTS

	U.S.S.R.	Non-Russian sold through mass-volume discount channels	Non-Russian sold through retail channels
Landed cost in Virgin Islands.....	\$3.32	\$5.00	\$5.00
Virgin Islands labor input.....	.10	1.00	1.00
Selling price (landed in United States) of assembled movement ¹	4.74	7.14	7.14
U.S. costs: ²			
Case.....	1.00	2.00	2.00
Band.....	1.00	2.50	2.50
Box.....	.25	.75	.75
Assembly labor.....	.50	.75	.75
Cost to distributor of completed watch.....	7.49	13.14	13.14
Selling price to retailer ³	8.25	14.45	18.39
Selling price to retail customer ⁴	9.88	17.34	26.75

¹ To meet requirements of a 70-percent ceiling for foreign content under general headnote 3(a), U.S. landed value must be at least \$4.74 for a \$3 movement and \$7.14 for a \$5 movement. In reality, many users of non-Russian watches must sell for considerably more than the \$7.14 minimum price in order to recover costs of labor, insurance, freight, and overhead, while users of Russian movements can take advantage of the minimum labor costs involved in the assembly of a Russian movement, thereby profiting from the minimum \$4.74 price.

² Russian-made movements normally are sold with less expensive watch cases, bands, and boxes from such foreign suppliers as Hong Kong. Non-Russian watch movements are normally sold with domestically produced watch cases, bands, and boxes.

³ Assumes a 10-percent markup for sale to a mass-volume discount outlet and a 40-percent markup for sale through jewelry stores and other retail channels. As sales to retail jewelry outlets involve much lower volumes and more expensive sales promotion, a 10-percent markup would not cover overhead, plant, insurance, or warranty costs for non-Russian movement users.

⁴ Assumes a 20-percent markup for sale to customer at a discount chain, in contrast to a 40-percent markup at a low-volume retail outlet.

⁵ The vicissitudes of fluctuating currency rates in the past 18 months have contributed to the problem. As prices for European and Japanese movements have risen by approximately 30 percent since January 1977 as the U.S. dollar has declined in value, the price of Russian movements has remained constant, conveniently affording the Soviet Union an even greater price advantage. In the case of at least one Soviet movement, the price has been reduced substantially in the past 18 months.

The table illustrates that the initial price advantage, created by unrealistically low pricing for Russian movements, results in at least two additional price advantages. First, in order to qualify for duty-free treatment under General Headnote 3(a), a watch movement must be sold in the United States at a price great enough so that the value (cost) of the foreign materials does not exceed 70 percent of the total value. Accordingly, a finished movement originally costing \$3.32 in the Virgin Islands must be sold for at least \$4.74 to meet the test. Similarly, a \$5 movement must be priced at \$7.14 or more. As a result, the initial \$1.68 difference in cost between a Russian and non-Russian movement is translated into a minimum difference of \$2.40 when the movements are sold to distributors in the United States.

At this point, the Russian-made movement, selling for approximately 50 percent below its rivals—an enormous and insurmountable edge in the low-end of the watch market, has pushed the non-Russian competition into a higher priced segment of the market. The non-Russian movement is no longer attractive for sale in mass-volume, discount chains. Therefore, at this point, the Russian watch has gained a second additional price advantage: only it and not its now higher-priced competition can be sold through such discount giants as K-Mart and Zayre where mass volume of sales permit a much lower margin of gross profit than the smaller jewelry or department store outlet. The customary mark-up in a small department store or boutique is 40 percent, in contrast to the 20 percent markups accepted by discount houses.

As the table demonstrates, Russian movements start out in the Virgin Islands with a 50 percent price advantage which increases steadily to an advantage of 100 percent to 200 percent over its non-Russian rivals.

But that is not all. The table below shows that the companies in the Virgin Islands that use Russian-made movements are able to reap a larger profit than firms selling non-Russian movements while at the same time selling their product at \$2.40 below the price at which a non-Russian firm is forced to sell its movement.

COMPARISON OF 6¾ LADIES REGULAR-WIND NON-RUSSIAN AND SOVIET 17-JEWEL WATCH MOVEMENTS

	Non-Russian	U.S.S.R.
Costs:		
Landed cost.....	\$5.00	\$3.32
Virgin Islands import duty (6 percent).....	.30	.20
Local labor costs.....	1.00	.10
Fringe benefits related to labor costs (10 percent).....	.10	.01
Virgin Islands excise tax (3 percent of foreign materials costs).....	.15	.10
Gross receipts tax (2 percent selling price of \$7.14 for non-Russian, \$4.74 for U.S.S.R.).....	.14	.09
Total costs (excluding overhead, plant, etc.).....	6.69	3.82
Subsidies:¹		
Virgin Islands duty subsidy (67.5 percent).....	.20
Virgin Islands excise subsidy (67.5 percent).....	.10
Virgin Islands gross receipts (exemption) (75 percent).....	.11
Total subsidies.....	.41	0.00
Total net costs.....	6.28	3.82
Selling price.....	7.14	4.74
Gross profits².....	.86	.92
Net profits³.....	.16	.57

¹ Where labor content is less than \$0.20 companies do not qualify for Virgin Islands subsidies and abatements.

² Before deductions for overhead, taxes, etc. (based on minimum allowable selling price of \$7.14 (non-Russian) and \$4.74 (U.S.S.R.).

³ After deducting for rent, utilities, maintenance, depreciation for machinery, equipment for timing and inspection insurance costs.

Enjoying gross profits of some \$0.92 per movement and net profits of approximately \$0.57 a unit—compared to gross profits of \$0.86 and net profits⁸ of \$0.16 for users of non-Russian watches—the firms that buy their movements from the Soviet Union are in a stronger position to discount their product in the U.S. This helps to explain why \$3.32 Russian-made watch movements can be sold for \$4.74, the statutory minimum, and the prescribed watch marked up only 10–15 percent to the retailer.

All of these advantages stem from the initial price advantage gained by non-market pricing of Russian goods in the Virgin Islands. With that advantage, users of these watches are able to outcompete their non-Russian rivals at every step of the way. No amount of regulatory change, beefing up the value-added requirements in the insular possessions, can ever alter that advantage.

III. RUSSIAN WATCH ASSEMBLY REQUIRES MINIMAL TERRITORIAL LABOR

The fact that Russian movements require very little assembly work to complete them also assures the firms that use them a greater degree of profitability to the detriment of the territorial economics.

Comparison of high and low labor assembly operations

Non-Soviet watches are typically shipped to the Virgin Islands and Guam either completely unassembled or with preassembled balance and barrel components but with the remainder of the movement unassembled. The majority of these movements require the assembly of 32 to 60 components in order to produce a finished movement. According to the Commerce Department, no insular firm using non-Soviet movements assembles significant quantities of movements having fewer than 25 discrete components.

AWA members incur a local labor cost in wages that ranges from \$0.90 to \$1.25 to assemble movements of 32 to 60 components.⁹ In contrast, a typical Soviet movement arrives in the insular possessions as three distinct subassemblies and components plus three (or at times two) screws. These parts can be assembled into a finished movement by a skilled worker in less than 30 seconds. The Commerce Department estimates that this labor might cost a firm no more than \$0.06 per unit and between \$0.10 and \$0.18 per movement for less skilled labor.

What is more, even this minuscule amount of assembly in the insular possessions may be a sham. There is some evidence which suggests that the Russian movements are fully assembled in Russia (for technical and economic reasons) and then slightly disassembled in the Soviet Union or elsewhere so that they can then supposedly be “assembled” in the U.S. insular possessions and thereby qualify for duty-free entry into the United States. Some of our members have inspected the “unassembled” Russian components as they enter the Virgin Islands and have reported that the movements appear

⁸ The Russian watch users' net profit advantage is even greater than their gross profit advantage in large part because of the low-labor assembly operations in the insular possessions which require minimal investments in plants and equipment.

⁹ Appendix A sets forth a list of the components assembled by one of our members in the Virgin Islands and a brief description of the assembly steps involved in assembling such a watch movement. This assembly operation is contrasted with the assembly of a Russian-made movement consisting of three subassemblies and three screws.

to have been "regulated"—that is, timed for accuracy—a step that cannot take place until the movement has been fully assembled. Moreover, these movements had been lubricated, a step which normally also occurs after final assembly.

Detrimental effects to the Virgin Islands economy from low-labor watch assembly

Commerce Department and ITC data demonstrate that the volume of insular possessions shipments has remained remarkably stable over the long run and that recent fluctuations have been the result of post-recession recovery to historical levels. Moreover, data supplied by the Commerce Department's Statutory Import Programs Staff show that the local wage contribution to the insular possessions has declined 16 percent per unit—from \$1.04 in 1975 to \$0.84 in 1977—during the same time that Russian movements have mushroomed from only 79,000 units to 816,000 units (or approximately 18 percent of total Virgin Island shipments). In addition, Commerce Department statistics show that during this same period there has been a decline in the number of Virgin Islands workers receiving wages from watch assembly employment—from 1,000 employees in 1974 to 914 in 1977.

Plainly, displacement of high-labor firms by low-labor competitors has not had a beneficial, or even neutral, effect on the Virgin Islands economy. Rather, low-labor competition has been injurious to the traditional watch assembly industry, to their employees and families, and to the territorial economy as a whole. Such displacement, as also evidenced by the generally reduced allocations for 1978 given most high-labor traditional companies in the Virgin Islands, is especially insidious because of the enormous differential in wage contributions between high- and low-labor firms. As was pointed out above, a typical high-labor assembler contributes between \$0.90 and \$1.25 in local labor per unit while low-labor assemblers employ a mere 6 cents to 18 cents of labor per unit. High-labor companies add approximately nine times as much local value in their operations as do low-labor firms. As a result, every unit of high-labor watch production displaced by low-labor competition represents an enormous loss to the Virgin Islands economy. Thus, even if the advent of inexpensive Russian low-labor movements were to cause a slight expansion of the existing U.S. markets for Virgin Islands products, a claim made by the users of these movements but one not borne out in U.S. Commerce Department statistics, the loss to the Virgin Islands economy would still greatly exceed any small benefit derived from increased production.

The simple fact is that low-labor concerns will inevitably put high-labor firms out of business long before they increase the percentage of the Virgin Islands quota that is used. Even if these low-labor firms are able eventually to employ 100 percent of the quota, this small gain would be vastly overshadowed by the loss of local labor now contributed by high-labor firms. The result to the Virgin Islands economy of the displacement of high-labor firms by low-labor firms, even if this means 100 percent use of available quota, would be devastating. Use of 100 percent of available quota by low-labor firms would mean a net decrease in the number of workers employed in the Virgin Islands watch assembly industry from the present 917 to only about 200.

Low-labor concerns have to sell nine times as many watch movements as high-labor firms to provide an equivalent amount of employment in the Virgin Islands. Accordingly, the only way for the Virgin Islands to have a low-labor watch assembly industry and to employ the same number of people presently employed in the watch industry there is for Congress to agree to amend Public Law 89-805 increasing by 400 or 500 percent the present quota of Virgin Islands watch movements that may enter the U.S. duty-free, something we believe Congress almost certainly will not do.

IV. DECEPTIVE MARKETING OF SOVIET WATCHES

Russian-origin watches are sold to U.S. consumers without any markings or labels of any kind to indicate that they were produced primarily in the Soviet Union. Instead, Russian watches are commonly sold under such Swiss-French brand names as "Geneva," "Jean Cardot," and "Cornavin,"¹⁰ or such an American sounding brand name as Timetone. To the best of our knowledge, no Russian watch assembled in the Virgin Islands and sold in the United States (i) contains any marking on the watch, box or enclosed sales literature to suggest that the watch contains any Russian content at all or (ii) is sold under any brand name suggestive of its true origin.

To add insult to injury, many of the Russian watches carry guarantees that further create the illusion that the consumer is buying an American or West European product. For instance, a warranty card supplied with many of the Russian watches proclaims that the watch can be repaired by the "American Swiss Repair Serv., P.O. Box 203, Brooklyn, N.Y. 11211."¹¹

V. THE COMPETITIVE EFFECT OF NONMARKET PRICING

Russian watches are not "additive"

The AWA is disturbed by the statements of low-labor companies that their operations in the Virgin Islands have developed a new market in the United States for insular possessions watches and have, as a result, added to the volume of shipments from the territories. These firms reportedly claim that their products are purchased as "fashion" and "specialty" items in multiple quantities by customers who are not especially concerned about the accuracy of their watches but who are seeking a particular sartorial effect. These assemblers of Russian-origin movements apparently assert that this "new" market does not compete directly with higher-priced watches shipped from the Virgin Islands.

Low-cost, low-labor Russian watches have not "created a new market" for "fashion" or "specialty" products. Such a market has existed for more than 20 years, stimulated by the advent of the inexpensive Timex watch. To the extent Russian-origin watches have been able to penetrate this market, they have displaced higher labor

¹⁰ To obtain the name Cornavin, the "Panamanian" sellers of Russian parts, International Ciers, S.A., bought out a small Swiss company, Cornavin, in 1973. International Ciers then caused the small Swiss company to give a power of attorney to the "Panamanian" company's vice-president and secretary, a U.S. resident. This power of attorney specifically conferred the right on the officer of the "Panamanian" company to permit the name Cornavin to be used by the Soviet trading company, Mashpriborintorg, for International Ciers watches.

¹¹ A copy of a warranty which accompanies at least one brand of Russian watch is attached hereto as Exhibit B.

insular possessions products in the process and have used their much lower nonmarket economy costs and marginal insular labor content to good advantage.

In fact, companies using the Russian-origin watches have not really emphasized the "fashion watch" market in their overall marketing strategy. The Russian watch sellers have concentrated on and have been most successful in an entirely different segment of the market—the mass-volume, discount watch market where price is the preeminent factor in determining a sale. However, this market is by no means a new one either. Until Russian-origin watches from the Virgin Islands began to dominate the discount market, this market served as a major outlet for the high-labor insular possessions companies. Penetration of this market has been accomplished only by displacing firms—including the high-labor firms in the Virgin Islands—already selling at the low end of the price scale.

Displacement of U.S. firms

In the past 3 or 4 years, high-labor companies, including AWA members, have been losing considerable sales in the mass-volume, discount segment of the market. For instance, one firm, Helbros Watches, Inc., sells its watches assembled in the Virgin Islands to a concessionaire in Chicago, S.M. & R. In 1977 Helbros bid for a \$250,000 order through S.M. & R. but was awarded a contract for only \$80,000. A company selling Russian-origin watches assembled in the Virgin Islands obtained the remaining \$170,000. In the Spring of 1977, K-Mart gave Helbros a tentative order for 100,000–150,000 units; however, a seller of Russian-origin watches, Cornavin Watch Co., tendered a last-minute bid and won the final contract. In 1977 and again in 1978, Helbros lost sales to Zayre (an account with the capacity to sell in excess of 750,000 watches per year) which elected to purchase Russian-origin watches instead.

Waltham Watch Co., Inc. and Swisstime Co. have experienced similarly damaging losses as a result of competition from users of Russian watch movements. Moreover, other AWA member companies, selling somewhat higher priced watches, have experienced an indirect challenge to their products as lower priced watches, displaced by Soviet sales, push up against more expensive watches. This ripple effect is common in any industry where demand is to a great extent inelastic.

Traditional firms will fill any void Soviet watches leave

Users of Soviet watch movements forecast major disruptions to the Virgin Islands economy if they are obliged to change their low-labor assembly operations. These jeremiads are without foundation. The firms that use Russian movements employ only 60–65 workers, reflecting their low-labor operations. These firms, according to Commerce Department statistics, have already caused a net decrease in overall employment in the Virgin Islands of 279 jobs—from 1,193 employees in 1973 to 914 in 1977—due to the replacement of employment by high-labor firms.

The fact is, however, that AWA members, Timex and Bulova—companies that have always been the bulwark of the Virgin Islands watch assembly industry—are convinced that they will be able to expand their operations in the territories if they are able to compete with users of Russian watches on a fair and equitable basis. Timex has indicated it has definite plans to increase its insular production

and it is our understanding Timex will describe its plans as part of its written comments to the subcommittee.

AWA members also anticipate a resumption of full operations in the Virgin Islands once the threat of continued and growing Russian-watch domination of the insular industry abates. Our members, like a good many companies in the Virgin Islands, were forced by Russian pricing methods to restrict their 1978 assembly operations, reducing by 8 to 20 percent their 1978 quota allocations compared to 1977 levels.

Moreover, AWA members would, under normal circumstances, be attempting to increase the share of assembly work performed in the Virgin Islands, purchasing their watch components from abroad in a less fully assembled state in order to counteract some of the effects of the devaluation of the U.S. dollar on their costs. Such a strategy would make sense if our members were able to compete with users of Russian movements on a fair and even basis. Unfortunately, that has not been the case so far. Should the threat of the low-labor companies abate and currencies fluctuations continue, we would anticipate a trend toward greater, not lesser, emphasis on local assembly work in the Virgin Islands, a trend which can only bolster the territorial economy and increase the demand for local workers.

In sum, Timex and AWA members firmly believe they will be in a strong competitive position to take up the slack—and more—should users of Soviet watches be forced to compete on an equitable basis. Simply by returning to historical levels of production, and reemploying the 279 workers displaced by Soviet watch production, our companies will more than compensate for any potential losses, and will do so in short order. On the other hand, if Russian watch production continues on its current course, the Virgin Islands industry will inevitably be damaged and the territorial economy will suffer as traditional firms (a) themselves begin to buy Russian-made movements, (b) purchase more fully assembled movements from other foreign sources, (c) go out of business entirely, or (d) shift their assembly operations to extremely low-wage countries in the Far East and import inexpensive complete watches directly to the United States. One thing is certain: our members cannot continue for long to do business in the Virgin Islands on the same basis as today. Whatever course of action they are forced to take, if the Russian watch problem is not solved, will unfortunately be detrimental to the Virgin Islands economy.¹²

¹² Representative Ron de Lugo of the Virgin Islands has proposed that Headnote 3(a) be amended so that if a watch movement were to be cased in the Virgin Islands, the completed watch could be imported into the United States duty free. Presently, the Customs Service only accords duty-free treatment separately to cases manufactured in the Virgin Islands and watch movements assembled in the Virgin Islands; the Service does not give duty-free treatment to the casing operation itself.

Were the de Lugo casing proposal to be adopted, there would be an immediate employment benefit for the insular possessions which in the short-run would certainly take up the 60 to 65 jobs which some argue would be temporarily lost if Column 2 countries were barred from using General Headnote 3(a). In the long-run, the de Lugo proposal would probably provide many more jobs than 60 to 65.

While the AWA unquestionably believes that a General Headnote 3(a) prohibition for Column 2 countries will both in the short-run and long-run provide a net increase, not decrease, in employment, we are prepared to support the de Lugo amendment, a copy of which is attached as Appendix C, if the Subcommittee on International Trade believes that the amendment is desirable. However, the association's support is contingent upon the adoption of a General Headnote 3(a) prohibition as we believe that the casing proposal standing alone, or accompanying a weak watch movement assembly test, could, if not properly administered, provide an avenue for the Russian watch industry to import duty-free watches (not simply watch movements) into the U.S. with minimum assembly in the insular possessions, further aggravating the problems of the U.S. watch industry.

Our support for the de Lugo casing proposal is also based on the understanding that casing operations would not be used as the basis for watch movement quota allocations.

VI. RUSSIAN WATCHES GAIN INEQUITABLE BENEFITS UNDER GENERAL HEADNOTE 3(a)

MFN treatment

The Soviet Union, in taking advantage of the duty-free treatment provided under General Headnote 3(a), has managed to circumvent U.S. policy. Congress has repeatedly denied nondiscriminatory tariff treatment to the Soviet Union and other nonmarket economy countries, and instead insisted that these countries be subject to the higher duties in Column 2 of the tariff schedules. The objective of this deliberate policy was to maintain a differential between the lower duties paid by MFN trading partners and the higher rates paid by the Soviet Union and others.

The principle that the Soviet Union and other nonmarket countries should pay Column 2 rates of duty has been most recently and unambiguously enunciated in the well-known Jackson-Vanik amendment to the Trade Act of 1974, Public Law 93-618, title IV (January 3, 1975). That amendment and the vast quantity of legislative history behind it clearly preclude most-favored-nation treatment for the U.S.S.R.

The principle is set forth in title V of the Trade Act of 1974 and is also enunciated in General Headnote 3(e) of the TSUS which provides as follows:

(e) Products of Communist countries—Notwithstanding any of the foregoing provisions of this headnote, the rates of duty shown in column numbered 2 shall apply to products, whether imported directly or indirectly, of the following countries and areas pursuant to section 401 of the Tariff Classification Act of 1962, to section 231 or 257(e)(2) of the Trade Expansion Act of 1962, or to action taken by the President thereunder: * * * Union of Soviet Socialist Republics and the area in East Prussia under the provisional administration of the Union of Soviet Socialist Republics." 19 U.S.C.A. 1202, 3(e).

Soviet access to duty-free treatment under General Headnote 3(a) abrogates this Congressional principle against according MFN status to the U.S.S.R. The Russians have found, and are exploiting vigorously, a major and unintentional loophole in U.S. trade law.

Soviet watches enjoy inequitable profit incentives

Congress and industry alike have long recognized that the General Headnote 3(a) watch assembly industry operates on the tariff differential between the duties paid on direct imports and the duty-free treatment accorded eligible territorial shipments. The incentive to produce in the insular possessions is directly proportional to the size of this tariff differential. Plainly, the incentive is greatest for Soviet-made watch movements because they escape the higher duties on direct imports imposed under column 2. In the 17-jewel watch category, where the vast majority of Russian-made movements fall, the tariff differential ranges from \$2.75 to \$4.

In contrast, the differential for MFN trading partners is only \$1.80 to \$2.70—a spread that only narrowly compensates for the added handling, shipping, storage and overhead expenses incurred in the insular possessions. Able to benefit from a \$2.75 to \$4 duty saving, it is no wonder that the Soviets prefer to ship their movements through the insular possessions rather than directly to the United States, even though they could easily compete with other watches by this latter

route.¹³ No other country has used the insular possessions loophole exclusively while ignoring direct imports to the United States. For most countries, the General Headnote 3(a) program is a small adjunct to their normal exports to the United States. This is as it should be in view of Congressional intent to restrict the exploitation of this loophole in U.S. trade law to the extent necessary to contribute to the potential for light manufacturing in the insular possessions. The program was never intended to become a major avenue for the importation of a country's entire U.S.-bound products. As employed by the Soviet Union, however, this has become the result.

VI. NEED FOR ACTION BY THE 95TH CONGRESS

Need for immediate action

There is very little time remaining before the start of the new insular possessions quota year that begins on January 1, 1979. At that time, the new rules for the 1979 quota year must be in place and the allocation of the quota to individual watch assembly firms commences. AWA members have long been convinced that the traditional high-labor segment of the industry cannot hope to survive if forced to continue to operate under existing rules until 1980. They have expressed this fear repeatedly to members of Congress and the Administration. In view of the rapidity with which Soviet watches gained a leading share of the markets in Great Britain and in Canada earlier in this decade, the AWA does not believe the United States can continue to delay acting but must find a solution to the problem in time for the 1979 quota year.

In matter of fact, one of our members has already given up any attempt to stop the Russian low-labor threat to the insular industry. This member is unconvinced that Congress will show the determination to resolve the problems this session. Absent such a Congressional solution, the member believes that it, as well as all other U.S. watch makers, will have to close up in the insular possessions or buy Russian merchandise. For our organization there is no more graphic example of the need for prompt action than this. Should other members of our

¹³ Until recently, col. 2 duties have been great enough to discourage all but a trickle of Russian watch movements entering in categories where the specific duties are the lowest. This obstacle may have been removed in the past year as a result of the devaluation of the U.S. dollar in relation to European and Japanese currencies. Today, AWA members operating in the Virgin Islands are unable to purchase their movements from traditional sources for less than \$5, while Russian watches enter the territory at \$3 to \$3.32. Under the requirements of general headnote 3(a), the \$5 movement cannot be sold in the United States at less than \$7.14. A \$3 to \$3.32 Soviet-made movement which is imported directly into the United States would, of course, pay the duties for watch movements specified in col. 2 of the TSUS. However, these duties are rarely sufficient to raise the price of a Russian-made movement to the \$7.14 price that a duty-free non-Russian movement must sell at in the United States.

17-jewel TSUS item	Value of Russian movement	Duty	Total
716.30.....	\$3.32	\$4.00	\$7.32
716.31.....	3.00	3.75	6.75
716.32.....	3.00	3.50	6.50
716.33.....	3.00	3.25	6.25
716.34.....	3.00	3.05	6.05
716.35.....	3.00	2.60	5.60
716.36.....	3.00	2.75	5.75

NOTE.—Accordingly, we can see no reason why Russian-made watches could not be shipped directly to the United States and compete with watches assembled in the Virgin Islands and other direct imports as well.

organization be put out of business or begin purchasing Russian merchandise—as we believe will be the case in the very near future if Congress fails to act—the ability of the AWA to oppose Russian penetration of the United States would, of course, have to cease.

Impossibility of obtaining an administrative solution

For more than 2 years, as some members of Congress have suggested, the AWA, Timex, Bulova and other members of the U.S. watch industry have sought to obtain relief from this unfair competition by administrative means. The AWA alone has expended a truly enormous amount of effort in attempting to get the Executive Branch to enforce existing law. To date these efforts have produced little or no effect.

In September 1977, the Commerce and Interior Departments published proposals to upgrade assembly operations in the Virgin Islands and solicited public comment. These proposals were subsequently withdrawn, reportedly as a result of opposition from users of Russian watches.

Again, in June of this year, after prodding by the U.S. watch industry, the Commerce and Interior Departments published proposed rules. These rules, while largely inadequate to solve the problem in the long-run, might just have slowed the rate of the Russian takeover of the insular watch industry. What is more, the proposed regulations held the promise that final regulations would be issued in time for watch companies to make plans for their 1979 operations. Accordingly, the AWA submitted careful, detailed comments to the Departments in an effort to improve the proposal. However, once again, reportedly as the result of pressure from the users of Russian watches, the proposed regulations were in effect withdrawn. After the deadline for comments had passed, the U.S. watch industry was told they had not commented on proposed regulations but on proposals to evaluate the need for regulations.

The watch industry had no better luck with the Customs Service. Meetings, telephone calls and correspondence resulted in no agreement to help solve the problem. Indeed, the AWA had to file a formal FOIA request even to obtain a copy of the Customs Service ruling that permitted the two-screw Russian watch assembly operations in the first place.

In the last couple of weeks since Congress has begun to turn its attention to the plight of the watch industry, it has been rumored that the Commerce and Interior Departments and Customs Service will again come forth with proposed plans of action. But we have yet to learn of any Executive Branch proposal that would be at all adequate to resolve the problem. Moreover, we believe implementation of any administrative proposals would be too slow to insure even marginal benefits to the U.S. watch industry.

Solution properly a congressional one

Perhaps the central reason why the Executive Branch has seemed so unequal to the task of resolving the Russian watch problem is the problem requires a Congressional solution. We believe that the appropriate way of handling the issue is through legislation.

In the first place, the central problem is that the application of Headnote 3(a) to merchandise originating in the Soviet Union creates a de facto loophole in the longstanding Congressional insistence on

subjecting Soviet goods to column 2 rates of duty instead of the much lower column 1 rates of duty governing most-favored-nation imports from traditional trading partners. Granting the Soviet watch industry this trade advantage clearly flies in the face of the intent of the Jackson-Vanick amendment and General Headnote 3(e) of the TSUS.

To force the watch industry to seek tardy, inadequate and precedential solutions to this problem simply permits the Executive Branch to continue to disregard the will of Congress. Only if Congress addresses this problem in unequivocal terms will its long-standing policies be respected in this case.

Further, it should be emphasized that short of requiring column 2 countries to pay column 2 rates of duty with regard to insular possessions watch movements of Soviet origin, which we understand the Executive Branch is unwilling to do, it is virtually impossible to force the Executive Branch to help the watch industry with the central problem created by the assembly of Soviet watch movements in the insular possessions—nonmarket pricing. It is not at all clear that the U.S. anti-dumping laws can be invoked against the import of these nonmarket-priced Soviet watch movements because they enter the customs territory of the United States, after passing through a number of "sales,"¹⁴ as products of the insular possessions.

Finally, because the problem of Soviet watch imports from the U.S. insular possessions is multifaceted (involving nonmarket pricing, deceptive selling techniques and low-labor, sham assembly techniques), any meaningful relief from the Executive Branch is only possible if a number of different Departments and Agencies (i.e., the Customs Service, the Treasury Department, the Federal Trade Commission, the Commerce Department and the Interior Department) are willing to act decisively. Even if we could expend the resources necessary to get all these parties to so act, the time lost would insure disaster.

VII. RECOMMENDATIONS

Need for amendment to Headnote 3(a)

Clearly, the Congress never intended the insular possessions quota system to be exploited by a country seeking to ship the vast majority of its U.S.-bound exports past American tariffs. Nor did it intend the system to have the paradoxical effect of discriminating against our closest trading partners, who enjoy most-favored-nation treatment, in favor of countries such as the U.S.S.R. which must pay the higher duty rates of column 2. However, that is exactly what has happened in the Virgin Islands and Guam under General Headnote 3(a). It is, at best, ironical that the Soviet Union has been able to penetrate the U.S. market with duty-free watches at the same time that the House Ways and Means Committee and Congress as a whole estab-

¹⁴ Even if it is possible to prove that the various "sales" that take place before the Russian watches reach the U.S. discount houses (from the Soviet trading company, Masharborlitora, to Panamanian subassembly suppliers, from the subassembly suppliers to the assemblers in the insular possessions, and from the assemblers to the wholesalers) are not arm's-length transactions, a task of considerable difficulty, the fact that the watch movements are considered by the Customs Service as products not of the Soviet Union but of the insular possessions may preclude any relief under the anti-dumping statutes.

lished substantial restrictions on trade with that country through the provisions of title IV of the 1974 Trade Act, the Export-Import Authorizations Act and other statutes.

For more than a year, members of the House Subcommittee on Trade have waited for the Commerce Department and the Customs Service to solve this problem. Distressed by the glacially slow progress of these agencies, as well as the ever-increasing takeover of the watch industry in the Virgin Islands by low-labor firms marketing Soviet movements, the subcommittee on July 17 of this year unanimously adopted an amendment proposed by Representative Dan Rostenkowski (D.-Ill.) to a bill by Virgin Islands Delegate Ron de Lugo, H.R. 8222. This amendment attempts to resolve the Soviet watch problem by requiring that for a watch movement to obtain a Headnote 3(a) duty-free treatment, it must be assembled in the insular possessions from at least 25 discrete parts.

The Rostenkowski amendment is clearly a step in the right direction. Unfortunately, however, if enacted, it is apt to be effective only temporarily in resolving the Russian watch problem.

The Rostenkowski amendment will almost certainly cause low-labor firms to stop their present "two- or three-screw" operations. Nevertheless, the enormous Soviet industry is undoubtedly capable of altering its operations so that the 25-parts test can be met without increasing to any significant extent the local labor contribution.¹⁵ Moreover, compliance with this test in no way causes the Russians to engage in fair free-market pricing of watch movements. On the contrary, the Russians can be expected to adjust their prices to continue to take advantage of Headnote 3(a) to leapfrog over columns 1 and 2 of the tariff schedules in order to penetrate the U.S. watch market with duty-free merchandise.

Rather than rely on a 25-parts test to stop the Russian takeover of the insular possessions watch industry, the circumvention of the U.S. tariff laws by the Soviet Union should be dealt with directly. Neither the tariff laws themselves nor applicable legislative history suggest that Headnote 3(a) was meant to provide a springboard for column 2 countries to export their watches to the United States duty free.

Proposal

Accordingly, the following proposal provides that the watch products of column 2 countries would be prohibited from obtaining duty-free treatment under Headnote 3(a). Headnote 3(a) of the TSUS, 19 U.S.C. 1202 headnote 3(a), should be amended by adding the following subsection:

(iv) No watch or watch movement containing any parts manufactured, assembled or otherwise processed in a country, all or some of the goods of which are subject to the rates of duty set forth in column numbered 2 of the schedules, shall be exempt from duty under this headnote 3(a), and any such watch or watch movement shall be subject to the rates of duty set forth in column numbered 2 of the schedules.

¹⁵ Appendix D describes two possible procedures by which users of Russian-made movements could meet the criterion of a 25-parts test and still contribute no more than 10 to 20 cents labor in the Virgin Islands.

APPENDIX A

COMPONENT PARTS AND ASSEMBLY TECHNIQUES FOR WATCH MOVEMENTS ASSEMBLED BY HIGH LABOR CONCERN (AWA MEMBER) AND LOW LABOR CONCERN (USER OF RUSSIAN PARTS)

I. High Labor Concern

A. Separate parts

mini-wheel	crown wheel
set wheel	crown wheel ring
clutch wheel	crown wheel screw
winding pinion	click
clutch lever	click spring
clutch lever spring	click screw
stem	bell bridge
yoke	mainspring bell
yoke screws	ratchet wheel
pillar plate	ratchet wheel screws
center wheel	pallet
third wheel	pallet cock
fourth wheel	screw
escape wheel	balance
train bridge	balance cock
bridge screws	balance cock screw
mainspring	jewel pin
bell drum	guard pin
bell arbor	hairspring
bell cap	

B. Assembly

- (1) Add mini-wheel, set wheel, clutch wheel, winding pinion, clutch lever, clutch lever spring, stem, yoke and 2-yoke screws to pillar plate,
- (2) Add to pillar plate center, third, fourth, and escape wheels, train bridge and 2 bridge screws,
- (3) Adjust endshake on all wheels, plus or minus as required by moving plate or bridge jewels,
- (4) Put mainspring in bell drum,
- (5) Add bell arbor and bell cap,
- (6) Oil cap,
- (7) Close cap,
- (8) Add crown wheel, crown wheel ring, crown wheel screw, click, click spring and click screw to bell bridge,
- (9) Add mainspring bell, bell bridge, 3 bridge screws, ratchet wheel, ratchet wheel screws,
- (10) Test endshakes of mainspring bell,
- (11) Add pallet, pallet cock, screw,
- (12) Test endshakes,
- (13) Adjust endshakes plus or minus,
- (14) Adjust lock and slide endshakers,
- (15) Attach balance with hairspring cock by gluing,
- (16) Balance and balance cock are added to plate by balance cock screw,
- (17) Endshake is adjusted plus or minus as required,
- (18) Jewel pin and guard pin shape are adjusted,
- (19) Hairspring is levelled and centered and vibrated between regulator pin of balance cock.

II. Low-Labor Users of Russian Subassemblies

A. *Separate parts*

Subassembly (1) (consisting of fitted balance and hairspring, train wheels, and winding and setting mechanism.)

Subassembly (2) (consisting of the bridge click, the click, the click spring, the click screw, the click crown wheel, crown wheel ring, and the crown wheel screw.)

Subassembly (3) (consisting of main spring, arbor barrel drum, and the barrel cover.)

B. *Assembly*

1. Insert main spring into base plate in proper position.
2. Place on barrel bridge.
3. Place on barrel bridge screw one.
4. Place on barrel bridge screw two.
5. Put on ratchet wheel to be snapped on barrel arbor.
6. Put on ratchet wheel screw.

APPENDIX B

TIMETONE 2-YEAR SERVICE CERTIFICATE

Two-year service

Your watch has been adjusted and electronically timed by skilled watchmakers. It has been carefully checked and will give you excellent service. This watch is guaranteed for 2 years against defective materials or workmanship. This Service Certificate applies only to the mechanism of the watch and does not include necessary periodic cleaning and oiling of movement, replacement of crystals, cases, parts accidentally damaged, or rusted non-waterproof watches. Should this watch develop any defect within the 2-year period, please mail to us, plus \$3.50 (Skindiver, Date and Automatic models \$1 extra) to cover handling charges.

Important: Do not return this watch to your store.

Mail to: American Swiss Repair Service, P.O.B. 203 Brooklyn, N.Y. 11211—(212) 388-3034.

If your watch needs service:

Send the watch via insured parcel post to: American Swiss Repair Service., P.O.B. 203 Brooklyn, N.Y. 11211. Include a brief note explaining what is wrong. Tell us where and when the watch was bought. Print your name and address clearly.

Please wrap securely and insure when mailing, but do not use original gift box, as we cannot return it. **Important:** Do not send money, guarantee or correspondence under separate cover. Enclose them in the same parcel with your watch to avoid delay.

Damaged watches and watches out of guarantee will be repaired at standard cost of labor and material. An estimate of cost will be sent to you for your approval. We reserve the right to replace lost articles with the like grade and quality. Be sure to include \$3.50 handling charges with watch plus any additional cost for special request service listed below.

Expansion Bracelet \$1.00 Leather Strap \$1.00 Round crystal (plain) \$1.00**WHEN RETURNING FOR REPAIR**

(Please, print your name and address clearly)

Name of Owner.....

Address

City..... State..... Zip.....

Date of Purchase.....

When time counts most—count on Timetone

Timetone Watches, quality watches for decades

APPENDIX C**CASING AMENDMENT PROPOSED BY REPRESENTATIVE RON DE LUGO,
DELEGATE FROM THE VIRGIN ISLANDS****Delete the following language:**

“(or more than 70 percent of their total value with respect to watches and watch movements)”

Substitute the following language:

“(or more than 70 percent of the total value of watches, which total value shall include the value of both the movements and cases and shall be evaluated on a unitary basis, and of watch movements)”

APPENDIX D**HOW SOVIETS CAN CIRCUMVENT A 25-PART TEST**

Technicians at AWA member companies have examined the Soviet watch and determined that it would be relatively easy to meet the requirements of a 25-discrete-part assembly test under General Headnote 3(a) and not incur a substantial additional cost in labor. These experts have isolated 25 parts which are essentially peripheral to the train assembly—the core of any movement—and which can be attached to the train assembly with 6 screws to produce a complete movement. In comparison with current Russian assembly operations—which are judged by the Commerce Department to involve assembly of between 3 to 4 components and 2 to 4 screws at a cost of approximately 6 cents per unit—our experts calculate that a 25-part, 6-screw operation would entail between 10 cents and 20 cents labor per unit as the assembly work for the final 17 parts is no more sophisticated than that for the first 8 parts.

A description of the 25 parts and the train assembly follows:

Example No. 1: Movement T 72-75:

1. Ratchet wheel.
2. Ratchet wheel screw.
3. Crown wheel.
4. Crown wheel ring.

5. Crown wheel screw.
6. Click.
7. Click spring.
8. Click screw.
9. Barrel bridge.
10. Barrel bridge screw.
11. Barrel bridge screw.
12. Minute wheel.
13. Intermediate wheel.
14. Set bridge.
15. Set bridge screw.
16. Clutch lever.
17. Clutch lever spring.
18. Detent (set lever).
19. Winding pinion.
20. Clutch wheel.
21. Stem.
22. Main spring.
23. Main spring barrel.
24. Main spring barrel cover.
25. Main spring barrel arbor.

Complete train consists of: 4 wheels, train bridge, 2 screws, main plate, pallet, pallet bridge, pallet bridge screw, balance wheel with hair spring, balance bridge, balance bridge screw, balance bridge shock device, with jewels, regulation Titan mobile, carion pinion.

Example No. 2: Movement INT-69:

1. Carion pinion.
2. Minute wheel.
3. Intermediate wheel.
4. Detent—set lever (9).
5. Clutch lever.
6. Clutch lever spring.
7. Set lever bridge.
8. Set lever screw.
9. Set lever screw.
10. Winding pinion.
11. Clutch lever (3).
12. Stem.
13. Balance bridge.
14. Balance bridge screw.
15. Balance bridge screw.
16. Ratchet wheel (8).
17. Ratchet wheel screw.
18. Crown wheel.
19. Crown wheel screw.
20. Click.
21. Main spring.
22. Main spring barrel.
23. Main spring barrel cover.
24. Main spring barrel arbor.
25. Main plate: with jewels, train 4 wheels, bridge 4 wheel screws, balance bridge wheel screws, balance assembly, pallet assembly.

Complete train same as T-72-75.

ROZA WATCH CORP.,

Christiansted, St. Croix, U.S. Virgin Islands, September 1, 1978.

Mr. MICHAEL STERN,

Staff Director, Committee on Finance, Dirksen Senate Office Building, Washington, D.C.

GENTLEMEN: We welcomed your offer to give our view with reference to the assemblers of Russian watch movement parts and we thank you for the opportunity.

We are the second largest Watch Manufacturing Firm in the Virgin Islands with respect to the allocation of watch quotas. The watch industry in the Virgin Islands is faced with many problems, one of the greatest is the skyrocketing cost of watch parts due to currency devaluation of the dollar against the Swiss Franc, German Mark, etc.

The users of Russian parts do not have this problem as they deal only in dollars. The Russian assemblers devote an insignificant amount of labor in their assembling. In addition to the fact that they contribute little to the economy of the Virgin Islands, contrary to the expressed intent of Congress when it passed General Headnote 8(a), they place us at a great competitive disadvantage which threatens our continued existence.

For these reasons and many more we are opposed to any watch firm receiving duty free status under General Headnote 8(a) for watch movements which are assembled with very little labor, as we believe in the case of the assemblers of parts originated in Russia.

Again we wish to thank you for permitting us to give you our position.

Sincerely yours,

MARTHA L. KAUDERER, *President.*

COMMENTS OF WALTHAM WATCH CO. CONCERNING THE TARIFF TREATMENT OF WATCHES AND WATCH MOVEMENT ASSEMBLED IN THE INSULAR POSSESSIONS USING SOVIET PARTS

The Waltham Watch Company ("Waltham"), which currently assembles watch movements in the Virgin Islands pursuant to Public Law 89-805, wishes to submit the following comments concerning the use of Soviet-origin parts by the watch assembly industry in the U.S. insular possessions in response to the August 21, 1978, press release of the Subcommittee on International Trade of the Senate Finance Committee. Waltham is a relatively recent entry into the insular possessions' assembly industry, having commenced operation in the Virgin Islands in 1978. However, Waltham has been concerned about the role of Soviet watch parts for the past year and has studied the question as closely as any of the interested parties.

For some time, Waltham was one of the principal advocates of statutory and regulatory restrictions on the use of Soviet-origin parts. Continued study of the question against the background of present and projected conditions in the U.S. watch market, as well as international economic trends, has caused Waltham to revise its thinking. It is Waltham's conclusion that the availability of Soviet parts must be preserved if the watch assembly industry in the insular possession is to once again be competitive with other watch producers supplying the U.S. market.

For this reason, Waltham is opposed to any across-the-board exclusion of products containing parts from "column 2" countries from the benefits of General Headnote 3(a). Such an arbitrary and discriminatory response would not necessarily resolve the specific issues involved here and, by eliminating competition in the sourcing of watch parts in the insular possession, would neutralize the assembly industry's ability to compete in the domestic market, ultimately accelerating the decline of the industry. In this connection, Waltham submits that the Subcommittee should view with suspicion any support for such a "column 2" restriction coming from companies whose watches compete in the domestic market with the jewel lever watches assembled in the possessions. Such support is obviously premised on a desire to eliminate actual and potential competition in the marketplace by preserving the stagnation in insular assembly operations.

With regard to the specific concerns relating to the pricing of Soviet parts and the degree of labor expended on their assembly, Waltham submits that these concerns are best explored by the agencies responsible for the administration of General Headnote 3(a), both of which have initiated inquiries in these areas.

Should the subcommittee conclude that some legislative action is called for, however, Waltham suggests that a simple revision of General Headnote 3(a), requiring the addition of specified minimum of direct labor and permitting the duty-free entry of cased movements

on the same basis, would meet the concerns expressed by the subcommittee in a nondiscriminatory manner and provide a basis for the future development of the insular possession assembly operations as a dynamic segment of the U.S. watch industry.

1. THE NATURE AND FUNCTION OF GENERAL HEADNOTE 3(a)

As the subcommittee is aware, General Headnote 3(a) provides for the duty-free importation of articles produced in the insular possessions provided that no more than a specified percentage of the article's U.S. landed value (70 percent in the case of watches and watch movements) is of foreign origin. The import of watches under this provision is subject to a quota system, administered by the Department of Commerce and Interior, which limits total annual imports to no more than one-ninth of apparent U.S. consumption during the preceding year.

In sum, General Headnote 3(a) provides an incentive for the development of light assembly industry, that is, watch assembly, in the insular possessions by conferring certain tariff benefits on the products of such industry, up to a maximum level equivalent to a fraction of domestic consumption.

2. THE WATCH ASSEMBLY INDUSTRY IN THE INSULAR POSSESSIONS

Historically, the watches supplied to the U.S. domestic market by the insular possession assembly operations have been less expensive, conventional jeweled lever movement watches. The assemblies and sub-assemblies for these movements have traditionally come from European suppliers, principally those in Switzerland, Germany, and France.

The reason for the reliance on foreign supplies is the lack of any U.S.-source ebauches¹ and watch parts—the basic component of all conventional watch movements. The last U.S. marketer of ebauches and watch parts ceased manufacturing here in the late 1950's because of its high labor costs and consequent inability to compete with the products of the European ebauche manufacturers.²

While one company now has a plant in the U.S. manufacturing pin-lever ebauches, all of its output is used in that company's operations and the pin-lever ebauches would, in any event, be unacceptable for use in the manufacture of jeweled lever movements. The Soviet-source ebauches and other watch parts thus represent the only competition to the European suppliers in sourcing the insular assembly operations.

This alternative source of supply has become increasingly important in the last 5 years as the U.S. dollar has declined steadily in value, particularly in relation to the principal European currencies. The loss of dollar purchasing power, together with general inflation of producer costs, has placed the insular assembly operations in a classic cost-price

¹ The ebauche is, in essence, the frame on which the watch movement is built.

² The collective actions of the Swiss watch industry in attempting to preserve their dominance in the manufacture and marketing of watches have been catalogued in *United States v. The Watchmakers of Switzerland Information Center, Inc.*, [1963] Trade Cases (CCR) ¶ 70,600 (S.D.N.Y. 1962), order modified, [1965] Trade Cases (CCH ¶ 71,352 (S.D.N.Y. 1965)). Obviously, the U.S. antitrust laws preclude U.S. watch companies from taking any collective steps to reinstitute such manufacturing activities and, because of the large capital investment required and present market uncertainties, no single U.S. company has been willing to reenter the ebauche manufacturing industry.

squeeze. The cost of European parts for the watches and watch movements assembled in the insular possessions has approximately tripled in the last 5 years while fierce competition in the domestic watch market has held producer prices relatively steady.³

The impact of these developments is reflected in the lack of growth in insular production, despite apparently increasing domestic demand, and the consistent inability of the insular producers to utilize the available quota. The statistics of the Commerce Department, for example, indicate that, although annual quota allocations have increased significantly since 1973, the number of units assembled and shipped in the insular possessions has actually declined in every year but 1977, when the increase was relatively insignificant. The ratio of shipments to quota has also declined markedly from 94 percent in 1973 to 67 percent in 1976, with a slight recovery to 80 percent in 1977.⁴

The availability of Soviet cbauches and other watch parts presents the insular assembly industry with an opportunity to control costs and improve its competitive position vis a vis the digital watches and Timex. The appreciation of the Soviet ruble has been of a relatively smaller magnitude than in the case of the European currencies,⁵ and the Soviet manufacturers appear to be using their relatively low-production costs and scale economies to provide a quality product at a reasonable price to the insular assembly operations. These producers, in turn, can use the Soviet-source materials to produce a conventional 17-jewel watch which can, for the first time, be marketed at prices competitive with those of the less-expensive Timex and digital watches. The ultimate beneficiary of this increased competition will be the U.S. consumer who will have a greater selection of jeweled lever watches to choose from, including for the first time jeweled lever watches priced competitively with the less expensive Timex and digital watches.

As the subcommittee's press release of August 21, 1978, notes, two arguments have been advanced in an effort to eliminate the competitive Soviet-source supplies of cbauches and watch parts: (1) that insufficient labor is performed on these movements to qualify them for the benefits of Headnote 3(a); and (2) that the parts are sold at prices less than their cost of production. As to the allegedly inadequate labor contribution made by the assemblers using Soviet parts, it must be remembered that, while those using European-sourced components claim they incur greater labor costs per unit, they have not been able to

³ Watches containing movements assembled in the insular possessions have faced stiff competition both from the large manufacturers of digital watches, including Texas Instruments which now markets a digital watch for less than \$10, and from the low-priced pin lever and other watches manufactured and marketed by Timex, which uses both U.S. and foreign parts and labor.

⁴ Virgin Islands watch companies industry wide statistics for calendar years 1973-77. (Source: U.S. Department of Commerce.)

⁵ For example, data available from the IMF and U.S. Commerce Department indicate that the ruble has appreciated approximately 11 percent in U.S. dollar terms from 1973 to the first half of 1978 while the Swiss franc appreciated approximately 68 percent in U.S. dollar terms.

	1973	1974	1975	1976	1977
Annual quota allocation (units).....	4,913,000	4,874,000	4,960,000	5,008,000	6,256,000
Actual units shipped to United States under headnote 3(a).....	4,631,819	4,048,876	3,046,757	4,012,810	4,650,803
Watch movements assembled (units).....	4,678,175	4,032,322	3,042,565	4,056,703	4,826,618

increase their output in recent years or to participate in the general growth of the domestic market in the face of the two major competing styles of watches—the low-priced digital models and the Timex pin-lever watches.

Accordingly, whatever differences there may be in per unit labor contributions, there is no assurance that the conventional assembly operations can expand to fill the void which would be left by the elimination of Soviet parts and, indeed, very good reason to believe that such action would contribute to the decline of the insular possessions watch assembly industry.

As to the alleged underpricing of the Soviet parts, no evidence to support this contention has ever been produced and an inquiry into Soviet costs of production would clearly be an inappropriate and unwieldy subject for legislative hearings. As noted, the Soviet manufacturers appear to have utilized scale economies as well as their own relatively low costs to offer their product at prices designed to attract a share of the market formerly monopolized by the European suppliers. It is difficult to understand why the Soviet competitive initiatives, which appear to be freely available to all and ultimately to result in lower watch prices to U.S. consumers, should require legislative scrutiny.

It is noteworthy, in this regard, that the Government of the Virgin Islands, which is most intimately concerned with this issue, has consistently opposed any action by the Federal agencies or Congress which would cut off the flow of Soviet parts to the insular possessions assembly operations. The Virgin Islands Government has apparently concluded that, in view of the inability of European-supplied producers to use up the statutory quota in contrast to the relatively more successful efforts of the Soviet-supplied producers, the best interests of the Virgin Islands lie in the continuing availability of the Soviet parts.

3. NO LEGISLATIVE INQUIRY OR ACTION IS APPROPRIATE

As the preceding background makes clear, the issues raised by the subcommittee's press release are extremely complex, involving both technical issues concerning the operation of General Headnote 3(a) and broader questions concerning the role of the insular possession's assembly operations in the total domestic watch market. In addition, the resolution of these issues must take account of the diplomatic and political sensitivities of the foreign states involved, particularly those of the Soviet Union—a task not well-suited to legislative hearings.

The Commerce and Interior Departments have been studying this problem for some time and recently solicited the comments of interested parties concerning the need for revision of their quota allocation rules in light of the availability of Soviet watch parts. The U.S. Customs Service has also initiated a review of its procedures for the classification and valuation of watches and watch movements imported under General Headnote 3(a).

In view of the expertise which these agencies have developed with respect to this subject and their broad administrative authority under existing law, Waltham submits that it would be premature for the subcommittee to consider taking any action in this area.

4. IF LEGISLATIVE ACTION IS TAKEN, IT SHOULD NOT BE IN THE FORM OF AN EXCLUSION OF SOVIET PARTS

Waltham firmly believes that no legislative inquiry or action in this area is necessary at the present time. Nevertheless, in anticipation of possible calls for legislative change from other interested parties, Waltham wishes to make its views on possible legislative action known.

The most frequent form of statutory amendment suggested is one which would make the benefits of General Headnote 3(a) unavailable to products of the insular possessions containing parts from the Union of Soviet Socialist Republics or any other "column 2" country. Waltham submits that such a provision would be an arbitrary and unwise exercise of legislative power, unfairly discriminating against the Soviet products while failing to focus on the real issues which have generated concern with respect to the Soviet movements and failing to consider the competitive consequences which such exclusionary action might have on the industry.

A more rational and measured approach, responsive to the concerns expressed in the subcommittee release while preserving competition among suppliers of ebauches and watch parts to the assembly industry, would be the adoption of a simple labor-added test which requires, for example, that a minimum of 65 cents in direct labor costs be added to each unit produced. This labor contribution could take the form of assembly of the movement, casing of the movement, attachment and setting of dials and hands and the attachment of watch bracelets. In addition, the more extensive use of local labor could be encouraged by making more explicit Congress' intent to permit cased movements duty free entry under this headnote on the basis of the unitary value of the resulting watch (rather than on the basis of the constructive segregation of the values of case and movement—the view which is espoused by Customs and which presently discourages the casing of movements in the insular possessions).

CONCLUSION

Waltham appreciates the opportunity to comment on the issues raised by the Subcommittee and would be pleased to provide any further information which might prove useful. Waltham believes that the availability of Soviet watch parts in the insular possessions represents a healthy competitive development for the insular assembly industry and for the U.S. watch industry generally. While the Soviet parts should obviously enjoy no unfair competitive advantage, Waltham firmly supports the continued availability of these parts as in the best interests of both the industry and the insular possessions.

**STATEMENT OF TIMEX CORPORATION IN SUPPORT OF LEGISLATION TO
ELIMINATE THE LOOPHOLE IN THE U.S. TARIFF LAWS WHICH PERMITS
COLUMN 2 WATCHES TO ENTER THE UNITED STATES DUTY-FREE**

I. SUMMARY

Seventeen-jewel watches of Communist-bloc origin (particularly from the U.S.S.R.) are now available at chain stores across the United States at a retail price as low as \$9.88. No Free World manufacturer of 17-jewel watches can compete with this price. Far more important, this price even undercuts the prices at which the most basic domestically produced nonjewelled watches are sold. Russian watch imports, as a consequence, directly threaten the jobs of thousands of workers in what remains of the U.S. watch industry, an industry which already faces substantial import penetration of its domestic market.

It is improbable Russian watches could be sold at such a depressed, unrealistic price unless importers had found a way to evade "column 2" tariffs, which are the duties Congress intended to be paid on all products of the U.S.S.R. and most other Communist countries. By performing certain final-assembly operations in the U.S. Virgin Islands, these traders are permitted under current law to import watches from any column 2 country duty-free.

It is clear from the record that Congress has never intended this tariff loophole (whose only purpose is to stimulate the local Virgin Islands economy) to operate in a way which threatens American jobs and the health of a domestic industry. Moreover, it is clear the wisdom of Congress in assigning column 2 tariffs to imports from state-controlled economies (where cost and profit need not be the basis behind the price of goods) remains the only workable principle for placing watch competition from Communist-bloc producers on a fair and equitable basis.

The U.S. watch industry, including Timex, Bulova, General Time, and the members of the American Watch Association, together with representatives of American labor, all support the specific proposal contained in this statement.

II. BACKGROUND

U.S. Tariff Schedule General Headnote 3(a) permits watches and watch movements to be imported duty-free from the U.S. insular possessions (the U.S. Virgin Islands, Guam and American Samoa) if the value of foreign materials contained in the goods represents no more than 70 percent of the value of the finished product when landed in the United States. The total quantity of watches and watch movements which may enter into the United States free of duty during each year may not exceed one-ninth of estimated U.S. consumption of watch movements during the preceding year. Under this formula, in 1978

approximately 8 million watches and movements were eligible for duty-free entry from the insular possessions.

The Secretary of the Interior and the Secretary of Commerce, acting jointly, are authorized to allocate the total quota fairly and equitably among watch producers in the insular possessions. The Secretaries have the authority to issue regulations which seek to maximize the economic contribution to the insular possessions generated by trade under Headnote 3(a). Unfortunately, the Secretaries apparently have not construed their quota allocation authority also to permit consideration of the impact of such trade on the domestic industry, U.S. jobs and relations with our most favored trading partners.¹ Such issues may therefore be resolved only by appropriate legislation by the Congress.

Congress has long recognized the need to limit the scope of Headnote 3(a) by legislative amendment when the operation of this tariff loophole risked injury to the U.S. industry. In the mid-1960's, under Headnote 3(a) as then worded, it became apparent the potential for unlimited duty-free shipments of watches from the insular possessions raised a threat to the future viability of domestic watch production. Accordingly, in 1966 Congress amended the tariff schedules to limit duty-free watch shipments to no more than one-ninth of apparent U.S. consumption during the preceding year.

Timex believes eliminating duty-free trade in column 2 watches is unquestionably in the best interests of the U.S. Virgin Islands and the other insular possessions. However, today, as in 1966, the primary issue before the Congress is not how best to support the local Virgin Islands economy. The primary issue is how to avert the loss of thousands of American jobs through unfair competition from underpriced Russian watches—even if assemblers of such watches in the Virgin Islands were making a significant contribution to the local economy. One of the central benefits of the levy by Congress of special tariffs on products from column 2 countries is the protection these tariffs afford American workers and industry from unfair competition from products of state-controlled economies. The administration of Headnote 3(a) for the benefit of the Virgin Islands should be subservient to this general and far more important Congressional intent.

III. THE IMPACT OF SUCH IMPORTS UPON THE U.S. DOMESTIC WATCH INDUSTRY

The essential facts about the state of the remaining members of the U.S. watch industry are a matter of public record and probably well-known. Only a handful of companies remain. The jobs they provide for American workers have been declining for decades.

The remaining producers and jobs are essentially in three industry segments: final assemblers and casers of movements from our Free World trading partners (imported primarily from Western Europe

¹ Although the Departments of Commerce and the Interior have devoted substantial attention over the past year to the issue of Russian watch trade through the insular possessions, none of the proposed regulations published by the Departments offers an effective solution to the impact of such trade on the domestic watch industry. U.S. employment and competition from Free World exporting countries whose products normally enjoy preferential ("nondiscriminatory") tariff status. On the contrary, the proposed regulations have been limited to addressing what to domestic interests is clearly a secondary issue—the failure of Russian watch assemblers in the insular possessions to make a significant contribution in wages, taxes and purchases to the local economies.

and Japan), some U.S. electronics companies producing portions of nonconventional watches in this country, and Timex. While reliable data on the volumes of domestic production or numbers of employees are not available, Timex believes it is the largest remaining producer and the largest employer of watch production workers in the country. Persistent competition from the traditional foreign watch producers over the years has forced Timex to relocate more labor-intensive operations overseas. In the past 5 years, in the face of growing import penetration of the domestic market (see Appendix A), domestic employment engaged in the manufacture of Timex watches has declined by more than 20 percent. (See Appendix B.)

Timex production remaining in the United States consists basically of mass-produced nonjewelled mechanical watches. Suggested prices for these watches range from a low of \$12.95 (for one of our models) to a maximum of \$39.95. The average (by volume) for the entire domestic line is approximately \$20. Thousands of workers in Connecticut, Arkansas, and our other domestic locations, as well as many others who supply Timex with components and materials, depend upon the sale of these watches for their employment. (See Appendix C.) In addition to Timex employees and suppliers, thousands of additional U.S. workers are engaged in production of solid state watches (which are sold almost exclusively in the below-\$25 retail market) and in final assembly and casing of jewelled mechanical movements imported from Europe and Japan.

Today, in virtually every major U.S. retail market, 17-jewel watches originating in the U.S.S.R. and partially processed in the Virgin Islands are available at retail prices below those of the least expensive Timex watch. The Timetone brand, believed to be entirely routed here through the V.I. loophole, is widely listed at \$16.88, and almost as widely is discounted and offered for sale at retail at \$11.88 and \$9.88. Major chains such as J. M. Fields and Zavre are already merchandising Russian watches under the Timetone brand. The Cornavin brand, also of Russian origin, is available through the huge K-Mart chain of stores at \$12.88.

Chain stores of this type are the cornerstone for domestic distribution and sale of all watches under \$25 (whether jewelled, nonjewelled or solid state), including Timex watches. It is clear, therefore, that Russian watches are being placed in direct competition with Timex and virtually all other domestically produced watches, and that, purely as a result of price, importers of duty-free Russian watches are poised to capture a major share of the market (up to 8 million units annually out of a total approximate U.S. retail market for watches under \$25, including imports, of 25 million units).

A second comparison also demonstrates the competitive advantage now enjoyed by duty-free, low-priced Russian watches. In addition to its basic nonjewelled watches, Timex produces a line of higher-appeal 17-jewel watches imported duty-free through the Virgin Islands under Headnote 3(a). The suggested price for the least expensive of these Timex 17-jewel watches is \$29.95. Most sell for approximately \$40. This price differential between competitive Timex and Russian 17-jewel watches becomes even more intriguing when one considers the fact that Timex suggested prices for these products are kept low by

the production, marketing and distribution efficiencies of the volume which overall Timex watch sales generate in the United States. No U.S. producer or Free World exporter of mechanical watches retailing under \$25 can compete against the price differential created by duty-free entry of Russian watches. In fact, \$9.88 represents price parity with the cheapest plastic-cased digital watches which are now partially assembled in the United States. Funnelling into the domestic market of up to 8 million underpriced Russian 17-jewel watches annually is by far the greatest threat to the survival of remaining U.S. watch production.

IV. ONLY REMEDY

The U.S. watch industry urges that importers of watches from column 2 countries be prevented from utilizing Headnote 3(a). The appropriate change to the current text of Headnote 3(a) is set forth in Appendix D.

There is no measure short of eliminating this duty exemption which will place competition in the U.S. market on a fair and equitable basis. It has been suggested that it will suffice merely to require that some additional assembly operations be performed on Russian watches in the insular possessions in return for duty-free treatment. Such proposals assume that the additional expenditures thus required in the insular possessions will necessarily increase the U.S. retail price of the watch. With regard to watches produced in the U.S.S.R. and other column 2 countries, this is not the case. A state-controlled economy can freely manipulate downward the price of unfinished watches shipped to the insular possessions so as to offset the effect on U.S. selling price of any additional cost incurred in the insular possessions. Appendix E shows that even if labor costs of \$1 per watch were incurred (any higher labor cost requirement probably would jeopardize continued use of the Virgin Islands by any watch company), the landed price of the Russian watch in the United States could remain precisely the same. All that would be required is a corresponding reduction of 73 cents in the export price from the U.S.S.R. For a Free World watch exporter, such a reduction in price might be ruinous. But column 2 countries are not market-controlled. The profit requirement does not exist as a rationalizing factor. Consequently, watch movements in virtually any state of assembly will be sold at any price required to achieve the substituted objective (initial) penetration of a lucrative U.S. market, exchange of goods for hard Western currencies, disposal of excess production, etc.).

Congress in its wisdom has sought to avoid injury to domestic producers from the market practices of state-controlled economies through the imposition of column 2 tariffs. The American watch industry requests no less protection, but no more.

In fact, if the current column 2 tariff loophole is eliminated as proposed the U.S.S.R. and importers of Russian watches may decide to continue to compete in the U.S. market by importing watches directly, paying the applicable column 2 duty. Recent official import statistics show a modicum of such direct trade exists already. Our proposal would not interfere with or abridge such competition.

V. ADVANTAGES OF THE PROPOSAL TO THE INSULAR POSSESSIONS

If watches with parts from column 2 countries are dutied at full column 2 rates, the Virgin Islands watch industry will be a prime beneficiary. Our affiliate, TMX V.I. Inc. ("TMX") is the single largest watch industry employer in the Virgin Islands. TMX forecasts in 1978 a direct contribution of approximately \$1.3 million in payroll, purchases and various taxes to the local economy. The 1979 projection is for the direct injection into the Virgin Islands of roughly \$1.5 million. TMX anticipates shipping more watches from the Virgin Islands this year than last and an even greater number next year. Even with these planned increases, TMX would be prepared to increase production further if a market gap results from the elimination of trade in Russian watches. It is our understanding, moreover, that other companies who do not purchase Russian movements envision expanding their Virgin Islands operations (if duty-free trade in Russian watches is eliminated. Since their contribution to the local economy in the form of wages and taxes paid and supplies purchased is greater per watch often by as much as 10 to 1 over Russian producers, it is difficult to visualize any adverse effect of the proposal.

If, on the other hand, the proposal is not enacted, the consequences on the Virgin Islands could be severe. Under the value-added requirements for duty-free entry contained in Headnote 3(a), assembly of Russian movements offers the most profit. This is because Russian watches provide the lowest possible cost basis and because eligibility for duty-free treatment is determined by the difference between cost and landed value in the United States. Under competitive pressure, Timex itself and others might have no choice but to turn to Russian movements as a source of supply, with the consequent diminution in wages paid per unit assembled and in other contributions per unit to the local economy.

In short, the alternative to the legislation recommended herein seems clearly to be more Russian watches, but fewer American jobs and less stimulus to the economies of the insular possessions.

APPENDIX A

U.S. ANNUAL IMPORTS OF CASED WATCHES AND WATCH MOVEMENTS, 1973-77

Year:	Total (thousands of units)	Index (1973=100)
1973.....	22,695	100
1974.....	22,871	101
1975.....	21,408	94
1976.....	33,847	149
1977.....	37,808	166

Source: U.S. Department of Commerce.

APPENDIX B

DOWNWARD TREND IN NUMBER OF PERSONS EMPLOYED BY TIMEX AND AFFILIATES IN THE UNITED STATES IN WATCH-RELATED ACTIVITIES 1973-77

	1973	1974	1975	1976	1977
Direct.....	5,797	5,867	4,976	4,271	3,254
Indirect.....	3,803	4,169	4,000	4,082	4,174
Total.....	9,600	9,976	8,976	8,353	7,428

The decrease in the 5-year period is 2,172 employees. The percentage decrease is 22.6 percent.

APPENDIX C

1. 1977 Timex U.S. Watch Related Employment (see Appendix B) : 7,428.
2. Estimated Current Number of U.S. Workers Employed in the Production of Goods Purchased by Timex or Otherwise Dependent on Timex Watch Production: 6,475.
3. Current Total U.S. Labor Force Association with Timex Watch Production Affected by Import of Low-Priced Russian Watches: 13,903.¹

APPENDIX D

PROPOSED AMENDMENT TO HEADNOTE 3 (A)

The following language should be inserted as new subparagraph (iv) to General Headnote 3(a) of the Tariff Schedules of the United States:

No watch or watch movement containing any parts manufactured, assembled or otherwise processed in a country, all or some of the goods of which are subject to the rates of duty set forth in column numbered 2 of the schedules, shall be exempt from duty under this headnote 3(a), and any such watch or watch movement shall be subject to the rates of duty set forth in column numbered 2 of the schedules.

APPENDIX E

In the report accompanying Assistant Secretary of Commerce Frank A. Weil's response to Representative Charles A. Vanik, Chairman of the House Trade Subcommittee, dated March 6, 1978, it was stated that in 1977 the per unit landed price of Russian movements to Virgin Islands assemblers in the two most popular sizes was \$3.25. The

¹ We emphasize this figure does not include U.S. workers who are employed by companies assembling and casing imported movements, or U.S. electronics companies producing portions of nonconventional watches domestically. Indirect labor dependent on such companies is not known. There are thus thousands of U.S. jobs in addition to those associated with Timex which will be threatened as a result of growing sales of low-cost Russian movements.

table below demonstrates that by lowering the landed price of such movements by a mere 73 cents, the net cost will remain the same for these assemblers even if local labor content were increased to \$1 per movement. This would enable Russian watch assemblers in the Virgin Islands to sell movements to U.S. distributors at precisely the same price and with the same profit margin as existed in 1977 with only 10 cents local labor. A \$1 labor-added requirement would be, moreover, the maximum amount which could be imposed on Virgin Islands watch producers without severe disruption of the entire local industry. In fact, any amount above 60 cents would disqualify current producers of a sizeable portion of Virgin Islands watch production, including the largest single producer and employer.

In short, a requirement of increased contributions to the economy of the insular possessions does not represent a solution to the issue of primary concern—the funnelling of underpriced column 2 watches into the U.S. market.

COMPARISON OF 1977 TOTAL VIRGIN ISLANDS COSTS BETWEEN RUSSIAN MOVEMENTS REQUIRING \$0.10 LOCAL LABOR AND \$1 LOCAL LABOR PER MOVEMENT

	U.S.S.R. movement	
	With \$0.10 local labor	With \$1 local labor
Costs:		
Landed cost.....	\$3.25	\$2.52
Virgin Islands import duty (6 percent).....	.20	.15
Local labor costs.....	.10	1.00
Fringe benefits related to labor costs (10 percent).....	.01	.10
Virgin Islands tax (3 percent of foreign materials costs).....	.10	.08
Gross receipts tax (2 percent of final selling price of \$4.64).....	.09	.09
Total cost.....	3.75	3.94
Virgin Islands Government subsidies¹:		
Duty subsidy.....	.01	.10
Excise subsidy.....	.01	.05
Gross receipts (exemption).....	.01	.07
Total subsidies.....	.03	.22
Total net cost.....	3.72	3.72

¹ Where labor content is \$1, Virgin Islands duty subsidies and excise subsidies are 67.5 percent of Virgin Island import duty and excise tax respectively. The gross receipts exemption is 75 percent of the Virgin Islands gross receipts tax. When labor content is \$0.10, Virgin Islands duty subsidies and excise subsidies are 6.75 percent, and the gross receipts exemption is 7.5 percent.

HAMEL, PARK, McCABE & SAUNDERS,
Washington, D.C., September 27, 1978.

Att.: David Foster.

Mr. MICHAEL STERN,
Staff Director, Committee on Finance, Dirksen Senate Office Building,
Washington, D.C.

DEAR Mr. STERN: The following comments are submitted in response to your press release No. 65 of August 21, 1978 soliciting comments with respect to the impact on the economies of the U.S. Virgin Islands, Guam and other U.S. possessions of the assembly in the Virgin Islands and Guam of low-labor Russian movements. Our letter is late due to circumstances in Switzerland beyond our control but is submitted nevertheless as authorized by your staff.

These comments are submitted on behalf of Progress Watch Co., Inc., a Virgin Islands corporation engaged in the assembly on St. Croix of watch movements of Swiss origin. I am counsel to Progress Watch Co., Inc. Progress is owned 25 percent by Eurotime Corp. of New York and 75 percent by Ronda S.A. of Switzerland, the world's largest manufacturer of watch parts.

Progress believes that the assembly of low-labor Russian movements in the U.S. Virgin Islands and Guam is contrary to the intent of General Headnote 3(a) and is, as long as it continues, seriously adverse to the interests of the Virgin Islands people and their economy and to the interests of the people and economies of Guam and other U.S. possessions where watch assembly work has been or could be done. Millions of Russian movements have been and are being assembled in the Virgin Islands and Guam (particularly in the last 3 calendar years) and these low-labor Russian movements have necessarily cut deeply into the market for conventionally assembled movements such as Progress Watch Co. and others produced or could produce in the U.S. possessions.

It is also true that there are less strong companies assembling movements in the U.S. Virgin Islands (and we believe in Guam) which prefer not to assemble low-labor Russian movements but have had to do so because their customers have required them to furnish low-labor Russian movements which cost less to produce and therefore sell for less than conventionally assembled movements. It has also been said that the pricing of the Russian movements amounts to dumping—an allegation which we have not attempted to verify. The assembly of low-labor Russian movements, in short, is a spreading blight that must somehow be eliminated. Employment in the Virgin Islands watch assembly industry (and we believe in Guam) can only increase if the assembly of low-labor Russian movements is somehow foreclosed. Many more regular movements would be produced—probably nearly as many more as the low-labor Russian movements now assembled—and many additional people would have to be employed to produce

them—many, many more people than have been required to produce the very low-labor Russian movements.

It is a certainty, insofar as the management of Progress Watch is concerned, that Progress would this year have employed many more Virgin Islanders were it not for the in-roads made by the low-labor Russian movements. Even though Progress still hopes and intends to complete its quota for the year, Progress' production and shipments to date are behind what Progress anticipated they would be at this time in the year. Orders that surely would otherwise have gone to Progress have been siphoned away by the low-labor Russian movements and Progress is behind schedule accordingly.

Perhaps equally as significant is the under-utilization of Progress' production capacity so far this year. As of a month ago Progress had achieved a production capacity of 50,000 to 60,000 units per month depending upon the caliber and execution of the movement or movements being assembled. Progress very much wants to put this production capacity, and more if necessary, to its full use on a year-round basis. The surest way that can happen would be for the U.S. Congress to redress the unfair advantage enjoyed by the low-labor Russian movements, an unfair advantage which, though never intended, has steadily insinuated itself into the Virgin Islands and Guam watch assembly pictures with ever-increasing impact (Guam we believe, is now entirely given over to the assembly of Russian movements).

It should be stated, of course, that the problem is not the Russian origin of the movements. It is rather that the Russian movements require virtually no assembly, and therefore relatively very little Virgin Islands or Guam Labor. In fact, we have been advised that the movements arrive on the Virgin Islands (and perhaps Guam) fully assembled and are then in small measure partially disassembled before delivery to assemblers who merely replace the few parts that have been disconnected. Surely such an evasion or circumvention was never intended by headnote 3(a).

One resolution of the problem would be a flat requirement that so much specified assembly work be done if a movement is to qualify for duty-free treatment under headnote 3(a). Another solution that we understand has been considered would be Column II tariff treatment of Russian origin movements. Either of these legislative routes would be satisfactory from Progress' standpoint. Perhaps some other legislative solution is being considered in addition. If it would also accomplish the purpose, it would similarly be fully supported by Progress.

It is of the utmost importance, however, that something be done as promptly as possible and, hopefully, yet this year; that is, before the Congress adjourns sine die. As has been detailed above, the situation is steadily worsening. Less strong companies are being pressured into more and more Russian movement production which weakens them still further and the stronger companies, such as Progress, are also suffering increasingly accordingly: The real loser, however (to return to the main point and purpose of headnote 3(a)), is the Virgin Islands economy and the Virgin Islands people and the people and economies of Guam and other U.S. possessions.

With kind regard.

Sincerely,

HENRY ROEMER MCPHIEE.