

OVERSIGHT OF THE TRADE ACT OF 1988

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

SUPER 301—FOREIGN TRADE BARRIERS

AND

SPECIAL 301—PROTECTION OF INTELLECTUAL PROPERTY
RIGHTS

MAY 3 AND JUNE 14, 1989

(Part 3 of 3)



Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

21-705

WASHINGTON : 1989

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S361-52

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OVERSIGHT OF THE TRADE ACT OF 1988

WEDNESDAY, MAY 3, 1989

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 10:07 a.m. in room SD-215, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Also present: Senators Moynihan, Baucus, Bradley, Riegle, Rockefeller, Daschle, Packwood, Roth, Danforth, Chafee, Heinz, Durenberger, and Symms.

[The press release announcing the hearing follows:]

[Press Release No. H-19, April 18, 1989]

SENATOR BENTSEN ANNOUNCES THIRD IN SERIES OF OVERSIGHT HEARINGS ON THE TRADE ACT OF 1988

WASHINGTON, DC—Senator Lloyd Bentsen (D., Texas), Chairman, announced the third in a series of hearings on oversight of the Omnibus Trade and Competitiveness Act of 1988.

The hearing is scheduled for 10 a.m. on Wednesday, May 3, 1989 in room SD-215 of the Dirksen Senate Office Building.

"The 1988 Omnibus Trade and Competitiveness Act requires the U.S. Trade Representative to issue the National Trade Estimate report on foreign trade barriers by the end of April," Bentsen said.

"The Congress intended this report to be a key event in the Administration's implementation of the Act, because a number of significant trade policy decisions will be based on the information and analysis of foreign countries' practices made in the report," Bentsen said.

"The timing of this hearing will give the Committee an excellent opportunity to examine and discuss the report and the upcoming policy decisions, including the priority country designations under Super 301 that USTR must make by May 30," Bentsen said.

OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM TEXAS, CHAIRMAN, SENATE FINANCE COMMITTEE

The CHAIRMAN. This hearing will come to order.

We are meeting at a very critical time. What is the best way to deal with this country's worsening position on trade? A few years ago, nobody knew. Business took one position, labor took another. You had the administration on one tack, and the Congress on another. And trade and commercial considerations usually took a back seat to some foreign policy objective of the moment. Arguments over protectionism and free trade got in the way of finding fair and practical means of dealing with our trade difficulties.

For some time now there has been a growing consensus on trade policy, both within the Government and in the business and labor communities. The consensus that we are beginning to move toward

is that this country needs an export-oriented trade policy, one that expands world trade. That is a priority not just for the United States but for the entire international community. The importance of implementing that policy points up how critical the decisions are that must be made in the coming weeks.

Nations are a little like members of a basketball team: Sometimes they can't decide whether to shoot or pass off. They know they have to play like a team, but would it really hurt if they tried just this one shot?

But free nations have to cooperate with each other, whether it is the free exchange of ideas or goods and services, we need fair and just rules of conduct. Do we want to achieve our common goal, expanding world trade? Then we have to play like a team. That is why it is so disturbing to see some of our trading partners uncommitted to improving overall trade. They continue to follow practices designed to enrich their economies at the expense of others.

Despite the decline in the value of the dollar, the U.S. trade deficit has failed to improve significantly. One country, Japan, has accounted for most of this continued imbalance. The Japanese share of the trade deficit in our country increased from 35 percent to 40 percent last year, and to 45 percent in February of this year.

Now, I don't discount the problems in our own economy that contribute to the trade deficit, but it is also clear that a large measure of our inability to trade with Japan and other such countries is the continued presence of enormous and pervasive barriers to foreign products.

A small measure of those kinds of barriers is indicated by the 42 submissions on Super 301 made to the USTR by a wide variety of U.S. corporations and labor organizations. Some of these organizations and businesses came forward notwithstanding the possibility of retaliation in the countries in which they are doing business.

Among the questions that we will be facing today is whether we need to move immediately against all Super 301 violators, or whether Ambassador Hills needs some additional flexibility as she negotiates with them.

Meanwhile, I think one thing is really clear: We need a greater awareness and sensitivity in foreign capitals to the legitimate trade concerns of the United States. Lacking that kind of resolve abroad, we will have to act in our own behalf.

Do we want to play like a team? Sure, we do. But if nobody else does, we will likely wind up on the bench.

Ambassador Hills, we have selected this day for a hearing on the implementation of the Trade Act, because of the imminence of some of the very crucial decisions that have to be made later this month. And with the many demands on your time, we are particularly appreciative of having you here today.

I would like to defer now to the ranking minority member, the distinguished Senator from the State of Oregon.

**OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR
FROM OREGON**

Senator PACKWOOD. Madame Ambassador, I have a solution for you. You list all of the countries and all of the practices that are

listed in the National Trade Estimate—all of them, so that it is kind of an insult to be left off the list, rather than having been put on it. You clearly don't have the personnel to pursue 301s on all of those, so you have to come to a committee and ask us for substantial increases in your budget in order to pursue this.

We will then say no, that we don't want to pursue them all; but you should pursue the ones that you think are most important. But then you simply have to pursue them administratively, having listed everybody as malefactors. And that way, I think you are completely out of the problem of who's on and who's off, and what's on and what's off.'

Now, obviously that is half in jest. From the standpoint of politics and fairness, you have got to list some countries, and we have all talked to you about which ones we think those are. You have got to decide, if you list two or three, will that satisfy Congress? If you list 50, it is too many, probably.

I just hope, in weighing your decision, that you pick the most egregious practices. Clearly, telecommunications and intellectual property are specified separately, and you have got to give those a different consideration; but if you bend to every one of us that calls you, on every practice that might have some unique character, then you would have to list more than the major egregious practices. If you can list the major ones, and win significantly on those, I have a feeling that a great many other moderate and minor ones will start to fall into place more rapidly than we think they might.

The CHAIRMAN. I am going to ask my colleagues to defer their opening statements because of the limitations of time this morning, and wanting to hear Ambassador Hills. Then, in turn, you will each have your opportunity to ask questions of her.

Ambassador Hills, if you will, proceed.

STATEMENT OF HON. CARLA A. HILLS, U.S. TRADE REPRESENTATIVE

Ambassador HILLS. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, I have filed a written statement that deals with the National Trade Estimates Report and those provisions to which you have referred, known as "Super" and "Special" 301. With your permission, I would simply summarize the written statement.

The CHAIRMAN. Without objection, that will be done.

Ambassador HILLS. The administration's trade policy goals are to liberalize trade globally through the successful conclusion of the Uruguay Round negotiations, and to broaden access to foreign markets by removing formal and informal barriers to U.S. goods and services.

We will energetically use Super and Special 301 as well as other negotiating tools provided in the act.

The trade interests of all nations, including those of the United States, are best served by a global trading system with clear and enforceable rules, applied equally to all participants.

The global trading system today is often strained by disputes involving unfair trade practices, denial of market access, and viola-

tions of trade agreement obligations. Such disputes occur most frequently where GATT rules are weak or non-existent.

Our energies in the Uruguay Round are directed to establishing rules in areas where they now do not exist or are ineffective. Thus, we seek:

To achieve multilateral agricultural reform;

To expand the scope of international rules to cover trade and services, protection of intellectual property rights, and trade-related investment measures;

To reduce or eliminate tariff and non-tariff barriers; and to strengthen and reinforce the credibility of the GATT by integrating developing countries into the trading system, addressing the problems of subsidies, improving the rules related to import relief, and enhancing dispute settlement procedures in the GATT as an institution.

But until we can achieve our goals for the Uruguay Round, we must work within an imperfect system and take what steps we can to protect U.S. trading interests.

We will use the negotiating tools contained in the 1988 Act vigorously but, hopefully, constructively to open markets, combat unfair trade practices, and persuade our trading partners to honor agreements.

On Friday, ahead of the statutory schedule, USTR filed the National Trade Estimates Report, which identifies significant trade barriers affecting goods, services, investment, and intellectual property rights. The report provides, where feasible, quantitative estimates of the effects of foreign practices upon U.S. exports. It also provides information on what actions the United States is taking to eliminate those barriers.

The National Trade Estimates Report results from a comprehensive interagency effort to gather information. It classifies trade barriers into eight different categories, and this year's report covers 34 countries and two regional trading bodies, which represents our largest and most promising overseas markets.

The report has been and will continue to be a valuable source of information concerning the existence and extent of foreign trade barriers and a useful tool in helping the administration identify which of those barriers we will devote our resources to trying to eliminate.

The report is one of the sources of information we will be using to evaluate priority practices of priority countries for designation under the Super 301 provisions. In addition, the USTR-chaired interagency process will review advice from the private sector and from Congress, as well as the results of consultations with our trading partners, to determine which practices should be the subject of self-initiated investigations.

I will submit to the Congress by May 30 our list of trade liberalizing priorities as required by the statute. I will identify by that same date the most onerous or egregious foreign country policies that deny adequate and effective protection of intellectual property rights or market access for intellectual property products.

I want to assure you that the administration will use the new Section 301 provisions to maximum effect to pry open foreign markets for U.S. exports. I also want to assure you, and at the same

time our trading partners, that we will administer the Super 301 and Special 301 provisions in a manner that strengthens the global trading system and increases the trading opportunities for all nations and not as a tool of protectionism.

I view this hearing as an important continuation of the consultative process that we have followed and from which I have benefited. And I welcome your views on the implementation of the 88 provisions.

[Ambassador Hills' prepared statement appears in the appendix.]

The CHAIRMAN. Thank you, Ms. Hills.

The arrival list is: Senators Baucus, Riegle, Symms, Danforth, Packwood, Heinz, Roth, Chafee, and Rockefeller.

I have been reading in the newspapers that there is quite a trade dispute taking place within the administration itself as to what our trade policy should be. And then I note the "Economist" writing that it looks like we may finally see an emerging trade policy on the part of the United States.

On the other hand, I see the Chairman of the Economic Advisors, yesterday in the Wall Street Journal, saying that, if we wind up with a series of retaliatory measures with our trade partners, it will not only cause a recession in the United States but it could cause a worldwide recession. Do you agree with Mr. Boskin?

Ambassador HILLS. None of us, not one person on this committee, nor I, nor Dr. Boskin, want to retaliate. If we are successful in our negotiations, we will not have to retaliate. What you have given us is the leverage to have more successful negotiations to carry out the administration's trade policy, which is to open markets and expand trade.

The CHAIRMAN. Well answered, Ms. Hills. I totally agree. What we are talking about here is actually a trade liberalization program.

I think about this measure and how it was approved in this committee. Everyone on the committee, as I recall, voted for it, except for two members, and they didn't vote for it because they didn't think it was tough enough.

So, what we are talking about here is a liberalization of trade and trying to develop a consistent trade policy for our country, not some kind of ad hoc response, where our trading partners also know where they stand.

Isn't it true—we are talking about Super 301—that the priority country designation just starts the case, and you still have all the safeguards of Section 301: the 2-year time limit, mandatory retaliation only for violation of trade agreements. Aren't those, in general, the provisions of it?

One of the other concerns, of course, is with the trade agreements that we have with Japan. Over the last 10 years the United States has entered into a great many trade agreements with Japan. I am not talking about the general agreements like GATT itself, but we have special agreements to open up specific sectors, such as telecommunications, lumber, pharmaceuticals, financial markets, baseball bats, semiconductors—many others—but it has been difficult to negotiate those agreements and even more difficult to enforce them. And Japan has been in violation of some of them.

Do you see these agreements as enforceable under Super 301? Or is Japan somehow immunized from Super 301 in areas where they have a special agreement with us?

Ambassador HILLS. We will look at trade agreements with any of our trading partners that are allegedly in breach, evaluate whether they are in breach, and, if they are, take action as required by the statute. We neither treat Japan differently or more harshly. We try to deal with our trading partners evenly, and our trade strategy is to cause markets to open for the international trading system, not just for the United States, so as to expand trade. And that is our goal with respect to negotiations that will follow this 301 consultative process.

The CHAIRMAN. In looking at the priority country designations under the Special 301 for intellectual property, you are allowed by the Trade Act to consider how cooperative a country has been in the negotiations that you have undertaken with it. Have you found this tool to be helpful in trying to get greater cooperation?

Ambassador HILLS. There is flexibility in the Special 301, which deals with the intellectual property protection that we are trying to secure, both in the Uruguay Round and with our trading partners. We have found that there is leverage to begin to negotiate, and that those provisions do provide leverage. We will know at the end of the day how successful we can be with that leverage.

The CHAIRMAN. Ambassador, in connection with debating the Trade Bill, we heard the figure of \$100 million having been spent to lobby the Congress and the executive branch. And I can imagine our doing the same to the Japanese Diet or the parliaments of Europe.

But now that we are talking about designation of countries under Super 301, is the same crowd back?

Ambassador HILLS. We have had a good number of visitors. [Laughter.]

The CHAIRMAN. Thank you very much.

Senator SYMMS. Mr. Chairman, could I ask unanimous consent to submit my remarks in the record, and an additional article?

The CHAIRMAN. Certainly, and any of the other members who would like to.

Senator SYMMS. I apologize to the Chair, and I will give up my time. I had some remarks here that were favorable to one of our trading partners, Taiwan, but I will insert them in the record.

The CHAIRMAN. All right. We are delighted to have them.

Senator SYMMS. I have an amendment to manage on the floor.

The CHAIRMAN. I see. All right.

The first arrival, Senator Baucus.

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

Senator BAUCUS. Thank you, Mr. Chairman.

Ambassador Hills, in view of recent remarks in the press, particularly by Dr. Boskin and others, I think it is important to underline what Super 301 is and what it is not.

As you known, Super 301 is not a market-protecting measure, it is a market-opening measure. That is, those of us who wrote Sec-

tion 301 did not write it to protect certain American industries or to protect an American position. We wrote it to open up foreign markets in the name of freer trade, so that we Americans could send more products overseas and be more accepted overseas. It is a market-opening provision; it is not a market-closing provisions.

So, those who talk about protectionism or say that Super 301 is bashing a certain country, I think, have not read the statute. As you know, by May 30 of this year, you are to designate—according to your judgment—certain countries as priority countries. There is then an 18-month period within which the USTR investigates and negotiates with a country that you might name, a full 18-month period to negotiate. There is no retaliation during this time.

As you know, the statute provides that by November 30, 1990, this government must enter into some agreement with a priority country, and that country over the next 3 years can either open up its market or pay reparations, according to whatever agreement is negotiated by November 30, 1990.

So, as a practical matter, we have until the end of the 3-year period or more, within which the United States and a priority country, pursuant to an agreement, can work out the differences and address the problems as we see them—that is, that a country is closing their markets to our products.

So it is important to emphasize that first this is a market-opening provision; and, second, there is a long period, virtually up to 5 years, within which we can work out our differences.

It is also important to realize that various objective third parties have named Japan as a country that is still much too closed. For example, as you know, the Brookings Institute and the Institute for International Economics, have both basically concluded that Japan is about 35 to 40 percent more closed than it should be for a country as developed as it is. And there are all kinds of other indicators.

So it is clear, for the Dr. Boskins and the others of the world, to recognize that, again, this is a market-opening procedure.

What I would like to ask is, what possible different alternatives do you see, hypothetically, if Japan, Taiwan, Korea, and some other countries are named? That is, how do you think they should be named in order to, in the most constructive way, begin to work out ways to reduce those countries' trade barriers? Because I think the real question there is not "whether" certain countries should be named, the real question is "how" they are named, and in what manner.

I would like to ask you what various ways can you think of to name a country, in order to promote not only the breaking down of these barriers but to do it in a way that is very constructive?

Ambassador HILLS. Senator Baucus, we are required to evaluate priority practices and priority countries, and we must make a judgment based upon the information that we have gotten in response to our Federal Register notice, as well as from our private sector advisors, comments from Congress and various industry groups that have communicated with us, to determine whether the country should be cited, whether the practice should be cited, or whether countries and practices should be cited.

You are correct, in our interpretation, this is a market-opening device. That is how we interpret your statutory mandate.

I would say that the time-frames are much shorter than you have alluded to—it is 12 months for most practices, 18 months for an agreement which has a dispute mechanism, and many of our agreements do not have dispute mechanisms—so that, within 12 months we would have to have a resolution, and that has caused both our trading partners and others looking at the statute to wonder, where the practices have been longstanding, whether we will be skilled enough and persuasive enough to be able to negotiate changes within that 12-month period before we must take action.

We will be trying very hard to do just that. The only reason I mention it is because I did not want you to think that we had 5 years before we took action. That is really not the case.

Senator BAUCUS. No, I didn't say there was 5 years before taking action; I said that, at least with respect to priority countries where there is a dispute mechanism in place, it is 18 months, to November 30, 1990. And then, under the law, there is a 3-year period within which the United States and a particular country work out their differences.

Ambassador HILLS. Yes.

Senator BAUCUS. As a practical matter, in your best judgment, what credibility does this country have if this government does not name countries which, in the eyes of most people, should be named?

Senator PACKWOOD. I didn't hear the question, Max.

Senator BAUCUS. As a practical matter, what credibility will this country have in enforcing its trade laws if the major countries are not named?

Ambassador HILLS. This country will gain credibility from doing a good analytical job that stands on its analysis, and that is what we are in the midst of doing.

Senator BAUCUS. Thank you.

The CHAIRMAN. Thank you.

Madame Ambassador, you said that there were "some" people calling on you. I think that is somewhat of an understatement. But I think it is of interest to note that, of the 12 cameras here, a majority of them represent Asian countries rather than our own country. So, what happens is of great interest to the rest of the world.

Next is Senator Riegle.

**OPENING STATEMENT OF HON. DONALD W. RIEGLE, JR., A U.S.
SENATOR FROM MICHIGAN**

Senator RIEGLE. Thank you, Mr. Chairman.

I would like to share some thoughts with you this morning, as you approach the end of this very important decision process that you are in the middle of.

I want to stress what I consider to be the enormous strategic importance of the job that you have and the decisions that you now have to make under Super 301.

When you take a look at our net debtor position as a nation, at the end of 1987 our net foreign debt position—we had, of course,

become a debtor nation—was about \$400 billion. At the end of last year the figure had grown to about \$500 billion, and the New York Federal Reserve Board is estimating that by 1992 we are going to be a net debtor to the rest of the world to the tune of roughly \$1 trillion. This is just an astronomical change in national economic circumstance that no one can fully comprehend the meaning of, because it is without precedent in our modern experience.

If you take a look at the annual trade deficits with Japan, particularly, in 1986 the trade deficit was \$58.6 billion; in 1987, \$59.8 billion; in 1988, \$55.4 billion. Based on the first 2 months of this year—and, of course, you don't know how relevant that will be to a 12-month run—we are running at \$48.9 billion. So, there is some drop, but I think quite modest, and it may well be that even that is designed in certain ways to try to influence the Super 301 designations.

But if we run at the January and February rate for the full year, that will bring us out at a point where the total net deficit, the trade deficit with Japan for 1986, 1987, 1988, and what would then be 1989 would be a figure of \$225 billion, in their favor. I mean, it just really takes your breath away when you think about a deficit of that size with another modern industrial nation, whose needs are much like ours in terms of what they must consume, to run that kind of a pattern.

I have a chart behind me—I won't go through it—that shows the dominance of Japan, and others that are sort of copying the Japan model, over a period of years, in terms of the build-up of this huge trade deficit.

I think it really threatens our future. I think we are talking here about a strategic impact on our future that is as dangerous as a military threat, in fact probably more so because it is easier to identify a military threat; an economic threat is a more insidious kind of threat.

I am concerned because I sense that there is a full-court press going on. I don't say to you—and I think you are a person of great strength; you have demonstrated that over the years in other capacities, as well—but I sense that our government today is under great pressure, lobbying pressure, by foreign countries not to make the 301 list.

I can tell you, as one of the two principal authors of that section, along with Senator Danforth here, that, speaking for myself, my intention clearly was to identify specifically Japan, but other countries like Japan, modern industrial nations that continue to run these enormous, perpetual trade surpluses.

When you look behind the patterns that have led to those persistent surpluses, I think you find dozens and dozens and dozens of unfair trading practices, of all manners and sorts.

I don't know if you have had a chance to see the article by James Fallows in *Atlantic Magazine*—there is a lot being written on the trade issue. I think this is about as good a piece as has been done in terms of going down to a deeper level of analysis as to why it is manifestly in the interest of the Japanese, as they see it, to trade in the international marketplace the way they do, which has accrued these enormous advantages to them and disadvantages to us.

I don't know what all the pressures will be that will come to bear between now and the end of this month. I can see a lot of it already in the news, and people scurrying around, and so forth. If Japan is not on the list, it seems to me the Trade Bill has sort of been dropped in the ash can, and I don't think we can afford to let that happen. I don't think, if we are going to protect our future, that we can allow that to happen.

So I would hope that any of those pressures that come your way, that you will be absolutely tough as nails about it. You certainly will have the backing, I think, of people here, regardless of party, who feel that this issue has to be dealt with.

The reason we have the Super 301 procedure, the reason we have a Trade Bill, is that this country did not act for a very long period of time as these enormous deficits have been run up.

So, my hope would be, as you come down to the wire on this thing, that, without being contentious about it—nobody wants to be contentious—you pursue our interests with trading partners like Japan, Korea, Taiwan, West Germany, and others, in a way that takes us to a common future that is good for all parties. That is where we ought to be heading.

But clearly, if we don't confront the pervasive trade barriers using the Super 301 procedure, we are going to find ourselves so weakened in the future that we won't have the strength to do it.

So I urge you to stand very strong on this thing. You will have a lot of people who will stand with you and will work with you constructively to try to find good answers from that point forward.

I thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

[The prepared statement of Senator Riegle appears in the appendix.]

Senator Danforth?

OPENING STATEMENT OF HON. JOHN C. DANFORTH, A U.S. SENATOR FROM MISSOURI

Senator DANFORTH. Ambassador Hills, this is truly an unusual hearing, if in fact it is a hearing at all. I arrived here right on time, and I was the fifth Senator to be here. More than half the members of the Finance Committee showed up in the first 20 minutes, and we showed up to talk about something that hasn't even gone into effect yet, Super 301.

So, I don't think we are really here to ask you questions in the manner of a typical congressional hearing. I think we are here in such numbers and with such forceful feelings because we really want to convey to you the importance that we attach to the implementation of Super 301.

We believe that Super 301 is not just important but that it is very important. We believe that the first use of Super 301, the implementation of it in its first year, isn't just important but that it is very important. Many of us view Super 301 as the last best hope for America to engage in a liberal trading policy on a successful basis.

I am asked over and over again, as I am sure you are, whether America is going protectionist. I think that the answer to that

question is no, provided that we can manage successfully the public sentiment about international trade. I don't think that we can ward off the forces of protectionism if government gives the impression that it is going to be passive or minimalist in its approach to very serious problems. I think we can avoid protectionism "if" we aggressively attempt to open up the markets of other countries, and that is what Super 301 gives us the opportunity to do.

We came here more to talk to you than to hear from you, I think; but I was encouraged to hear your opening statement, when you said that the administration will "energetically use"—I think those were your words—Super 301, and that you will "vigorously" use this tool to open up markets of other countries. I think, and I believe all of us think, that that vigorous use of Super 301 is really essential.

I have said to you before, with respect to Japan, that when we wrote this legislation, we did not have just Japan in mind. This legislation was not an effort to "pick on" Japan. It was not an effort to single out Japan. It was much more broadly-written than that. But while we did not have just Japan in mind, we had no less than Japan in mind.

So, some of us today—Senator Riegle, today, Senator Baucus and I in a letter that we wrote to you a week or so ago—indicated to you that we would be indeed amazed if Japan, with its whole panoply of trade barriers, is not included in the list.

I would say, finally, that my own hope and my own expectation would be that, as the administration approaches the implementation of this very, very important provision of our trade law, that it would focus both on specific barriers and specific problems we have in international trade—for example, supercomputers and the difficulty of selling them—and on broader issues, generic problems, generic barriers, such as, for example, the difficulty of penetrating Japan's closed distribution system.

I think that your opportunities here are very real. Senator Bentsen pointed out the cameras that were present—really an amazing array of cameras. I think what this indicates is that you, Ambassador Hills and the administration, right now are on center stage. The spotlight is on you, and the cameras are on, and we are watching. We are very, very attentive. A minimalist, legalistic approach to Super 301 is going to be something that we are going to note, and an effort to use this provision to enter the markets of other countries is also something that we are going to note. This is now up to you, and we take your actions very, very seriously.

The CHAIRMAN. Thank you, Senator Danforth.

Senator Packwood?

Senator PACKWOOD. Madame Ambassador, in your opinion, what do you think the effect of naming a country will be on their attitude toward continued negotiations in the Uruguay Round?

Ambassador HILLS. Senator, I think it depends on the country, and the circumstances, and the practice. It is very hard to give a single answer to the reaction of trading partners to the prospect of being identified as a priority country. There is great concern expressed by some, and by others, more belligerence, perhaps.

Senator PACKWOOD. Belligerence in the sense that they say, "Oh, well, the heck with it. We are not going to negotiate anymore, in

Uruguay or any place else, if this is the way we are going to be treated?"

Ambassador HILLS. Some nations' trade ministers have suggested that actions of this sort run contrary to the philosophy of the Uruguay Round, which is to negotiate in a multilateral fashion; and, as there are only 18 months left for the multilateral negotiations, some have questioned, the merits of our moving ahead unilaterally on a standard that has not been agreed to by all of our trading partners. And of course, as we have not moved nor have we specified a particular standard, there is general anxiety.

I can tell you that the standards that we will try to negotiate will be entirely consistent with the Uruguay Round, that we feel very keenly that the world's trading system will be enhanced by success in those 15 areas that we seek to bring within the disciplines of the GATT. And if we are successful in the Uruguay Round, all of the trading practices that have been enumerated in our National Trade Estimates Report would be addressed.

So, clearly, a success in the Uruguay Round is our top priority, and I choose to use the 301 tools as supportive of that priority. I am hearing from the members of this committee that, indeed, there is no intention to mandate a closure of the market. We hope, indeed, that there will be no retaliation, so that what we are embarking upon is a negotiation. The timeframe may be somewhat shorter than the Uruguay Round, but in that period statutorily allotted to us we will hope to obtain advance adoption of the liberalizing principles of the Round.

Senator PACKWOOD. It seems to me that this is the kind of thing you have to weigh, and this is where this committee has got to be tolerant if, on occasion, you don't list something.

Say you have got country A that has an absolutely egregious practice in agriculture. They get wind of the fact that you are going to list them, and they say, "Well, in that case, we are just not interested in pursuing any further intellectual property in the Uruguay Round"—which is also a goal that we wish to achieve. And they may be serious about the threat; you have had enough trouble getting this Round to even approach intellectual property.

I think that a fair consideration, when you are weighing the listing of countries and practices, is, what is the greatest good for the greatest number? At least I am one who is going to be sympathetic to some of those balances that you are going to have to make.

Ambassador HILLS. I appreciate that.

Senator PACKWOOD. I have no other questions, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Heinz?

OPENING STATEMENT OF HON. JOHN HEINZ, A U.S. SENATOR FROM PENNSYLVANIA

Senator HEINZ. Thank you, Mr. Chairman.

Ambassador Hills, I spent last week in Japan. They have obviously got a great deal of interest in this hearing. I am recovered from jet lag, almost.

When I was in Japan, the subject which I raised, and which they raised, was, repeatedly, "Well, what is going to happen to Japan on Super 301?"

I explained that if the United States found that there were countries, not including Japan, that had serious trade-distorting practices—barriers to market access—and that we intended to list them; then the Japanese with the vast array of market barriers they have, should be realistic about being listed. A case in point, of course, was semiconductors, which so far no one has talked about.

It seems to me that the semiconductor case is about as clear a case as can be: first, of a market barrier; second, of a trade agreement that is broken and not fixed—our retaliation remains in place—and third, our objective remains unfulfilled, at least as I have heard you describe it to this committee and in other fora. If that isn't grounds for listing under Super 301, what is?

Ambassador HILLS. We will follow the statutory authority. You will note in the Trade Estimates Report that we have mentioned the sector to which you allude. We will analyze it.

Senator HEINZ. Well, I did ask a more specific question.

If we have requested market access and we haven't gotten it, if we have promised market access and the promise has been broken, and if we have felt so strongly about it that we have retaliated, and the reason for the retaliation still is in effect, can you make a stronger case for a country being listed than that generic case? And if so, what is the stronger case you can make? What would be worse than having both a lack of market access and promises having been made that are broken?

Ambassador HILLS. Well, as you mentioned, we have a 301 action that we proceeded on, and we have sanctions outstanding. I think it behooves us to evaluate what is the appropriate recourse in that circumstance.

Obviously, we could increase the sanctions. We can commence again to negotiate. These are the things we are evaluating, Senator. I am very pleased to get your suggestion that there is no other course.

Senator HEINZ. No, I didn't say there is no other course. We have had a lot of statements today, and I am prepared to make one, but I was actually asking a question. I know this probably caught you off guard. [Laughter.]

Now let me make a statement. No answer is required to this—apparently it wasn't required before.

My concern—and I think Jack Danforth was getting at this in his comments—is that the Super 301 process is turning into an attempt by the administration to head off a very strong retaliatory response by the United States, following the wishes of the American people, by the Congress, against people who continue to keep their markets closed.

In my judgment, the American people do not want business as usual. They are sick and tired of excuses. They are particularly fed up with people blaming America. Example: Three years ago everybody said the dollar was too high; now it is half what it was, and we still have very substantial trade deficits with, among other countries, Japan. And what they want are something other than meaningless commitments and promises. As an example of "mean-

ingless commitments and promises," read "semiconductors," and a number of other things as well.

What our constituents, what the American people, obviously want, and we hope you are going to be able to get, are the kind of answers that are spelled "results."

I think the results are critical because, unless we get them, I can foresee trade being "the" issue in the 1992 elections. You have got 2 years to show results from the time of your listing at the end of May.

Two years puts us right in the middle of the first session of the next Congress. And without those results, I can see Congress saying, "We have got a large trade deficit, we have some unjustifiably large bilateral trade deficits"—say, \$55 billion with Japan—"we are concerned that such countries are taking advantage of the open trading system and contributing very little to it, we are concerned about the loss of economically strategic sectors—be they semiconductors, aerospace, high-definition television spin-offs, or other high-value high-tech areas." And what you are likely to see, irrespective of what we would all like as the alternative, is the strongest possible retaliatory response that would make the Gephardt Amendment look like a very soft and wishy-washy approach.

I have no desire, Madame Ambassador, to see us end up in that spot; but I do think an enormous amount of responsibility rides on your shoulders, because it is your success or lack of it—and we want you to succeed—that will determine whether or not we have that kind of all-out response here on Capitol Hill and with the American people.

Good luck to you.

The CHAIRMAN. Thank you, Senator Heinz.
Senator Roth?

**OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S.
SENATOR FROM DELAWARE**

Senator ROTH. Thank you, Mr. Chairman.

First I want to start out by saying I have great confidence in you. I think what you have said and done today demonstrates both your toughness and brightness.

I want to say, at the same time, that I am a strong supporter of Super 301, for the reasons you listed. It gives you bargaining power, and that will be critically important as you proceed to open up markets and not move the protectionist way.

But I want to say at the same time—and I essentially agree with what has been said before—that I am not persuaded that Super 301 is going to answer all our problems.

Much of our imbalance, as Senator Riegle pointed out, comes in the Pacific Basin, particularly Japan, but other Pacific Rim nations as well. And I am not persuaded, as I know many others or are not, that we necessarily are going to solve the problems of the trade deficit on a sector-by-sector, product-by-product basis, because, frankly, I think many of the difficulties are of other types.

In the case of Japan, for example, I suspect it is partly cultural. There is a, shall we say, "Buy Japanese" syndrome, one that we once had back in the thirties, ourselves. In addition, Senator Dan-

forth pointed out a second problem, the problem of Japan's distribution system.

The reason I mention these, and they are two examples, is that they do not necessarily fall within violation of GATT. At the same time, it is critically important, as I think Senator Heinz very eloquently underscored, that progress be made. If we don't make progress or it is perceived as not making progress, the situation can get uglier and uglier, with bashing Japan and other countries on this side and, frankly, bashing America on the other side.

In my judgment, that would be a tragedy. It would be a tragedy because, number one, the Pacific Basin is the fastest-growing area. We not only want to reduce and eliminate the trade deficit but we want to share in the growth, so that it helps us create jobs and a better standard of living.

Now, the reason I go through all of this, Carla, relates to the legislation we also proposed, a sense of the Senate resolution which was unanimously adopted in this committee. The resolution called for a summit conference at which Japan's Prime Minister, Finance Minister and Members of the Diet, and the equivalent here, meet in an effort to address all of the problems. The conference would cover not just those practices that are violating GATT and the various sections on a sector-by-sector basis. We would really try to maximize our progress—not just to attack individual problems. And some of those are critically important, such as in the high-tech area.

I would urge you and the administration to look at this approach. I wouldn't say now, because of the political problems the Japanese are having. But I really think that the time may come, to avoid alienation and lack of progress, that we might very well find it in our interest to have a summit conference at which we address these problems in some fashion and try to bring them to an orderly and friendly conclusion.

I, like everyone else, talked too long; but I wonder if you would care to comment on that?

Ambassador HILLS. Senator, our efforts in the Uruguay Round are to have a major consultation amongst 96 nations, and pressures from outside the United States help us accomplish our goals. Those pressures help us as well as for others. It helps us liberalize the trading system, and we move not just for the United States but for the global trading system.

So the consultative process, which goes on in regions as well as bilaterally, and with 96 nations in the GATT, really carries out what you are recommending. We we need the help of our other trading partners to address problems that we face from lack of market access.

We have seen the positive effect of multilateralism in our negotiations in Geneva. That has enabled us to get greater market access. We will continue to use it, and in regions where we can get pluralized help, if you will, in solving problems of market access.

Senator ROTH. Well, my time is up, Mr. Chairman.

Just let me conclude that I, like you, hope that in the Uruguay Round we can resolve many of these problems. But what I am saying is that I see the time where we will have to sit down together with the leaders, particularly in the case of Japan but possibly

others as well, and seek some means of addressing the problems in an orderly manner, in order to prevent the kind of alienation I think has been demonstrated could happen if progress is not made.

Thank you, Mr. Chairman.

**OPENING STATEMENT OF HON. JOHN H. CHAFEE, A U.S. SENATOR
FROM RHODE ISLAND**

Senator CHAFEE. Thank you, Mr. Chairman.

Ambassador Hills, I think you have got one of the most difficult jobs in this administration, and I think you are the right person for it.

I believe in the vigorous enforcement of 301, and I think some of the nations out there have been particularly egregious. I share the concern that has been voiced about Japan, and South Korea, probably. I notice in the Chambers list they also include Brazil and India as the nations they think are abusing and restricting the entrance of American products unfairly.

I also think we want to make it clear that a trade surplus doesn't necessarily mean that a nation is involved in unfair trade practices. I don't think the fact that we have a trade surplus with Australia means that we are being unfair.

But I think that where the real challenge for your job comes in what you say on page 8 of your testimony, and that is in reconciling your efforts to proceed in the multilateral trade negotiations while trying to negotiate the bilateral solutions under 301, and you are confronted, as you say, with a Hobson's choice.

I think it is important that we not lose sight of the principal goal, the long-range goal for the benefit of our country, which I think is to be involved in a system of international rules, which we seek to expand under the Uruguay Round, and there get coverage of intellectual property, of services, and other activities that aren't currently covered.

So, I want to enlist as an ally to you in your efforts to pursue the new GATT round, realizing that you are confronted with some very, very difficult choices there.

I believe it is in the best long-range interest of our country to have that international multilateral agreement with as many nations as possible. I want to encourage you in that direction and say that we are conscious of the challenges and the difficulties you face as you try to balance these two, sometimes different objectives or results that you might achieve as a result of trying to pursue the 301 in the Uruguay Round.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Rockefeller?

**OPENING STATEMENT OF HON. JOHN D. ROCKEFELLER, IV, A U.S.
SENATOR FROM WEST VIRGINIA**

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Ambassador Hills, we have been waiting a long time in the Finance Committee for the kind of opening statement that you gave, with a toughness and resolute attitude.

I strongly support the idea, and urge you, to include Japan under Super 301. The National Trade Estimate list for Japan is really

quite extraordinary, in terms of the variety of barriers and unfair and hidden trade practices that exist there. It covers a sweeping area of issues.

I agree strongly with Senator Heinz that I would find the absence of semiconductors on the final designation list to be disturbing. I think if that is not included—that is, the commitment to a 20-percent market share by 1991 the Japanese will take it as a sign that we are not serious about semiconductors, and I think the health of the semiconductor industry is essential to this nation's future.

I understand the arguments: that it is not just trade, it is macroeconomics that is at the heart of our problems; it is not just Japan, it is what we have to do; you can't blame the Japanese or the Koreans for the fact that we don't save enough, or that we won't reduce our budget deficit. I think, by the way, that our budget agreement with the White House, frankly, is a sham, and I would like that to be noted.

But I think we could do more research and development, we could do much more aggressive exporting, we could improve our education, we could do all this and much more in the United States—all the things the Japanese criticize us for not doing—and we could do all of them well, and it would still not have a substantial effect on Japan's trading practices or our ability to sell there.

I think making a substantial impact is what Super 301 is all about. That is why we created it. Section 301 was part of our law but was not used to deal with unfair trading practices, except for the last 2 years of the previous administration. And since it wasn't used, the American people's frustration grew, Japan became the symbol of it, a fair symbol of it because of their prosperity. Japan is now co-equal to us economically; their average wage is higher than that of people in our country. Our frustration grew, and we created, as a tool for you and for the White House, Super 301. It must be used.

Where do we want to go in this country? Are we going to return to the days when the State Department, the Defense Department and the National Security Council decided what the bilateral relationship between the United States and Japan was going to look like? Or, with the new muscle that Secretary Mosbacher, you, and others have shown, will we make sure that trade and international economics become part of our definition of national security, and accept that these are fundamental elements of our international security?

If you do designate Japan under Super 301, it will not be easy for them. They are culturally strongly constrained. It is difficult for them to change. They are homogeneous, like no other nation in the world. They took very few Vietnamese refugees after the Vietnam War. They are the way they are because they choose to be that way. Ever since the Meiji Restoration, there has been a century-plus continuity of strategic planning. They always plan strategically. They always know what they are doing. And they will only bend when they understand that the other side truly means business and intends to take strong measures to develop a fair and equal bilateral relationship.

So, I think your decision on whether or not to include Japan under Super 301 is an important definition of our future relationship with Japan.

I should also say that I recognize that if Japan is designated under Super 301, and if barriers fall and markets open, it is still not guaranteed that the United States will rush in to take advantage of those new opportunities. We have much work to do to improve our own international competitiveness. Our market is open; we are accessible; we are the world's greatest market. The Japanese depend on us, yet their market is not available to us and the rest of the world in the way that it should be.

So, I encourage you to include Japan as a way to establish a constructive, long-term bilateral relationship. I think it will be a more honest one, and it will be a more effective one, and I wish you well in your consideration of this problem.

The CHAIRMAN. Thank you.
Senator Daschle?

**OPENING STATEMENT OF HON. THOMAS A. DASCHLE, A U.S.
SENATOR FROM SOUTH DAKOTA**

Senator DASCHLE. Thank you, Mr. Chairman.

I find myself in agreement with much that has been said this morning, especially with the statement that you are in a difficult position, not only because of the difficult decisions you have to make with regard to the selection of specific countries; but, in my view, much more difficult and far-reaching is how you, as USTR, interpret the law for the first time, how you take the process and make it an objective process.

I am concerned that we not take this whole Super 301 question and apply the pornography definition, which is, "I know it when I see it, but don't ask me to put it on paper." And I am concerned that, as we go through this process, objectivity be a very high priority.

In that regard, as I was reading your testimony—I am sorry I missed your oral presentation of it; it is an excellent document—and as I consider the criteria, in my view, there is a vagary about the criteria that maybe you could clarify further. You indicate that the NTE with its eight different categories will be a primary source by which one judges unfair trade practices. You also say that the priority practices in Super 301, the advice from the private sector and from Congress, will also guide your decisions with regard to the selection of those countries.

It seems to me that countries may be wondering: What are the rules? And are the rules going to apply in each and every case to all of us equally? How is this process, in other words, going to affect each and every one of us? And can we be assured that there will be objectivity and uniformity in the application of Super 301 as it goes from one country to the next?"

Could you address that, briefly?

Ambassador HILLS. Senator, you are right, because the statutory standards are relatively subjective, and we are going to have to put an objective interpretation into the standards which talk in terms

of a "major impediment to trade." That is why we are trying to be so careful in our analysis.

We are taking all of the problems that have been brought to our attention, all of the problems of market accessibility, of investment that have been brought to our attention, to try to get a sensible analysis of what is truly a barrier that can be brought down, an egregious barrier that can be brought down, and can provide maximum access to the United States. But when you read the statute, it is not without its flexibility in interpretation.

Senator DASCHLE. Well, you will be setting some very important precedents, obviously, in what you do, precedents that will probably have a great deal to do with decisions made long after all of us are gone. That is why I think it is important, as we consider this process, that to the maximum degree possible we set down some criteria by which everyone knows what the rules are.

Is it correct to interpret what you have indicated this morning, that the NTE, to the extent that there are delineated criteria, will be your primary guide by which you make these decisions?

Ambassador HILLS. An enormous amount of work went into the NTE, and it is certainly a very principal source of what actions we will take. We have listed eight categories of practices. We have listed them with respect to 34 countries and two trading areas, and we have tried to be uniform in our evaluation. We have looked at restrictions with respect to market access; we have tried to be uniform in how we looked at those restrictions. We have looked at the failure to provide protection of intellectual property. We have tried to be uniform in our standard, using our model from the Uruguay Round.

So, yes, I do think that this book, the National Trade Estimates Report, is enormously helpful in identifying the universe; which is not to say that it will be exclusive. We do receive comments from American industry, oftentimes well documented, and clearly we would not ignore such an analysis that was put before us. But a great deal of work has gone into this, drawing on the comments here, to this date received, and drawing on letters and comments from the Congress, and drawing on the expertise that has been developed over the years at USTR and Commerce, and utilizing the inter-agency process.

So we have tried to bring all of our knowledge to bear, and we will try to implement the statutory mandate in a clear and objective way, to the extent that we possibly can.

Senator DASCHLE. I am out of time.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Durenberger?

Senator DURENBERGER. Mr. Chairman, I take it my opening statement will be made a part of the record at this point?

The CHAIRMAN. That will be done.

Senator DURENBERGER. Ambassador Hills, some economic historians suggest that the United States and Japan have sort of been in a teacher-pupil relationship since the end of World War II, and we are now in that very difficult period when the pupil seems to be outdistancing the teacher.

We know that in the fifties one of our great quality-control experts, Edward Demming, went to Japan and showed the Japanese the virtues of total quality-control systems; the Japanese came to our automobile assembly plants during that same time, and they learned about the efficiency in manufacturing automobiles. In many of our high technology areas we have been the technology leaders, and the Japanese have piggy-backed that expertise in marketing and developing products.

Given that history, which I take it we all agree with, in the U.S.-Japan technology transfer, I want to ask you a couple of questions.

First, if the Japanese were just setting out today to develop the supercomputer industry, would you think it advisable for the United States to allow either Cray or IBM to enter into a joint development project with a Japanese company to build supercomputers?

Ambassador HILLS. We have a free enterprise system in this country, Senator. What we are asking of our trading partners is market access. What I hear in the bitterness that is being expressed this morning about some of our trading partners, is a resentment that they do not let us into their market. I think that the philosophy in what we are trying to accomplish through the Uruguay Round multilateral negotiations is to provide access with respect to investment.

We resist when a foreign country says we can only take a minority interest in one of their concerns or puts up barriers on technology transfer. We ourselves have restrictions where it is in our national interest for defense purposes, and we utilize those restrictions and have in fact blocked joint efforts or investment in this country.

But I as well as the Secretaries of Commerce and Defense would have to look at all of the facts if the Cray company wanted to engage in a joint venture with the Japanese, to see what sort of technology would be flowing in this direction and what was in the terms of the contract that someone as bright as John Rollwagen, who has built that company, thought he was going to get from the transaction. I think it would be very shallow of me to say today, without knowing what the terms were—

Senator DURENBERGER. Excuse me. I am just trying to get at the issue of predictability. I mean, we have the ability now to estimate the direction in which the Japanese are headed. The question is designed—and I will ask you a follow-on question—is designed to say, have we learned anything about which we can then predict what is going to happen in supercomputers?

Given Japan's long history of building on our technological advances, why do you think it is in our best economic interests as a nation to enter into a joint development of the FSX? Why is it in our best interest?

Ambassador HILLS. Well, the globe is becoming smaller. When we look at the quantum of U.S. contribution to aerospace built overseas, it is growing. The aerospace industry has favored opening up of joint development, partly because of the astronomic cost of new generations of aircraft, partly because trading partners often have technology that is superior. It is like any contractual obligation: there are many facts that go into making a decision and

many reasons why the contracting parties think that they have an advantage in developing a joint venture.

Senator DURENBERGER. My last question: On page 103 of the National Trade Estimates you provide a detailed history of the failed attempts by American supercomputer companies to break into the Japanese public sector market. I will just quote from page 103. It says: "The first formal annual review of the Agreement"—that is the August 1987 Agreement—" in October of 1988 found U.S. companies still face severe obstacles in Japan supercomputer procurements. No foreign sales have been made or are expected in the near term under the new procedures."

Since that review, one of the two American supercomputer companies has gone belly-up—Control Data's ETA subsidiary. So the only remaining true supercomputer company in the United States is also a Minnesota company, Cray, and it faces intense competition all over the world from three giants, Japanese—Hitachi, Fujitsu, and NEC.

Michael Smith, who used to be the Deputy US Trade Representative, recently wrote in the Post that the Japanese big three have systematically discounted their supercomputers to the Japanese public agencies by as much as 90 percent of list price. My question is: Given those facts, given the predatory pricing strategy, why should the U.S. Government allow these companies to bid on U.S. Government contracts?

Ambassador HILLS. We practice, in most areas of our economy, an open-bidding system, and we are urging upon our trading partners that they emulate our open practice, so we do not have any specific bar, save in areas which are limited by reasons of strategic interests.

Senator DURENBERGER. Thank you. I see my time has expired.

The CHAIRMAN. Thank you, Senator.

Senator Moynihan?

OPENING STATEMENT OF HON. DANIEL P. MOYNIHAN, A U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. Thank you, Mr. Chairman.

I wonder if I might walk through some of the larger numbers involved here and see if you share the view, which I have, for example, and to start with the question of the pricing, if that is the term, of the dollar?

In the 8 years of the previous administration, the United States tripled its national debt. In constant dollars, in those 8 years of Mr. Reagan's term, we borrowed almost as much money as we borrowed during the Second World War, and all we have to show for it is Grenada. [Laughter.]

Senator MOYNIHAN. But I think it is agreed, Ambassador, that there was a large amount of foreign borrowing, that we had to borrow abroad, to maintain the deficit here in Federal activities. And I gather you would agree.

Ambassador HILLS. Yes.

Senator MOYNIHAN. Yes.

Ambassador HILLS. Well, I wouldn't say that we have borrowed from abroad; we have imported foreign capital, Senator, to fill the

gap between our savings here at home, which has fallen 4 percentage points in the last decade and a half, and the spending, which has been excessive, both Federal and——

Senator MOYNIHAN. Granted. But the savings dropped because the Federal Government, being the borrower of first resort, had used up the savings to finance the deficit. Those are economics, and you agree. [Laughter.]

Is it not the case that the trade deficit is the reciprocal, which is to say exactly equal to the amount of borrowing abroad?

Ambassador HILLS. Yes, Senator, you are absolutely right, and I was so hoping someone would say that this morning.

Senator MOYNIHAN. As much as we borrow abroad, that will be our trade deficit.

Ambassador HILLS. That is correct.

Senator MOYNIHAN. And if you continue to run a \$300 billion Federal deficit, as we are now doing, you are going to be borrowing abroad, and you are going to have a trade deficit. Isn't that right? Pretty much right. Ambassador Hills. The trade deficit is the gap between our savings and our spending.

Senator MOYNIHAN. Yes.

Ambassador HILLS. Now, we could spend at a high rate if we would save more. But we have fallen off in savings. Now, the Federal deficit is simply Federal dissavings.

Senator MOYNIHAN. It is Federal dissavings, right.

Ambassador HILLS. But, in addition, I would call to your attention that in the past we as a nation have saved far more. So we did not have to go abroad to finance our investments; but we could dip into our national savings to finance our investment.

Senator MOYNIHAN. Exactly. That was the normal assumption since about 1916.

But could I ask, is it not the case that in 1981 we had a trade surplus on current account?

Ambassador HILLS. You are right.

Senator MOYNIHAN. Do we have to think that the world broke out in protectionism in the next 50 months, or American industry collapsed? Isn't it really the case that the dollar appreciated 80 percent in 50 months?

Ambassador HILLS. The dollar did appreciate.

Senator MOYNIHAN. In direct correlation with the borrowing to make up for the deficits of the 1980's.

Ambassador HILLS. There is a correlation.

Senator MOYNIHAN. Well, it seems to me we are looking in the wrong direction for an awful lot of our troubles.

Ambassador HILLS. I could not agree more. I could tell you quite honestly that we could open all the markets that we have enumerated, and it would not correct our trade deficit. And I do think we make a mistake not to tell the American people that.

Of course we need to open our markets, because we want to have expanded trade, and we want our factories to be humming at the top rate, and we want the correction in our trade deficit, the gap between our savings and our spending to be shrunk in the context of export expansion, not import contraction.

Senator MOYNIHAN. Right.

Ambassador HILLS. But to tell the American people, "If we open these various markets, the trade deficit will go away," that is not true.

Senator MOYNIHAN. Because we are still borrowing to finance our own deficits.

Ambassador HILLS. Our deficit is the product of broader economic factors than are barriers to trade.

Senator MOYNIHAN. Right.

Ambassador HILLS. The barriers to trade contribute only a very small amount to our trade deficit, which does not mean that the barriers must not be brought down or that it is not imperative that we get market access.

Senator MOYNIHAN. But it is not sufficient. Yes.

Ambassador HILLS. It doesn't take care of that particular problem: the trade deficit.

Senator MOYNIHAN. I couldn't more agree, and thank you for saying it.

Could I ask one last question? Isn't it the case today that about one-third of the goods imported into the United States are under some kind of restriction or other?

Ambassador HILLS. About 20 percent, I believe.

Senator MOYNIHAN. Didn't most of that take place in the 1980s? I would guess it is a little higher, but you would know better than I. It is a lot.

Ambassador HILLS. A lot.

Senator MOYNIHAN. And that took place in response to those trade deficits which were in response to the budget deficits. And again, you circle around. We grew protectionist much more than the rest of the world, I think, in the 1980's.

Ambassador HILLS. Well, I wouldn't go that far.

Senator MOYNIHAN. You probably shouldn't, in your job. [Laughter.]

Thank you very much, Ambassador.

Ambassador HILLS. Thank you, Senator.

The CHAIRMAN. Thank you.

Senator Bradley?

OPENING STATEMENT OF HON. BILL BRADLEY, A U.S. SENATOR FROM NEW JERSEY

Senator BRADLEY. Thank you very much, Mr. Chairman.

Ms. Hills, let me follow on with Senator Moynihan's analysis about the causes of the trade deficit, and get to your opinion of some of the suggested remedies.

As you know, a very volatile issue is the issue of foreign investment in the United States. Some people see a very big trade deficit and say, "Well, what we have to do about this is, we have to prevent foreign investment from coming into the United States."

What would be the impact of limiting foreign investment in the United States? What would be the impact on jobs? What would be the impact on interest rates? What would be the impact on the economy as a whole, given these very large budget deficits and very large trade deficits?

Ambassador HILLS. I think it would be disastrous. We would have plants and factories closed which now are the product of foreign investment. If that investment left our country, our interest rates would go up, because we would have to bid higher for other foreign capital to come in and fill the gap between our savings and our investment. Our savings are just too low to handle it today by ourselves.

And even worse, because we are one of the largest importing nations in the world, we could almost predict that if we were to restrict investment here by others, others would turn around and restrict our investment.

Senator BRADLEY. And do we have more investment abroad, in real investment, than foreigners have in this country?

Ambassador HILLS. Yes, we do.

Senator BRADLEY. So we have more to be hurt?

Ambassador HILLS. Exactly.

Senator BRADLEY. If we cut off the inflow from abroad in terms of capital, what would happen to interest rates in this country?

Ambassador HILLS. They would go skyrocketing.

Senator BRADLEY. And when interest rates skyrocketed, what would happen to the economy?

Ambassador HILLS. Well, we would be, obviously, in a very dire strait, and I think we could predict import contraction, which just is another word for recession.

Senator BRADLEY. So, you would advise us to go slow, if we looked toward a remedy to our current account and budget deficit problem with restricting the flow of foreign capital and investment to the United States? You would say go slow, because you are playing with fire?

Ambassador HILLS. I would say that our goal is to have an open market for goods and capital. I would not slowly limit investment here; I would not limit investment here.

Senator BRADLEY. Thank you.

Let me go on to another subject. When you consider what countries will be under the Super 301 provisions, what weight do you give to bilateral trade balances between the United States and another country?

Ambassador HILLS. It is a factor that is considered because of the legislative mandate, and we are just now, having done this work to gather together all of the data, analyzing the kinds of facts that will enable us to make a sound and, as suggested, a more objective selection of the priorities. So, although it is a factor, I can't give you the weight.

Senator BRADLEY. What if a country had a bilateral surplus with us but gigantic deficit with the rest of the world? Does it make sense to look at the overall trade balance, or to focus on the bilateral balance?

Ambassador HILLS. We are looking at all factors. But you must understand that the legislative criteria is that we should cite the countries and the practices which will have the maximum opportunity for export from this country.

Senator BRADLEY. From your perspective, is a multilateral trade balance or a bilateral trade balance a better gauge of unfair trading practices?

Ambassador HILLS. The deficits here and abroad are a product of broader economic forces than trade barriers. You know, Rumania has a surplus.

Senator BRADLEY. Would you suggest that, in addition to reporting the bilateral current account deficit with a country or surplus with a country, it is also appropriate to look at the multilateral deficit or surplus of the country?

Ambassador HILLS. I think it is appropriate to look at all factors. But, for the purposes of 301, we are looking at access by United States' entrepreneurs to a specific market, really focusing on barriers to entry. And mind you, I think that to liberalize the trading system, so that the entrepreneurs in the United States as well as in other parts of our global trading system can maximize the efficiency to get their goods into markets, is highly important.

I just am suggesting to this committee that trade efficiency will not erase the trade deficit; that the trade deficit is a product of broader economic factors—the rate of savings, the rate of spending, taxes, interest, and the like. And were there any message to be given to the American people, it is a recognition that we as a nation really must save more, which means that the Federal Government must spend less, but also that the American people must save more.

Senator BRADLEY. Thank you.

The CHAIRMAN. Thank you very much.

Madame Ambassador, nearly every member of this committee has been here at some time this morning, in spite of all the competing demands for their time. I think that shows the intense interest we have. Sometimes you determine the number of members by how many cameras are present; but in this instance every camera has been pointed toward you, as they should be. But they are here because they think this is one of the most difficult problems facing our nation.

It is true, a good part of the problem is what we have done to ourselves insofar as savings and budget control and not doing the proper things on productivity and education. But those aren't your responsibility; your responsibility is that of trade. It is a many-faceted problem, and part of it is barriers to trade.

Now, the most successful of our trading partners has been Japan, and there is no question that there are all kinds of barriers to our products going in there. That could be forgiven if it was a small struggling country, but this is the number two economic power in the world.

When I visit with the Japanese, they say, "Well, the budget deficit is your problem, and that is why you have the trade deficit." That is too simple an answer. It is a contributing factor, but we also have to look at the level of burden-sharing in this country in the defense of the democracies. If we spent the same percentage of our GNP as the Japanese on defense, we wouldn't have a budget deficit; but I think the free world would have a crisis if that was the case, and particularly an island empire that depends on trading as much as the Japanese and is so dependent on free sea lanes.

The Japanese Government had a chance to buy our fighter aircraft off the shelf, the world's most advanced fighter. It wasn't a problem of cultural differences, it was a conscious decision on the

part of the Japanese Government. They chose not to do that. Had they done it, they would have made a very major impact on the trade deficit and a great impression, I think, on the Executive Branch, the Congress, and the American people. That was not their decision. That is their prerogative; but we have to understand that they are working very much in their self-interest, I think sometimes in short-range interest, because I think it is important for all of us to expand world trade and to work to bring down those barriers. And that is the purpose of Super 301.

I believe the Japanese have been the most effective of lobbyists that I have run into insofar as legislation. They have been able to retain some of the best minds in Washington, and some of the most experienced, and they are going to try to put their point of view across.

Some who try to make these points about trying to cut the trade deficit will automatically be charged with "Japan bashing." I really don't think that is the case. I think we are working for our self-interest, too, and I believe that self-interest requires the use of this tool to try to break down those barriers, whether it is Japan or any other country around the world, and that is the purpose of this legislation and the responsibility with which you are faced. We will obviously be watching with a great deal of interest.

Are there any other comments?

Senator RIEGLE. Mr. Chairman?

The CHAIRMAN. We do have a panel yet to come.

Senator RIEGLE. I understand. If you would indulge me for just a minute, there was one point that Senator Bradley raised. I didn't want to ask him to yield on his time, because we have only had one round today; but I would not want the impression left, at least without one other speaking, that foreign investment in the United States by itself, if carried to ultimate extreme, is somehow always a good thing for the United States.

I think in a balanced situation it has a value, but if you were to take the argument to its ultimate extreme, and if in effect, over a long period of time, we find ourselves where a very substantial part of the means of production in this country or the income-earning assets of this country become owned by foreign investors, then there are very serious implications that go with that, both in terms of how they operate those assets over a period of time and, very importantly, where the income stream, where the profit goes from those investments.

So I think, in terms of the normal flow of funds today with respect to the need to accommodate our overly large deficit and so forth, we need to maintain the flow of funds. But I want to file a very strong view that, if there is any suggestion left that for the next 5, 10, 15, 20, 30 years we can rely on foreign investment in the United States to solve our problem, then I would want to file a very strong dissent from that.

I think that is a subject for another time, but I want to make sure there is another point of view on the table.

I thank the Chairman.

The CHAIRMAN. I well understand that.

Senator BRADLEY. Mr. Chairman?

The CHAIRMAN. Yes, Senator Bradley?

Senator BRADLEY. I would like to hear Ms. Hills comment on what the Senator has said; but my reaction is, "You tell me when the budget deficit is going to drop, and I will tell you pretty much when foreign investment is going to drop."

Ms. Hills, I would like to hear your comment.

Ambassador HILLS. If we were to save more, we would correct our budget deficit, because we would shrink the gap between our savings and our investment. Until we do that, we are going to import foreign capital—from Japan, from Europe, from someplace—because we don't have it at home, by definition. Our savings is not there to fill the gap. And whether we sell some goods or some hotels or some real estate, we have to sell something; that is where we get our foreign investment.

So, the way to correct the need to import foreign capital is to have our Nation produce more and to save more.

Senator RIEGLE. I understand that, and I agree with that point. Let me pose a related question: The Japanese trade surplus with the United States over the last 3 years, and assuming that the trend of the first 2 months continues over the remainder of this year, is a quarter of a trillion dollars. It is \$225 billion.

In terms of foreign investment coming back into the United States—I am talking about permanent, long-term investment over that same period of time from the Japanese—do you have any idea what it is?

Senator BRADLEY. And compare it with the English and the Dutch.

The CHAIRMAN. Gentlemen——

Senator RIEGLE. I am not sure this is the time to get into a debate between the members on this subject, but I would like an answer to the question, if you have it.

The CHAIRMAN. Well, the Chairman has some ideas on this subject, too; but I really would like to limit this if we can. We have a very distinguished group of business people to testify yet this morning, and I would like to get to them.

But why don't you try to answer the question, in brief, if you will?

Ambassador HILLS. I am apprised that direct investment data for 1988 is not yet available. However, for the 3 years ending in 1987, the United States received \$34.7 billion in indirect investment inflows from Britain, \$16.5 billion from Japan and \$14.9 billion for the Netherlands. If U.S. direct investment outflows to these countries are subtracted, the net direct investment inflow to the United States was \$19.7 billion from Britain, \$10.7 billion from Japan and \$6.8 billion for the Netherlands.

Senator RIEGLE. Yes, that is a very important fact. I would just make the point, in sort of closing, because I am mindful of the time and getting to the other panel, which is that there is an enormous net capital dis-investment taking place in the United States in the direction of Japan, because of the enormous trade surplus that they maintain with us.

I don't argue that the Federal budget deficit is not an important factor that relates to that, that a low savings rate is a factor that relates to that; but predatory trading practices that are sucking capital in multi-billion dollar amounts out of this country is a very

important fact. And to suggest that somehow, over some stretch of time, we can solve that problem simply by having foreign interests come in as a result of predatory trading practices and buy U.S. assets, and to leave any hint or suggestion that this is a satisfactory or sound long-term solution, I think is just nonsense.

I just want to make sure that at least there is a dissent filed if there is a suggestion that that is really a long-term answer to our problem.

The CHAIRMAN. Well, I would say to the gentlemen that in the short run it would be absolutely disastrous if we deterred foreign investment in this country, and in the long run it would also be disastrous if we were totally dependent on foreign investment.

Ambassador HILLS. I agree with that.

The CHAIRMAN. Are there other comments?

Senator MOYNIHAN. Con brio. [Laughter.]

The CHAIRMAN. I think it has been a good session, and we are most pleased to have you. Thank you very much for your attendance, Ambassador Hills.

Ambassador HILLS. Thank you, Mr. Chairman.

The CHAIRMAN. Next we have a panel of business groups who have submitted recommendations to USTR to designate certain countries under Super 301.

We tried to find some witnesses for American businesses who did not want Super 301 implemented. They may be somewhere out there. Maybe they didn't like the forum, or maybe there are just no such American businesses; but we weren't able to find them for this occasion.

Would the witnesses please come forward?

[Pause.]

The CHAIRMAN. Mr. Archey, you have been a leader on these issues, and I don't see any reason to stop now. Why don't you lead off?

STATEMENT OF WILLIAM T. ARCHEY, VICE PRESIDENT, INTERNATIONAL, U.S. CHAMBER OF COMMERCE, WASHINGTON, DC

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

As you know, the U.S. Chamber was a strong supporter of the 1988 Trade Act. We disagree with the critics who maintain that it is protectionist; rather, we see it as the Congress intended, to be aimed at opening markets, not closing them.

However, the Chamber also believes that a successful trade policy must begin, rather than end, with the enactment of trade legislation. Last November, the Chamber's Board of Directors specifically recommended to the Bush administration that they vigorously enforce the new trade law, including its Super 301 provisions.

The Chamber strongly supports aggressive use of Super 301 procedures to obtain trade liberalization agreements with certain designated countries. We do not view Super 301 and the other market-access provisions in the Trade Act as simply a series of "hit lists." The ultimate objective of Super 301 is not to punish other countries by erecting new barriers to their exports. Instead, as the legislative history of the provision states, Congress intended for Super 301 to be used to open markets and not to close them. Achievement of

this objective will benefit not only U.S. exporters but also exporters from third nations and, indeed, consumers in restricted markets who pay higher prices as a result of trade restrictions. Moreover, Super 301 also requires the Executive Branch to focus more clearly on elevating trade policy to a priority consistent with other foreign policy and national security interests.

Mr. Chairman, although it is not in my prepared statement, I would like to take note of something that I think captures the intent of Super 301, the intent of the trade bill, and perhaps fundamentally suggest some altering of U.S. trade policy. And that is from a new book, just out, by Peter Drucker called "The New Realities." There is an excerpt of it, and I am just going to briefly quote from it, from this month's Business Month magazine, just out yesterday.

This is from Mr. Drucker. I also might want to note, I don't know of anyone who has ever accused Mr. Drucker of being a protectionist. I don't think anyone has ever called him soft on free trade, or some of those issues, but he says:

The emergence of new non-Western trading countries, foremost Japan, creates what I would call adversarial trade. Complementary trade seeks to establish a partnership—that was trade, he was noting, in the 19th century. "Competitive trade aims at creating a customer; adversarial trade aims at dominating an industry. Complementary trade is a courtship; competitive trade is fighting a battle. Adversarial trade aims at winning the war by destroying the enemy's army and its capacity to fight.

The Japanese felt so backward, and indeed were for a long time, as to have to keep out foreign competition. This led, step by step, to adversarial trade in which the aim is to gain market control by destroying the enemy or to obtain such predominance in a market that it would be almost impossible for a newcomer to challenge the market leader.

The aim in adversarial trade is to drive the competitor out of the market altogether, rather than to let the competitor survive. When the attacking country is closed to imports, or at least severely restricts them, the competitor under attack cannot effectively counterattack. It cannot win. It will, at best, not lose everything.

Adversarial trade thus challenges the conventional assumptions. Clearly, protectionism that shuts off one's economy is the wrong answer; it can only make one's own industry even less competitive. But free trade is not the answer, either.

One answer is to form economic regions or blocks: the economic merger of the European Community planned for 1992; the North American Free Trade Zone, which the 1988 U.S.-Canada Free Trade Agreement is trying to create; and, perhaps in the future, a Japanese-centered Pacific Rim Region. This would give smaller economies the large region and market needed to create the critical mass of production and sales to be competitive.

Regionalism creates a unit capable of a trade policy that transcends both protectionism and free trade. It creates a unit capable of reciprocity, and reciprocity is clearly the only trade policy that can work in a world economy that features adversarial trade. Free trade can work under reciprocity, but only if the other side reciprocates. But there will be protectionism, if that is what either side chooses.

Under reciprocity, either country's business would enjoy the same degree of access to the other country's markets, and no more. Indeed, reciprocity is the only way to prevent the world economy from regressing into extreme protectionism. Reciprocity is emerging fast as the new integrating principle of the world economy. It is fast becoming the policy of the United States in choosing for its economic relations with Japan, Korea, and Brazil.

Reciprocity is thus likely to become the vehicle for the integration of the world economy, just as competitive trade was the vehicle for the integration of the international economy during the past 150 years.

Mr. Chairman, whether one subscribes to Mr. Drucker's views or not, and I happen to subscribe to a good part of that, I happen to think that, basically, Super 301, the trade bill, are in fact an at-

tempt at perhaps—not by design, but in anticipation of the fact of how much, fundamentally, world trading patterns have changed.

Furthermore, it is my argument that the Super 301 doesn't go as far as Mr. Drucker is suggesting. It isn't asking for absolute reciprocity, it is asking for national treatment, a standard that I would argue is considerably less rigorous than the concept of reciprocity.

It is in that context, in terms of our desires, that we, the Chamber, submitted to the U.S. Trade Representative office our submission for Super 301, listing Korea, Japan, India, and Brazil.

Finally I would note that, in terms of our submission, we agree with some of your colleagues on the dais that there is more to trade policy than just the trade bill and the Super 301; but we also would argue that, in terms of the kinds of situations that Mr. Drucker is describing, to suggest that the government should not have a role in asserting the legitimate trade interests of the United States, I think is folly.

As my former boss and very good friend, and a man whose loss I deeply lament, Mac Baldrige used to say: "Trade will not be free for very long if it isn't also fair." And furthermore, aggressively asserting our legitimate trade interest on the world stage is the best antidote to protectionism.

Thank you very much, Mr. Chairman.

Thank you, Mr. Archey. And I will go right out and buy that book of Peter Drucker's.

Mr. Perkins, Vice President, Chrysler Corporation, we are pleased to have you. If you would, proceed.

[Mr. Archey's prepared statement appears in the appendix.]

**STATEMENT OF ROBERT A. PERKINS, VICE PRESIDENT,
WASHINGTON AFFAIRS, CHRYSLER CORP., WASHINGTON, DC**

Mr. PERKINS. Thank you, Mr. Chairman, members of the committee.

Last year the U.S. trade deficit was \$138 billion. Our deficit with Japan was \$55 billion, or 39 percent of the total. If you take a look of what constitutes our deficit with Japan, it becomes clear that the automotive sector is the single largest part of that \$55 billion, accounting for \$35 billion or 64 percent of the problem. Given the importance of this industry to the overall economy, and the trade figures, we were disappointed to see that the Trade Representative made only minimal mention of the automotive sector in this year's National Trade Estimate; to be exact, three sentences on the effects of the closed distribution system.

Super 301, as Chrysler understands it, is meant to address priority countries and priority practices. If the country with which we have the single largest trade imbalance and the sector which accounts for 64 percent of it are not priorities, then Chrysler has misunderstood the objectives of the 1988 Trade Act. It is clear to us that Japan was intended by Congress to be the principal priority country for our negotiators' efforts. It is also clear that Japan's distribution system is, by itself, the world's largest non-tariff barrier, not only for the auto sector but many others.

I appreciate Senator Danforth's and Senator Riegle's remarks on this subject this morning. Frankly, we believe that if you don't

solve the automotive sector problem, the U.S. will not solve its trade imbalance with Japan or its overall trade deficit.

An open distribution system would send a strong message to U.S. auto manufacturers that they are welcome there. The big three in Japan are Toyota, Nissan, and Honda. Together, they account for 77 percent of the Japanese car market. In 1988, imports into Japan accounted for 2 percent of the total vehicle market from all sources. Last year, U.S. exports totalled 14,511 vehicles; 5,395 of those were Hondas, shipped in from their Ohio operations. These vehicles went to the closed Honda distribution network, a network like Toyota and Nissan which sells no makes other than those they control. As a result, last year Chrysler, Ford, and GM sold a grand total of 9,116 vehicles out of a total market of over 6.7 million units.

Simply put, unless we have access to the volume distribution networks of Japan, we can never hope to achieve meaningful results.

Some of the Japanese success in the United States is due to the fact that they have had a strong product line to sell. But of equal importance, we would emphasize, is that they have been able to take advantage of the most open distribution system in the world. When they came to the United States in the early 1960's, their products were not barn-burners. In fact they had lots of problems. But they got launched in the United States by piggy-backing their lines with existing U.S. dealers of domestic makes.

Chrysler has a total of 5,317 dealers today. All of them, 100 percent of them, sell Japanese "captive" imports. In addition to the "captives," 438 of them sell at least one or two competing Japanese product lines, and you can drive around Washington and see GM and Ford dealers with the same type of arrangement.

The Big Three of Japan do not sell any imports at all except those they control, like Honda USA's 100-percent-owned subsidiary. We think it is a positive step that Honda has invested in this country—a point I want to emphasize. We think it is a positive step that they are shipping 100 percent left-hand-drive Hondas back to Japan. But how about their dealers putting out the welcome mat for Ford, GM, and Chrysler, as well?

Since Chrysler does not have access to Japan's major domestic dealer body, we have to approach the Japanese market in a more expensive, complex, and limited manner. We have just reestablished distribution in Japan with an excellent import group. This distributor, J. Osawa, is part of the giant Seibu Saison group. We would like this aggressive distributor to have access to dealers across that nation, regardless of franchise held, or, failing that, access to at least one of the major distribution networks controlled by a Japanese manufacturer. In other words, we want true reciprocity.

Chrysler has made a commitment to export vehicles from the United States We believe we have world-class products to sell. We are the world leader in sport utility vehicles. We created the mini-van market and brought back the convertible after a long absence. We are prepared to do what it takes to compete, but we need the same access to Japan that Japanese companies have had in the United States for the past 20 years.

On the positive side, Chrysler was the number-one U.S. exporter of vehicles to Europe last year. We shipped 31,000, worth \$543 million. There are some things that could help us sell more in Europe—among them, reducing the 10 percent duty on cars to the equivalent U.S. level of 2.5 percent. Despite that, Chrysler anticipates that this year we will be able to ship about 50,000 vehicles to 875 European dealers. With a reduction in the duty to the U.S. level, we estimate we would be able to sell up to 50 percent more than our projections, and another \$300 million would be added to the plus side of our figures.

Finally, we would like to say that we recognize that trade barriers aren't the only problem. Some of those were mentioned by Senator Moynihan. We have a lot to do, we think, here as well. Chrysler has advocated tough domestic action to address our budget deficit for the past 7 years, and we continue to aggressively address our industry's competitiveness in terms of productivity and quality. We would like to have you see the attachment that we put to our testimony. But these efforts will not solve our trade problems without reasonable access to foreign markets.

Senator MOYNIHAN. Thank you very much, Mr. Perkins.

We will proceed, as Senator Bentsen suggested, across our panel, until we have questions.

Mr. Procassini, we welcome you, sir, representing the Semiconductor Industry Association.

[Mr. Perkins' prepared statement appears in the appendix.]

**STATEMENT OF ANDREW A. PROCASSINI, PRESIDENT,
SEMICONDUCTOR INDUSTRY ASSOCIATION, WASHINGTON, DC**

Mr. PROCASSINI. Thank you, Senator.

My testimony will address SIA's recommendation to the USTR that Japan should be identified as a priority country for trade liberalization under Section 310, and that Japan's continuing failure to abide by the market-access provisions of the 1986 U.S.-Japan Semiconductor Trade Agreement should be named as a priority practice under the statute.

As a businessman who has had many years of experience in dealing with the Japanese market, I believe that America's interests in the field of semiconductors can only be served by taking this step.

Placing Japan on the 301 list is not retaliatory or protectionist. It demonstrates firmness of purpose of the United States. It informs the Government of Japan that the administration finds failure to abide by its commitments as unacceptable. More is at stake than just American's commercial interests. The United States Government's credibility is also at stake.

Unfair trade practices, including lack of access to Japanese markets is a problem for many industries, including but not limited to semiconductors, telecommunications, supercomputers, and others. I am here as one representative of the electronics industry. The impact of Japan's market structure is felt by the entire U.S. electronics industry and is a major source of the overall trade deficit with Japan, comparable to the automotive surplus of Japan.

As the nerve center of the United States electronic industry, the U.S. semiconductor industry's research and technology are the

foundation for tomorrow's new technology developments. The vitality of the semiconductor industry and its technological competitiveness is critical to the economic strength and the national security of the United States.

The Omnibus Trade and Competitiveness Act of 1988 attempted to make trade policy formulation less ad hoc and more coherent. Super 301 was to be an integral part of the development of that trade policy. The goal is to identify those countries and practices which are in fact priorities for U.S. trade policy. Super 301 is intended to clear away the underbrush and reveal the most important issues. Trade problems with Japan dwarf America's problems with any other nation. If there is to be an effective U.S. trade policy, Japan must be front and center in the priorities which America establishes.

Japan's treatment of the U.S. semiconductor industry is a prime example of the adverse impact on America's interests of Japanese trading practices. Japan's failure to abide by the market access provisions of the Semiconductor Agreement should top the list of specific practices to be identified under Super 301.

In 1986, Japan entered into the 5-year semiconductor trade agreement with the United States. In exchange for U.S. Government suspension of the Section 301 case and two semiconductor antidumping trade cases, including the suspension of an estimated \$2 billion in potential duties, the Japanese Government committed to halt dumping in the United States and Third countries, and recognized as reasonable, given America's competitiveness, the U.S. expectation that foreign access should gradually and steadily increase from the 8.5 percent level in 1986 to a 20-percent share of the Japanese market by 1991.

Unfortunately, the agreement was not honored by Japan. Sanctions, with respect to market access, which were imposed in 1987 remain in place.

We are now at the mid-point of the Agreement. Linear progress would place foreign market share at above 14 percent, although it is now only at about 10 percent. In fact, at this point foreign market share in Japan is backsliding from a high of 11 percent. There has been no gradual and steady growth to foreign share of the Japan market, since it remains at the 10 percent that it has averaged for the last two decades. And those two decades include a period when imports were formally controlled. Despite Japan's commitment, United States and other foreign producers are still being confined to residual supplier status.

The U.S. semiconductor industry seeks unrestricted access to Japanese markets. It is not our objective to witness round after round of sanctions being put into place. But unfortunately, in order to seek compliance with the Agreement, the U.S. Government has already had to impose sanctions once.

We have only three choices: (1) do nothing, and watch a sharp erosion of U.S. industry; (2) impose further sanctions under existing Section 301 determination; or (3) place Japan and semiconductor market access on Super 301 and make every effort to obtain implementation of the Agreement. Super 301 is the only alternative.

Japan will treat as trade priorities what the United States treats and identifies as trade priorities. I urge this committee in the

strongest possible terms to seek the administration's naming of semiconductor market access as a priority under Super 301 procedures.

Thank you.

[Mr. Procassini's prepared statement appears in the appendix.]

Senator MOYNIHAN. Mr. Procassini, you obviously represent an advanced technology, because you finished your testimony before your time was up. [Laughter.]

A third-generation witness. [Laughter.]

We thank you, sir.

Now we have the pleasure to hear from Mr. Stephen Lovett, who represents the National Forest Products Association.

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

Senator MOYNIHAN. May I just say, Mr. Lovett, that a vote has just been called.

I know that you will want to speak to Mr. Lovett. Would you like to go and vote now and ask some questions afterwards?

Senator PACKWOOD. I can do that, yes.

Senator MOYNIHAN. Or would you like us just to recess until we can all come back?

Senator PACKWOOD. I will hurry back.

Senator MOYNIHAN. Sir, go right ahead.

STATEMENT OF STEPHEN M. LOVETT, VICE PRESIDENT, INTERNATIONAL TRADE, NATIONAL FOREST PRODUCTS ASSOCIATION, WASHINGTON, DC

Mr. LOVETT. Thank you, sir.

Members of the committee, our industry very much appreciates the opportunity to make our views known on the use of the Super 301 provision to identify trade liberalization priorities.

I would like to note that, while our written testimony, which we have submitted to you, focuses on Japan, our industry also submitted a request for trade liberalization of the Republic of Korea's closed market. This was submitted to USTR on March 24. Although I will concentrate on Japan today, this does not reflect any lack of enthusiasm for the market potential in Korea, should the barriers in that market come down.

I would also like to note that we submitted a data bank of tariff and non-tariff barriers worldwide to assist in the National Trade Estimates Report on Foreign Trade Barriers process. The message is that we are committed to exporting, but face barriers that all but preclude our ability to compete in many overseas markets. However, there is an additional message, in the fact that today I will direct my testimony to Japan's closed market to wood products.

Put simply, the United States should be selling more solid wood products in Japan, and is fully capable of doing so. The U.S. industry would be selling more but for barriers which inhibit imports, increase prices, and severely limit consumption of wood products. These barriers are unfair, unjustifiable, and unreasonable impediments to U.S. trade.

Lack of access to and constraints on the Japanese wood products market should be identified as a priority practice for trade liberal-

ization under the Super 301 provision. The National Forest Products Association believes that its submission to USTR concerning Super 301 fully justifies identification of Japan's solid wood products barriers as priority practices.

NFPA is concerned about several issues which might prevent USTR from appropriately identifying forest products practices.

First, while Super 301 requires the USTR to consider primarily the National Trade Estimate Report in identifying priorities, there is another very important resource which must be consulted with respect to solid wood products:

The Department of Commerce is currently in the process of publishing an extensive study of the Japanese wood products market, which was originally requested by Senator Packwood. NFPA believes that it is critical that USTR consult this report with respect to the identification of priority practices for solid wood products.

Second, perhaps echoing the concern of some other industries, NFPA is concerned that the National Trade Estimate Report might not have gone far enough in identifying practices which should be U.S. trade priorities. We recognize what a complex and difficult task it must be to prepare such a report, and we appreciate USTR's efforts; nonetheless, with respect to solid wood products, we believe that the Report does not fully identify some specific Japanese practices which are demonstrably unfair and which have the effect of blocking hundreds of millions of dollars annually in potential trade.

In addition, we are concerned that the primary barriers to solid wood products discussed in the NTE are referred to as "industry claims," although they have been fully supported by the Department of Commerce study requested by Senator Packwood. This could send the wrong signal to Japan.

By comparison, we believe that the information which NFPA has developed and presented to USTR, in combination with the information developed by the Department of Commerce, is compelling. We hope that this information is not lost in the shouting.

A careful analysis of that information demonstrates that the potential for increased consumption of wood products in Japan is enormous. If Japan's unreasonable non-tariff wood products barriers were eliminated or reduced, the possibility for increased imports of U.S. wood products would be immense.

It is wholly appropriate to identify the closed Japanese market generally as a trade priority under Super 301; indeed, it was precisely to address far-ranging systemic barriers that Super 301 was enacted. As Senator Byrd indicated in introducing the original version of Section 310, the "list of barriers must go beyond mere tariffs and quotas to include structural conditions that effectively bar imports."

The barriers to solid wood products are often just that type of structural condition which have kept the Japanese market closed to even the most competitive U.S. industries, such as the solid wood products industry.

Japan utilizes a number of specific mechanisms to protect its wood products industries. If USTR is unwilling to identify lack of access to Japan's wood products market, generally, as a trade prior-

ity, these practices should be identified individually as priorities for trade liberalization.

I would like to point out here that Japan's practices, although while individually might not be considered unfair, for example, a building code, nonetheless, when practices are linked together in a network, linked practices can create a wall which is very, very difficult to penetrate. This is the kind of barrier that we face in Japan. I would like to list a few of these:

An effective rate of protection for solid wood products which is caused by tariff escalation. Tariff escalation is a practice normally relied upon by developing countries to protect infant industries. Japan's tariff structure is intended to impede imports of further processed products to protect an antiquated, uneconomic, and uncompetitive industry, even though this is one of the most advanced economically developed countries in the world.

Japan misclassifies tariffs, utilizes subsidies, and employs a host of other practices which, because I have run out of time, I will not enumerate now, by which keep us out of the market.

If I may just add a few more words, sir, if you will indulge me for a second—

Senator MOYNIHAN. Please do.

Mr. LOVETT. We thank you very much for this opportunity to make our views known. Exports are essential to maintain the vitality of our industry. We are globally competitive, we are internationally a low-cost producer, and we are committed to exporting. We have done our work. Now we need your assistance in gaining access to the use of the Super 301 process for wood products in order to realize the full export potential of our industry.

Thank you very much.

[Mr. Lovett's prepared statement appears in the appendix.]

Senator MOYNIHAN. We thank each of you for very careful testimony, very moderate testimony—clearly, very exercised about one country, but not only that.

I hope we could all agree—and we get off on a good basis in these whole discussions if we understand—that so long as the U.S. Government runs a \$300 billion deficit, which we do, we will be financing part of it abroad, directly or indirectly, because that is dissaving by government, and that the amount of money borrowed abroad is exactly equal to the trade deficit. It will always be.

I don't think this is immediately clear to persons who haven't taken a course in international trade; but the term is the reciprocal, and you heard Ambassador Hills say just that, that if every trade barrier in the world disappeared tonight, and our Federal deficit continued, our trade deficit would continue.

Mr. Archey, you are an authority in this matter.

Mr. ARCHHEY. No, I don't think I am, but I have to just make one point. It is not taking exception to what you said, but I think one has to be careful how far one goes with that.

To use the trade deficit as the only criterion regarding what these issues are, regarding unfairness, et cetera, I think is too narrow, for this reason:

I think that one of the points that the Drucker article makes, and Senator Durenberger earlier noted: Would we have just one supercomputer manufacturer left in the United States if, 10 years

ago, the rest of the developed world's markets were totally open? We are in very high R&D-related industries. You are in a position where you need to have the access to markets other than the United States to recover your R&D costs.

Senator MOYNIHAN. Right.

Mr. ARCHEY. The point that I am raising is: Clyde Prestowitz last month in an article noted that, in all of the advanced technologies coming down the road, it is going to be essential that the U.S. company, if it has those technologies, goes immediately to the world marketplace in order to recover that R&D and to get to the market fast—the world market, not just the U.S. market. If countries like Japan or others are kept off from it, it is not going to take very long for that company to in fact have problems in terms of return on their investments, ability for further R&D, et cetera.

So, one of the points I am making is, if you look at some of these ideas about adversarial trade, you may have—like supercomputers. Senator, when I left the government in 1986, where I was the Acting Assistant Secretary for Export Controls, there were only 200 supercomputer sales, ever, in the world. Now, I am sure that has increased dramatically since. And the price was \$20 million apiece.

Now, if you sell lots of those, you are not going to have a significant overall change in our trade imbalance. But can the United States afford, in security terms let alone in economic terms, not to have an indigenous supercomputer industry?

Senator MOYNIHAN. I don't disagree, sir. I don't disagree. I have one minute to get to the Senate floor, and I have not got a supercomputer to get me there. So, if you won't mind, I am going to stand in recess. Senator Packwood will be back before I will, and he will resume. I will be back very shortly.

Thank you. Just relax. Stay right where you are.

[Whereupon, at 12:15 p.m., the hearing was recessed.]

[AFTER RECESS]

Senator PACKWOOD. Senator Moynihan just indicated to go ahead, and he will be back shortly.

Mr. Perkins, let me ask you a question. There is something in your testimony I didn't understand.

On page 3, you talk about your dealers, and you say, "All of them sell Japanese 'captive' imports." What is a captive import?

Mr. PERKINS. A captive import, in our case, is a line that we have made arrangements with a Japanese manufacturer to distribute in the United States.

Senator PACKWOOD. And you say, "A logical step we took to keep our dealers competitive"—with who?

Mr. PERKINS. With all the other imports that were coming into the market. When we made these arrangements, as you will recall, we were in serious financial difficulties. We needed units to help us balance our product line. And therefore, we saw that these type of units would be available from a Japanese manufacturer, and we brought them in.

But I would also like to add that, regardless of whether we brought them in or not all of our dealers probably would have

signed up with either that company or some other company to import their units. So, we decided to get in early and to participate in this process, and we are asking, sir, for the same type of openness that we offered in our system.

Senator PACKWOOD. How long have you been with Chrysler?

Mr. PERKINS. Thirty years, sir.

Senator PACKWOOD. Well, then, your memory will be better on this than mine. As I recall, the first serious penetration we had of foreign cars may have been the Volkswagens in the fifties—not big penetration, but certainly bigger than the Japanese in the fifties. Did they sell them through your dealers? Or did they open their own dealerships?

Mr. PERKINS. They had the opportunity to do both, and they took the opportunity to do both. When they started off, they did not open their own dealerships; they started off jointly with GM, Ford, and Chrysler dealerships. As their volume grew, they had the opportunity to go to independent stores.

Senator PACKWOOD. But when the Japanese cars came in, they did not open their own distributorships, or our imported auto dealers didn't handle foreign cars exclusively? They all came in and started associating with the Big Three here?

Mr. PERKINS. Not all of them. In the initial stages, yes. They started to use existing dealerships that were available in the market. As they grew, some Japanese and Korean companies were able to come in with heavy volume immediately, with prices far below the competition. Then, they were able to establish independent dealerships.

Senator PACKWOOD. In Japan—and this is a question of ignorance—the dealerships are not independent, they are owned by the auto companies? These are not franchises?

Mr. PERKINS. They are franchises, sir.

Senator PACKWOOD. Oh, they are.

Mr. PERKINS. From my experience, and I lived for a number of years in Japan and was a director of a Japanese auto manufacturer, it is a mixed bag. Some of them are owned by the factories; some of them, through the factories, banks lend the money; others are freestanding, independent dealers.

Senator PACKWOOD. All right.

In Japan, are you prohibited by law from opening Chrysler dealerships on your own, the way Volkswagen did here eventually?

Mr. PERKINS. No, not by law. It is just by practice, sir, that we are not able to get access to those dealers.

Senator PACKWOOD. No, I mean open your own. I don't mean access to those dealers. Could you open your own dealerships?

Mr. PERKINS. Yes, we could open our own dealerships, if we were willing to—and you might say, "Well, why don't you do it?"—spend the hundreds of millions of dollars that it would cost to buy real estate in a country that has extremely high real estate prices.

For example, we have estimated it would be \$10 to 20 million to open one dealership in the Tokyo metropolitan area, for the cost of the real estate alone. And frarily, we can put those funds to better use to expand our distribution system into countries who welcome us, like Taiwan.

Senator PACKWOOD. I want to back up on the law, first, so I understand.

The Japanese dealers, I assume, have to pay the same real estate prices. They are not given a favorable tax benefit or a favorable land sale break, are they?

Mr. PERKINS. No. The dealerships, frankly, that we are up against were established 20 to 30 years ago, and, hence, they paid very, very modest sums to enter. And that was a time when, by law, we were unable to export to Japan. Foreign exchange currency laws kept our entire industry well below 2,000 imports a year, for years and years and years.

Senator PACKWOOD. In the United States, if one of your dealers wants to handle a foreign car, can you prohibit them from doing that, or terminate your dealership with them if you want?

Mr. PERKINS. Absolutely not.

Senator PACKWOOD. You cannot?

Mr. PERKINS. We cannot.

Senator PACKWOOD. Somebody who is a Chrysler dealer, you cannot terminate them?

Mr. PERKINS. No, sir. We can only terminate them for cause. And in our company's case, that is if they aren't maintaining the sales rate that they should be in that area—

Senator PACKWOOD. Which means they can handle other products, and that is okay?

Mr. PERKINS. Absolutely. And they do. The only other thing that we are looking at is if they don't provide customer satisfaction; in other words, quality service.

Senator PACKWOOD. What is the law on that?

Mr. PERKINS. It is by individual States. You have a whole series of fair trade laws, and it basically goes back to the Robinson-Patman Act, where there are various fair trade laws on the books of all of our States, and it is to encourage competition and to encourage our consumer practices in this country.

Senator PACKWOOD. Now, educate me some more. Would the same apply to hamburger franchises?

Mr. PERKINS. I would assume so, sir. I am not in that business.

Senator PACKWOOD. So, the franchisee does not have the power to determine who they give the franchise to and what they will hold? You don't have a contract where I can say, "We want you to handle only Chryslers," or only Chrysler-Plymouth?

Mr. PERKINS. That is correct, Senator.

Senator PACKWOOD. All right.

Mr. Lovett, let me ask you a couple of questions. This is an area I do know better than automobiles.

Mr. LOVETT. Yes, sir.

Senator PACKWOOD. We have about \$2.2 billion in export trade with the Japanese now in wood, paper, and related products.

Mr. LOVETT. No, sir, in just solid wood products it is \$2.2 billion.

Senator PACKWOOD. Just wood solid products?

Mr. LOVETT. Just solid wood products. If you include paper, it is up over \$3 billion.

Senator PACKWOOD. Hold on just a minute.

[Pause.]

Senator PACKWOOD. While he is checking something, is the \$1.2 billion additional figure that you estimate only wood products? Or is that wood and paper and related products?

Mr. LOVETT. We are just talking solid wood products, sir.

Senator PACKWOOD. By "solid wood," do you mean logs and lumber, or do you mean lumber?

Mr. LOVETT. When we are talking about the additional increment? We are talking processed products. We are talking lumber, veneer, plywood, particle board, OSB, the whole range.

Senator PACKWOOD. Yes, but wood products, not paper products.

Mr. LOVETT. Wood products. That is right. Yes, sir.

Senator PACKWOOD. Now, I was intrigued with a couple of things. The Japanese houses, for example, although they do use post and beam constructions, they don't use the quantity of wood in a house that we do.

Mr. LOVETT. That is correct. And generally they are much, much smaller than our houses.

Senator PACKWOOD. And even for a small house, they don't use as much wood as we do?

Mr. LOVETT. I believe that is true. Yes, sir.

Senator PACKWOOD. Are you suggesting that Japan ought to be compelled to change its housing laws or its housing sizes, or something? Because clearly there is a Japanese timber industry. Protected as it is, one exists. But that kind of a law discriminates equally against them and us, doesn't it?

Mr. LOVETT. What we are saying is not so much that there should be any attempt to try to change Japanese lifestyles, per se; I think that this is just pointing out that they do have land-use policies, tax policies, bankruptcy policies, subsidy policies, and so forth, which, taken as a group of interlocking trade practices—although they are not specifically trade practices, but they do impact, they are trade distorting. But taken as a group, they do restrict the ability of the Japanese consumer to enjoy a lifestyle comparable to ours, even though they have a per-capita income that is much greater than ours.

Senator PACKWOOD. Of course, that is a conscious policy.

Mr. LOVETT. That is right.

Senator PACKWOOD. If you talk to some of the Japanese economic ministers over the years, they would make the contention this country is over-housed. They have made a conscious decision to spend less on consumption generally, of which housing is one item to consume, and spend more on saving. We are perpetually pushed in this country to do more on saving and less on consumption; but in this particular area you are saying, literally, the Japanese ought to change their policy and spend more on housing, whether that is bigger housing or whether it is cheaper land, or whatever.

Mr. LOVETT. It is a combination of those things. But really, the key factor is the availability of land—one of the major factors.

Senator PACKWOOD. One of the few things, though, over which government doesn't have control. We haven't yet figured out, short of the Dutch, how to create land.

Mr. LOVETT. That is true. However, the tax policies that are in place and some of the other policies, government economic policies,

very much inhibit the release of available land in the Tokyo area, for example, for construction.

Senator PACKWOOD. I can see the frustration. When you fly over, you see all of these rice paddies in Tokyo—I am not talking about 100 miles out—that cannot compete with our rice farmers. But no rice goes in. So, there is land that could better be used for housing, and the consumers could have cheaper rice and cheaper housing, and as a matter of policy the Japanese Government prefers not to do it.

Mr. LOVETT. That is correct. Yes, sir. And I think that we can feel virtuous about this particular 301 submission, because I think that it would benefit the Japanese consumer; it could also benefit the Japanese wood products industry in many ways. So it is certainly nothing that is going to be harmful in any way to the Japanese economy if they liberalize in the area of wood products.

Senator PACKWOOD. You have seen the same things I have—I don't know if our audience has—that Japan has lots of what we would call mom and pop sawmills.

Mr. LOVETT. Yes, sir.

Senator PACKWOOD. We haven't seen them in Oregon probably in 40 years. They used to be by the side of the road, and they had a band saw and a circular saw and maybe 10 employees. Japan still has lots of these.

They are not an economic producer of wood. The figures that you have about the efficiencies—they cannot produce wood as cheaply as we could produce it for them and send it to them. They can argue all they want about size, standards, or codes; but in terms of can they cut the wood as well as we can, they don't. The biggest mill they have produces 6 percent of the lumber that our single biggest mill produces in this country. So, they do have a very restricted policy.

Logs is another. They have a differential tariff between logs and lumber. The reason they want the logs is for these mom and pop sawmills, part of which are the backbone of the Liberal Democratic Party, which is true in any conservative party if their backbone is fishing, agriculture, timber, whatever the next-to-the-land group is.

I want to thank you very much, not only for the testimony today but for helping with the Department of Commerce study and the evidence that you gave. Have you had a chance to see the draft of that study now?

Mr. LOVETT. Yes, sir, I have, and we want to thank you very much for requesting it.

Senator PACKWOOD. I think it is 99 percent down the line—and I have very seldom seen a study come out like this—with the allegations that the National Forest Products Association was making, which clearly means that you weren't puffing, that you said, "Yes, here are things that can be changed that can make a difference."

Mr. LOVETT. Yes, sir. That is correct.

Senator PACKWOOD. Thank you.

Now let me go back to cars once more, Mr. Perkins, because now I have to ask questions that I don't know.

Under the Robinson-Patman Act, you cannot terminate a franchise if that person says, "We are not going to handle Plymouths

anymore, we are going to handle Chevrolets instead; we want to be a Chrysler-Chevrolet dealer”?

Mr. PERKINS. No. I am not a lawyer, sir; but under various fair trade laws that are operating in just about every State of the Union, you cannot terminate a dealer except for cause. In our agreement with our dealer body—let us turn it to our dealer body—the only way you can terminate a Chrysler dealer, would be if the dealer has not been able to make their sales objective, which is a statistically drawn-out exercise of what the average penetration should be in a market area; and second, we just put into our dealer agreement 2 years ago a factor of what we call “The Customer Satisfaction Index”—in other words, are they offering quality service to our customers.

Senator PACKWOOD. But this is a contractual arrangement between you and your dealers, isn't it?

Mr. PERKINS. Yes.

Senator PACKWOOD. It is not a legal arrangement.

Mr. PERKINS. No, this is our contractual arrangement.

Senator PACKWOOD. Right.

Now tell me this once more. If they dump Plymouth and pick up Chevrolet, you could not terminate that dealer?

Mr. PERKINS. Except for the two causes mentioned, that is my understanding.

Senator PACKWOOD. That is interesting.

I have no other questions right now. Senator Moynihan is not going to return, and we are therefore adjourned.

Gentlemen, I thank you very much.

[Whereupon, at 12:29 p.m., the hearing was concluded.]

OVERSIGHT OF THE TRADE ACT OF 1988

WEDNESDAY, JUNE 14, 1989

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 10:54 a.m. in room SD-215, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Also present: Senators Matsunaga, Baucus, Riegle, Rockefeller, Packwood, Roth, Danforth, Chafee, and Heinz.

[The press release announcing the hearing follows:]

[Press Release No. H-31, June 5, 1989]

SENATOR BENTSEN ANNOUNCES HEARING ON SUPER 301

WASHINGTON, DC—Senator Lloyd Bentsen (D., Texas), Chairman, announced Monday the Finance Committee will hold a hearing on "Super 301" and "Special 301", the fourth in a series of hearings on oversight of the Omnibus Trade and Competitiveness Act of 1988.

The hearing is scheduled for 10 a.m. on Wednesday, June 14, 1989 in room SD-215 of the Dirksen Senate Office Building.

"The decisions announced on May 25, 1989 by U.S. Trade Representative Carla Hills meet the initial requirement to identify U.S. trade liberalization priorities under the 'Super 301' and 'Special 301' provisions of the 1988 Trade Act. The law next requires a series of follow-up actions aimed at opening up foreign markets to U.S. exports. I am scheduling this hearing to review the initial 'Super 301' and 'Special 301' decisions, and learn how the Administration intends to proceed from here," Bentsen said.

The "Super 301" provisions of the Omnibus Trade and Competitiveness Act of 1988 require the U.S. Trade Representative to identify the trade liberalization priorities of the United States, including priority foreign countries and priority practices. Under the "Special 301" provisions of the 1988 Trade Act, the U.S. Trade Representative is required to identify countries that deny adequate and effective protection of intellectual property rights. On May 25, Ambassador Hills announced the "Super 301" and "Special 301" decisions. The Committee is expected to examine these decisions, and the bases for them, as well as consider the Administration's plans for future actions pursuant to these provisions.

OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM TEXAS, CHAIRMAN, SENATE FINANCE COMMITTEE

The CHAIRMAN. This hearing will come to order.

The Ambassador has a meeting with the President at noon, so she will be leaving this committee at a quarter of twelve. The committee had a private discussion with her earlier and we want to carry it on here now.

This hearing is the latest in a series of oversight hearings on the 1988 Trade Act and its implementation, and it follows the administration's designation under Super 301 of the countries of Japan, Brazil, and India as U.S. "trade liberalization priorities."

We also want to look at the decision under the Special 301 provision on intellectual properties to set up a watch list of countries that need to improve efforts in that area.

I must say that prior to the decision to name these three countries on the part of the executive branch, the administration was subjected to a great deal of pressure from those three countries and from others not to be put on the list, and the members of this committee saw a whole parade of lobbyists and folks that had an interest in seeing that the country they were representing would not be on that list. But the 1988 Trade Act calls for a prompt, comprehensive trade policy of opening foreign markets, and that is what Super 301 is intended to help accomplish.

There are still a lot of questions about where we are going to go from here. Particularly, I think, we will be seeking greater detail about the President's call for the USTR and the Secretary of State and Secretary of Treasury to put together an interagency group to negotiate on Japanese structural barriers to trade, such as the system of distribution. That effort goes to the very heart of the problems that American firms are facing in dealing with Japan. Any success that may follow from that effort could be far more important than the Super 301 specifications on lumber, satellites, and supercomputers, but I think may be even more difficult to accomplish.

In addition, I think the members of this committee will be interested in understanding who is going to lead that interagency effort, and how it is going to be staffed. As far as the members of this committee are concerned, and the Trade Act requires, the USTR is to be the administration's principal spokesman on trade. I am somewhat concerned that the Super 301 negotiations could be a throwback to the MOSS talks, which lacked that element of central coordination, and as a result, the Japanese nearly talked us to death. They talked and talked and shipped and shipped and talked and talked and shipped and shipped.

So even though the initial decisions have been made, there is a lot we have to discuss.

So once again, we are delighted to welcome you back before this committee, Ambassador Hills, and I would now defer to my colleague, the ranking member, Senator Packwood, for any comment.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON

Senator PACKWOOD. Madame Ambassador, first let me thank you for what you have done for the timber products industry in the naming of the Japanese in the unfair practices. I know you had a hundred practices from scores of countries to choose from and you could not name them all, and I am personally appreciative and the Northwest is personally appreciative.

And secondly, let me personally congratulate you. It is interesting to watch as new administrations come in and everybody in high-level positions sort of starts off equal and then certain people rise to the top and certain people sink to the bottom, and without mentioning any names, you can see some that are sinking already.

You have absolutely risen to the top. If you were a movie, you would be a "must see." [Laughter.]

And I just want to congratulate you personally because everybody starts out in this business roughly equal, and in a short period of time you are a star and with justification.

Ambassador HILLS. Thank you very much.

The CHAIRMAN. Most of them reach their high point at the confirmation hearing. [Laughter.]

But I would certainly agree with Senator Packwood.

Now let me say the early-bird list was Senators Riegle, Danforth, Symms, Packwood, Baucus, Chafee, Rockefeller, Roth, and Matsunaga.

Senator Riegle, do you have any comment to make?

**OPENING STATEMENT OF HON. DONALD W. RIEGLE, JR., A U.S.
SENATOR FROM MICHIGAN**

Senator RIEGLE. Thank you, Mr. Chairman.

Let me just say that I though we had a very constructive conversation earlier with Ms. Hills and a very useful one. I would like to just say at this point two things that are partly a restatement of our earlier conversation.

I must say I am very distressed by the information that continues to accumulate on our overall trade and debtor nation status. I draw attention to the article today on page 2 of The Wall Street Journal, a headline of which "U.S. Payments Deficit Widens By Seven Percent Indicating Trade Gains May Be Stalling," and it goes on to talk about the fact that there is a general view developing that the trade improvement seems to have pretty much stalled out. There are a lot of factors involved in that, only part of which, of course, deal with unfair trade barriers which Super 301, among other things, is attempting to deal with.

It must be said that we have a lot of internal improvements to have to make to drive up our savings rate and capital investment, productivity improvement, and so forth. But in any event, the fact that we are on our way to what the New York Federal Reserve estimates to be a trillion dollar foreign debt owed by the United States by 1992 I think is just a horrendous, horrendous trend-line problem for us and one that we need to bear down much harder on correcting.

And with respect to that and with respect to Super 301, I am concerned about the fact that we basically have 2 years as the law is now written to implement the Super 301 approach, and I am wondering about when you have to come back in early 1990 for the second go around.

Based on the work that you are now doing—and I feel very positive about the work that you personally are doing and your people—do you envision that when you come back around the second time that countries that have not been forthcoming will be under very intense examination, if you will, and with the prospect that they might be listed, or will we go further in terms of structural barriers that either we have identified in which too little progress is made or perhaps other structural barriers that more time gives us an opportunity to identify? Will we likely see when

we come back around a year from now sort of a second application of the examination aspect of this law and tool to bring to light and out into the open other problems, such as new countries on the priority list or new specific practices or structural barriers? Can we anticipate that if problems exist out there that we will see something brought forward in terms of a Round Two when we get to that point?

Ambassador HILLS. We surely will apply the law vigorously next year, as we have this year. I cannot tell you precisely the practices that will earn the right to come to the top of the list as our trade liberalization priorities, but I can say that we will energetically review all of the problems that our entrepreneurs face, and the fact that a country or a practice was not named this year by no means provides any insulation against being named next year.

Senator RIEGLE. I think that is a very important statement.

The second thing I would ask you is this. If we find, given your diligence and really very strong start that Senator Packwood and Senator Bentsen have mentioned, at the end, say, of the 2-year period, that the Super 301 tool has worked effectively, but it is something that requires continuation, I would assume that you would be prepared to recommend that if you felt that way so that we would not have that tool lost to us after a 2-year period of time if it was clear to you that we needed to retain it.

Ambassador HILLS. Of course. I will always be candid.

Senator RIEGLE. Very good.

The CHAIRMAN. Let me make a point here that I did not make clear. For now, I would ask members to limit discussion to just comments that you might want to make and then we will have a round of questioning, because I would like to have Mrs. Hills to have an opportunity to make her statement.

Are there others who would like to make a statement at this time?

Senator DANFORTH. Mr. Chairman?

The CHAIRMAN. Let me see who I have.

Senator Danforth is next.

Senator DANFORTH. Well, I would simply like to join in commending Ambassador Hills for the excellent job she has done. I think that Super 301 has worked out, is working out, as we intended when it was drafted, and I would say, Carla, that if you were a baseball team, you would be the Cardinals. [Laughter.]

Ambassador HILLS. Thank you.

The CHAIRMAN. Senator Baucus.

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

Senator BAUCUS. Mr. Chairman.

We all agree. You have done a great job. In fact, not only have you personally done a good job in persuading the administration to utilize Super 301 in the way that it was intended to, you also named the practices that probably should have been named.

Beyond all that, I have noticed a new high in cooperation between the executive and legislative branches on trade issues. That is very welcome news. That has not always been the case. Your

predecessor was very good, but you are even better, I think, at pushing the cooperation to even a higher level. And I continue to look forward to working with you, as I know other members of the committee do.

And one other final point, Mr. Chairman. I join you, Mr. Chairman, in saying that when the administration negotiates with Japan in the structural initiative, it is critical that the USTR have the lead role. In fact, if the USTR does not have the lead role, then those negotiations will lack credibility. It is my very firm hope that the administration understands the wisdom of naming the USTR, and if the cooperation continues, I think that they will.

Ambassador HILLS. Thank you very much.

The CHAIRMAN. Thank you.

Senator Chafee.

Senator CHAFEE. No thank you, Mr. Chairman.

The CHAIRMAN. Senator Rockefeller.

Senator ROCKEFELLER. No.

The CHAIRMAN. Senator Roth.

Senator ROTH. No, I will wait.

The CHAIRMAN. Senator Matsunaga.

Senator MATSUNAGA. No opening statement.

The CHAIRMAN. Ambassador Hills.

STATEMENT OF HON. CARLA A. HILLS, U.S. TRADE REPRESENTATIVE

Ambassador HILLS. Thank you, Mr. Chairman, and members of the committee.

I have filed yesterday a long written statement. In view of the time, I might just summarize a few points.

As you know, our U.S. trade strategy is clear. It is to open markets and to expand international trade within a multilateral trading system based upon clear and equitable rules. Our challenge is to muster all the tools at our disposal, including Section 301, toward that end.

I am pleased to report that we have already been able to use the leverage afforded by Super and Special 301 to obtain significant trade liberalization through bilateral negotiations in the month preceding our Super and Special 301 decisions. I refer particularly to the negotiations that we had, which were quite fruitful, with Korea, which agreed to open its markets in the areas of investment, localization, and agriculture, and also with respect to Taiwan, which developed an action plan that promotes the opening of the Taiwanese market to all exporters. We expect the two countries to live up to their plan.

We also obtained significant improvements in the protection of intellectual property rights through bilateral agreements with the Peoples' Republic of China, Columbia, and Taiwan under Special 301. These successes underscore the value of bilateral negotiations on particular practices to complement our multilateral negotiations.

We will address other practices, including trade distorting subsidies, agricultural practices, and barriers listed in the national trade estimates reports in our ongoing bilateral and multilateral

negotiations. And, of course, we retain the right to self-initiate 301 petitions on other practices throughout the year, and American industry is free to petition on its own.

On June 16 we will initiate the investigations under the 301 process on all six practices we have identified, and as of this time, we have requested consultation with our trading partners in each of the six areas.

I think with that, Mr. Chairman, I will end and I am more than happy to answer your questions.

[The prepared statement of Ambassador Hills appears in the appendix.]

The CHAIRMAN. All right.

Madame Ambassador, we have heard a lot of opposition to Super 301, and I can understand that. Many countries have a substantial trading surplus with us, and they do not want anything to change and certainly do not want a highlighting of protectionism in their own countries. But from what you have stated, I take it you have found Super 301 to be a useful tool thus far; is that correct?

Ambassador HILLS. Yes, the statute did provide us with some leverage, which is the good news. However, it did create some tension, which is the bad news. And what I have tried to tell our trading partners is that it is our intent to implement 301 in a manner that was consistent with the multilateral objectives which we shared.

The CHAIRMAN. Now the charge the Europeans in particular have made is that this is unilateralism.

How do you respond to that?

Ambassador HILLS. I tell them that the only thing unilateral that we have done is to post on a bulletin board our trade liberalization priorities for the year. We then will commence to consult, discuss, talk about those priorities and that is a bilateral effort. And since we are asking for liberalization in areas which all nations have identified as needed at Punta del Este there should be progress. Hence we are acting in a manner that is consistent with multilateral objectives and we will continue to do so.

The CHAIRMAN. So when we name Brazil and India, for example, who have been really obstructing the expansion of services, investment, intellectual property protection, that what we are really doing is trying to promote the objectives of the Uruguay Round and open up trade. And if we make headway on those objectives in the Uruguay Round, then we will have accomplished our goal it seems to me.

Ambassador HILLS. That is correct.

The CHAIRMAN. Let me ask another one about the Japanese security market, which pretty well closed to foreign investors and particularly closed insofar as participation of foreign investors in Japanese companies as stockholders, unlike this country. Once again, you have a structural impediment to trade.

Do you intend to try to pursue talks in that sector?

Ambassador HILLS. We are willing to discuss on behalf of investors impediments in Japan to investing. It has been brought to our attention that recently some investors have had difficulty in getting the kind of rights that they feel that they are entitled to as a

result of minority-share investment in a particular corporation. So we stay vigilant.

The CHAIRMAN. All right.

When you recited the things that Korea and Taiwan intend to do to liberalize their trade practices, do you have in place a means of monitoring their actions to see what progress has been made, and do you have some time period in mind in the achievement of those objectives?

Ambassador HILLS. Absolutely. Whenever we have an action plan, we have a time frame and we monitor very carefully what the countries are doing. When they say they are going to enact laws, we watch. When they say they are going to more rigorously enforce laws, we also watch.

The CHAIRMAN. Let me show you one of the many frustrations in trying to penetrate the markets of Japan. I have a steel company in Texas that makes hard-faced steel plate. Japanese producers cannot produce that product in Japan for anything like the cost that we can deliver it from the plant in Texas to Japan. But there is a strong feeling in Japan to buy from Japanese sources. I understand that, but I do not know how you overcome that. Some of the structural impediment are so diffused, I do not know how you seriously address it.

Ambassador HILLS. We spend time not only talking to the ministers who are leaders in the Japanese Government, but we spend a good bit of time talking to Japanese business organizations about the need for Japan to become a superpower in terms of importing and that that heed is not simply a wish of the United States to correct its trade balance. There is a need for Japan to participate as the economic power that it is in expanding world trade. It is in Japan's best interest to begin to import as well as export lest it create such a dramatic dislocation that it triggers a very bad result in the trading system that adversely affects its future. We hope that we are making ourselves clear.

The CHAIRMAN. You are just absolutely right, but it is hard to get that message down to the individual, specific interest in Japan, who says, "Well, let's get ours, and overall, let the collective image of Japan overcome that."

Ambassador HILLS. As the globe becomes more interdependent, as the Japanese companies invest more here, the problem of their restricting imports and failing to do business in an international fashion becomes more apparent in my view, and so I am very hopeful that they will understand that the thriving environment in which they have made investments and exports cannot continue if the second largest market in the world does not participate in international trade as an international superpower.

The CHAIRMAN. The second largest market—you are already talking about Europe 1992, I guess. All right.

Senator Danforth.

Senator DANFORTH. I have no questions, Mr. Chairman.

The CHAIRMAN. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Madame Ambassador, I compliment you on naming forest products as one of the practices under Super 301 with respect to Japan. I would like to know how widespread and I would like to know the

scope of your inquiry. As you know, the Commerce Department listed a long series of various processed forest products in Japan, including standards, tariffs, and subsidies.

Could you give us a sense of the scope of the inquiry that you intend to undertake?

Ambassador HILLS. Our inquiry will be broad. We focused our initial 301 investigation on standards which are discriminatory, but we also intend to address other impediments that make it impossible for forest products to be imported into the Japanese market.

Senator BAUCUS. So that will include subsidies and tariffs as well?

Ambassador HILLS. They will certainly be part of our discussions.

Senator BAUCUS. As you well know, one of the benefits of Super 301 is that it encouraged some other countries to grant concessions in order to avoid being named a priority country. Korea is one. I noticed, though, in the concessions that Korea granted, one concession Korea did not address was our 301 action with respect to beef in Korea.

Could you tell me the degree to which the administration intends to continue to pursue opening up Korea to American beef exports?

Ambassador HILLS. We have made it very clear to Korea that that market opening is very important. We believe that we will have a result through the GATT organization that permits us to negotiate market opening. The balance of payment rule on which Korea has relied to deny open access to its beef market is under scrutiny and we believe is an area where we will get a liberalization ruling in a matter of weeks. So that that, plus our efforts to point out the significance of that market for opening, I think will achieve the kinds of results that you are looking for.

Senator BAUCUS. Frankly, I think the best news in your announcement with respect to 301 and Japan is your structural initiative that you are undertaking with Japan to address consumption rates, as I understand it, the Japanese distribution system, and maybe even our low, unfortunately, U.S. savings rates. If we are going to have an agreement, obviously Japan and the United States both must grant concessions and work toward objectives that benefit, not only our two countries, but our trading system.

Could you give us a little better idea of the timetable and how you see those negotiations proceeding, including any dates, or just a little more flesh and blood so that we have a better sense of either how you have proceeded thus far or how you intend to proceed?

Ambassador HILLS. Well, first of all, let me say that I agree with you. I think the structural initiative is in the right direction and I know that you have urged this sort of effort in the past, and we very much agree with your suggestion.

We have commenced negotiations with Japan even before the end of the first week of June to schedule meetings so that we could commence the discussions necessary for the structural initiatives. This week we have a team in Japan. One of my deputies, Linn Williams, is there with his counterparts, subcabinet officials from State, Commerce, and Treasury. We are engaging in negotiations that include discussions of the sort you mentioned, and we will proceed with regularity to hold these discussions. And I think they

will be constructive because when we have talked, and when we did talk, with our Japanese counterparts when I was in Europe at the end of May and the beginning of June, we made it very clear that we do need to have results.

Senator BAUCUS. Well, I urge you to work very aggressively to set deadline dates, and to set benchmark dates, because now that we have this opportunity, it is very important that we not let it slip by. All these other matters are important. I think this one is as important, if not more important, because even if all barriers to trade are eliminated with Japan, as we well know, that is not going to totally eliminate the trade deficit. It probably will not eliminate more than 15 or 20 percent of the trade deficit.

Ambassador HILLS. Right.

Senator BAUCUS. And it is these structural matters, which are the primary cause of the trade deficit, and they are what we have to keep our eye on. I urge you to proceed very vigorously and be sure that you are in charge. Because if you are, I think we will do a good job.

Thank you.

The CHAIRMAN. Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

I have two questions, Ambassador Hills. I would join those who praise you for your work. I particularly echo the sentiment that there is a very different atmosphere between the administration and Congress, and I think that your forthrightness and clearheadedness is very much a part of that. We all very much appreciate that. Certainly on the Democratic side, it has been strongly noticed.

You, in your testimony, relate, that Korea and Taiwan did a number of very dramatic things in this rush to not be named under the Super 301. You have listed them, and it is extremely impressive. The Koreans, for example, make these changes to encourage imports from the U.S., although the actual measures, quite properly, open the Korean market on a global basis.

The Koreans, I think, are very worried now that those openings have been made that the United States business community will not take advantage of them, and that instead, other nations, most notably Japan, will get the benefit. This, tragically, would not be a new phenomenon.

I am curious about your thoughts on that worry. I know this is not in the charge of USTR to stimulate American industry to take action, I do think it is the responsibility of all of us to make sure that our businesses take advantage of what you have very skillfully negotiated and what the Koreans and the Taiwanese have made available.

Ambassador HILLS. You are right. In our small agency we do not engage in outreach programs in a massive way. That activity is within the portfolio of the Commerce Department; it is my impression that they are doing a very good job at that. They send more than 15,000 pieces of mail out per week, perhaps more now, but they try to keep the American business community fully apprised.

And we do too through our private-sector advisors. We have more than a thousand private-sector advisors in all areas of busi-

ness so that they are fully apprised when there is a market opening and their obligation is to help their sector to be knowledgeable.

Your are right, that when we do achieve a market opening, we do not restrict it to U.S. entrepreneurs. We do not make sweetheart deals for the United States. We open markets to all nations. We think that is in our best interests. Our trade strategy is to open markets and expand trade for all nations, and we believe that that is the motor of growth that will generate world prosperity.

The fact that we confess that in opening all markets we will not substantially reduce our trade deficit, which is a reflection of a gap between what we produce and what we spend or what we save and what we want to invest, and that gap simply must be filled by imported foreign capital unless we are willing to save more to fill the gap. But that gap is the result of broader economic factors. We have to deal with those factors ourselves. I agree. And I think that this administration is trying very hard to deal with them through improvement of the budget deficit, through reducing government "dissavings," if you will, and we will have to do more to encourage the private sector as well to increase savings.

But as we have this correction ongoing through the cooperation of the Legislative Branch and the Executive Branch, it is very important that that correction take place in the context of growth rather than import contraction. And so that is what our effort in trade is all about: it is to ensure that we get maximum world growth. We do not open markets only for the United States, but rather for the world trading system at large.

Senator ROCKEFELLER. I appreciate that. That is also where the U.S. Foreign Commercial Service within the Department of Commerce becomes enormously important.

Ambassador HILLS. Right.

Senator ROCKEFELLER. My second question, Mr. Chairman, relates to something that I often bring up. Ambassador Hills, please provide a written response to this at your convenience.

It relates to the Japanese patent system, and you have heard me on this before. They average 6 to 7 years to grant a patent. When you are dealing with high technology, a year and a half to two years is a generation. A patent delayed is protection denied. Japan uses its patent system to extract cross-licensing, i.e., "We will give you the patent. You give us the technology," and classically, Americans are forced to give into that. Thus, the Japanese win again.

There have now been two meetings of the joint U.S./Japan Bilateral Working Group on Intellectual Property. There has been absolutely no progress. The Japanese are stonewalling totally. They are saying that there are no problems; they talk about us harmonizing ourselves with the rest of the world. It is a very shabby story. The Japanese patent system is a major problem affecting our high technology areas.

You have put Japan on a watch list on this matter, and I would simply like to know how you see progress coming, and what you intend to do about it so that this matter of Japanese patent practices, particularly for high technology, can be resolved.

I would really like to have a written response on that.

Ambassador HILLS. I will be happy to give you a written response.

[The information requested follows:]

The United States has an ongoing dialogue with the Government of Japan on the problems U.S. companies have encountered in obtaining patent protection in Japan. Principal among these problems is the very long time that it takes to obtain a patent in Japan. We have raise patent issues with the Japanese through a number of fora. In fact we have created a working group on intellectual property which has devoted a whole week of meetings to patent issues. We are also raising patent issues with the Japanese in SII. Frankly progress has been slow, in part because many of the issues we have raised with them bilaterally are also under discussion in multi-lateral fora. But we intend to continue pressing at ever opportunity. And we will raise these issues with the Japanese at the September Trade Committee meetings.

The CHAIRMAN. Senator Roth.

Senator ROTH. Thank you, Mr. Chairman.

Ambassador, I would like to bring up a subject that I have discussed with you a number of times, and that is the question of some kind of structural relationship between the EC and ourselves to discuss periodically matters in dispute or controversy. A number of senators had the opportunity yesterday to meet with President DeLore, and he once again indicated his willingness and desire to do just that; in other words, to proceed with some kind of a process or procedure whereby we would have the opportunity to comment on matters of concern.

I might point out that this involves not only trade, but the entire relationship between the EC and ourselves. Obviously, it involves investment, monetary matters, as well as military procurement. I know that there is to be a meeting later today with President DeLore, and I would just like to urge you and the administration to take steps to open up this process.

There has been and continues to be concern as to the transparency of the process in the EC as they develop the various directives. There is going to be a lot of differences and disputes. I know that you have set up certain procedures with high-ranking officials in EC and yourself, but I think it would be a lost opportunity if we did not take advantage of this opportunity, and I would hope that you would do everything you can to see that we accept this invitation from the President.

Ambassador HILLS. Well, I appreciate your thoughts. I will be seeing President DeLors and I am happy to discuss with greater precision what he is suggesting and what we can do in response.

Senator ROTH. Well, I just want to join my colleagues again, Carla, in congratulating you for your strong leadership. We appreciate that.

Ambassador HILLS. Thank you very much, Senator.

Senator ROTH. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Madam Ambassador, I have another question I discussed with you earlier in the meeting and want to reiterate it now, and Senator Heinz has asked specifically a couple of questions on it which I would ask you to respond to in writing.

Ambassador HILLS. I am pleased to.

[The information appears in the appendix.]

The CHAIRMAN. That is the question of the limitation that the European Community is about to put on insofar as allowing foreign television programs in Europe. We had the same kinds of problems on financial services, and some of us went over and met with Presi-

dent DeLors and other members of the Commission. Although we have some limitations on our own banks, we afford European banks and financial services as much access as our own are allowed, and we felt that that was the way that this should be handled instead of mirror legislation on the part of the European Community.

And that, along with the efforts of others, apparently had some effect, and they changed their policy. We also talked about local content and domestic content, a fight we have had in this country. We listened to them talk in England about 60 percent domestic content; in France, 80 percent domestic content. Products had to be stamped "Made in Europe, 80 Percent" or they were not sold. Now we hear Vice President Bangeman is making some modest changes in that regard, and that is encouraging.

But then to see the Europeans turn around and start putting quotas on foreign television programs, that wherever feasible, at least 50 percent of it had to be domestic production. That gives us serious concern. This is a major product for us. It is growing in export numbers. In meeting with President DeLors yesterday I voiced my objection. I hope very much that you will do the same in your meeting at noon with President DeLors and President Bush. I would strongly urge that.

The other point, it is gratifying to me after we took some hits last year on the trade bill and Section 301, and we heard all of these countries saying we were going to start trade war. Well, that has not come to pass and I never did believe it would. I think Japan and others are much too smart to run off their number one customer.

But it was gratifying to me to hear you talk about how helpful Super 301 had been, and whereas the previous administration in many instances really fought us on the trade bill, it is interesting to see this one, and you as a representative of it, utilizing that tool, and we are very appreciative of that and delighted with the progress that is being made.

Do you have any further comment, Senator Baucus?

Senator BAUCUS. No.

The CHAIRMAN. We are going to let you out early. Thank you very much for your help.

Ambassador HILLS. Thank you very much, Mr. Chairman.

[Whereupon at 11:32 a.m., the hearing was concluded.]

APPENDIX

ALPHABETICAL LISTING AND MATERIAL SUBMITTED

PREPARED STATEMENT OF WILLIAM T. ARCHEY

I am William T. Archey, Vice President, International, of the U.S. Chamber of Commerce.

When Congress enacted the Omnibus Trade and Competitiveness Act of 1988 (the 1988 Trade Act), it sent two overriding messages: first, to the international community, that it is no longer "business as usual" on matters of international trade policy, as the U.S. intends more aggressively to assert its legitimate trade rights; and second, to the U.S. executive branch, that trade policy must be given a higher priority in the public policy process of the U.S. government.

As you know, the U.S. Chamber was a strong supporter of the 1988 Trade Act. We disagree with critics who maintain that it is protectionist; rather, we see it as the Congress intended, to be aimed at opening markets, not closing them. However, the Chamber also believes that a successful trade policy must begin rather than end, with the enactment of trade legislation. Last November, the Chamber's Board of Directors specifically recommended that the Bush Administration "vigorously enforce" the new trade law, including its "Super 301" provisions. To that end, I am pleased to report to the Committee the steps that the Chamber has taken to support the implementation of the Trade Act's market access provisions.

MARKET ACCESS AND "SUPER 301"

The 1988 Trade Act contains various provisions relating to general market access issues and procedures (e.g., section 301), as well as to such specific issues as restrictions on access to foreign telecommunications and government securities markets, inadequate intellectual property protection and discriminatory government procurement. However, the most widely noted and broadly applicable feature of the 1988 Trade Act is the "Super 301" provision. This provision was designed to combat generic or systemic practices that restrict U.S. access to foreign markets across the board.

Congress enacted the "Super 301" provisions because, under the "regular" section 301 process, the executive branch found itself embroiled in lengthy and tedious negotiations involving specific practices and sectors. The foreign country thus lacked an incentive to correct its broader, systemic trade-restriction policies. Moreover, the U.S. executive branch lacked enough resources and negotiators to address effectively the problems. For these reasons, Congress decided that U.S. trade law should seek to eliminate entire systems of trade barriers, and not just individual barriers or sector-specific problems one at a time.

The Chamber strongly supports aggressive use of "Super 301" procedures to obtain trade liberalization agreements with the designated countries. We do not view "Super 301" and the other market access provisions in the 1988 Trade Act as simply a series of "hit lists." The ultimate objective of "Super 301" is not to punish other countries by erecting new barriers to their exports. Instead, as the legislative history of this provision clearly states, Congress intended for "Super 301" to be used to open markets, not close them. Achievement of this objective will benefit not only U.S. exporters but also exporters from third nations, and, indeed, consumers in restricted markets who pay higher prices as a result of trade restrictions. Moreover, "Super 301" also requires the executive branch to focus more clearly on elevating trade policy to a priority consistent with our other foreign policy and national security interests.

CHAMBER "SUPER 301" RECOMMENDATIONS

While the U.S. Trade Representative's (USTR) National Trade Estimates (NTE) report constitutes one obvious source of information concerning the severity of foreign trade barriers and is itself based on company and other sources, the 1988 Trade Act's legislative history specifically states that "the identification of priority practices (under Super 301) is also not limited to those barriers in the NTE report. The USTR is expected to use all information readily available about foreign trade practices."¹

To facilitate this process, the Chamber's International Policy Committee (IPC) began in May 1988, before the Trade Act was even signed, to consider how best to implement the Act. Since that time, the Chamber's Board of Directors, the IPC, and its Subcommittee on Market Access met a combined total of seven times to consider these issues. More than 90 companies, as well as various trade associations representing other companies, were involved.

The Chamber obtained information from numerous companies and trade associations with worldwide interests, and American Chambers of Commerce abroad, as well as from earlier NTE reports and other official sources. Based on these sources and our own analysis, the Chamber recommended that USTR designate four countries—Japan, South Korea, Brazil and India—as "priority" countries for investigation and negotiation under the "Super 301" provisions. This designation, like the statute itself, was based on the premise that elimination of the trade barriers in these four countries had the greatest potential to increase U.S. exports, "either directly or through the establishment of a beneficial precedent." This meant consideration of two basic criteria:

- (1) The pervasiveness of trade barriers and distortions in a country, and
- (2) The size of the market and the potential market opportunities arising from trade liberalization.

We ask that a copy of the Chamber's "Super 301" submission to USTR be included in the hearing record.

In the case of Japan, whose bilateral U.S. trade is enormous, trade barriers were seen as pervasive. Although not necessarily a function of Japanese law, these barriers reflect systematic practices (e.g., restrictive distribution channels and "administrative guidance") that considerably limit imports.

Korea's barriers are as pervasive as Japan's. Moreover, they are frequently mandated in law. They include high tariffs and taxes on imports, restrictions on foreign firms' imports into Korea, discriminatory import licensing rules, forced technology licensing and transfer as a precondition to entry into the Korean market, and others.

In April 1989, the American Chamber of Commerce in Korea (AmCham Korea) issued an updated report, *United States-Korean Trade Issues*, which indicates that, if anything, Korean trade restrictions are even more severe than the Chamber's "Super 301" submission suggests. We also ask that a summary of AmCham Korea's April 1989 report be included in the record.

India's market potential lies in the fact that, despite its low per capita income, it actually has a middle class that is arithmetically larger than most European countries (at least 80 million, according to some estimates), as well as the world's largest pool of scientists and engineers. The dominant economic power in South Asia, India maintains a wide range of government restrictions on imports and foreign investment, such as mandatory technology transfer, among the world's highest tariffs and a virtual ban (through the licensing process) on the importation of any consumer or domestically producible goods.

Brazil is the dominant market in South America and has a history of maintaining pervasive barriers to U.S. exports and investment. The new Brazilian constitution, the fundamental law of the land, further institutionalizes such restrictions as market reservation, discriminatory credit preferences to Brazilian companies and a ban on foreign company participation in mining and oil exploration contracts. Discriminatory import licensing, local content requirements and inadequate technology licensing safeguards are also problems.

Therefore, based on these criteria, the Chamber believes that elimination of these countries' barriers will establish an important precedent for U.S. business which has long sought equal opportunity of access in these most promising future markets.

¹ House Report 100-576, *Conference Report to Accompany H.R. 3 (the Omnibus Trade and Competitiveness Act of 1988)*, "Joint Explanatory Statement of the Committee of Conference," page 578.

Further, it is our hope that, in conducting "Super 301" investigations and negotiations, the USTR will actively consult with U.S. businesses that may be affected by these proceedings. In particular, we strongly recommend that, for purposes of complying with the Trade Act's various consultation requirements, such as in Sections 303-308 of the 1974 Trade Act as amended, the USTR specifically deem "petitioner(s)" and "interested persons" to include companies and organizations that filed submissions in response to USTR's March 2 request for public comments on "Super 301" (Federal Register Docket No. 89-4950).

It needs to be emphasized that asserting America's legitimate trade interests is *not* protectionist. It is what almost all developed countries do for their companies and their interests. As my former boss and good friend, the late Commerce Secretary Malcolm Baldrige, once said: "If trade is not fair, then it won't be free very long; the best antidote to protectionism is to aggressively assert America's legitimate trade rights in the international market."

While implementation of the Trade Act's market access provisions is critical to a successful U.S. trade policy, such a policy cannot be based on these provisions. Moreover, a successful U.S. trade policy requires that not only the Trade Act be forcefully implemented in toto but that other major issues falling outside the scope of the Trade Act also be addressed. U.S. trade policy must be thought of in more generic terms, encompassing not only "traditional" international trade and investment policy issues but also broader issues of national concern, such as the quality and relevance of our education system, our savings and investment rates and our ability to commercialize our research and development programs.

Despite the urgency of the problems, the U.S. government remains ambivalent about what role it should play in fostering and promoting U.S. trade and investment. One important example is mixed credits—combinations of export credits and subsidies with foreign aid, which result in highly favorable financing terms for participating countries. The U.S. Agency for International Development (AID) estimates that, over the next twenty years, developing countries' demand for electric power-generating plants will be between \$370 billion-\$900 billion. In 1970, the U.S.'s share of the electric power generation plant market in developing countries was 20%; now it is less than 10%. The principal reason for this decline in U.S. market share is the use of mixed credit financing by our industrial competitors.

According to an Organization for Economic Cooperation and Development (OECD) report on mixed credit activity worldwide during 1984-1987, total activity was \$35 billion. While \$245 billion, or 70%, of such activity was attributable to four countries (Japan, France, Germany and Italy), the U.S. only put up \$1 billion, or 2.9%. Overall, we estimate that foreign mixed credit export financing is costing the U.S. from \$2.4 billion to \$4.8 billion annually in lost exports for capital goods industries. In this respect, we disagree with the U.S. Export-Import Bank's estimate that only \$400 million-\$800 million is lost annually.

The Chamber believes that, ultimately, export financing terms should be determined in the marketplace. Both the U.S. and its competitors have a strong interest in reducing subsidies of all kinds that drain our respective treasuries misallocate resources. But it makes little sense for the U.S. government to seek open markets while continuing to neglect its own export promotion and financing programs, if the net effect is to open those markets to foreign competitors that are aggressively supported by their governments. U.S. exporters continue to be disadvantaged not only by a weak mixed credit program but also by an underfunded U.S. and Foreign Commercial Service.

At the heart of this ambivalence is the executive branch's continuing reluctance to recognize that U.S. national security is fundamentally dependent upon our economic vitality, especially in today's global marketplace. Until such time as the U.S. government embraces this tenet and begins to behave accordingly, it will be difficult, if not impossible, to retain our competitive edge internationally and even at home. The post-World War II era is over. The policies of that era were very successful in rebuilding the economies of our friends and foes alike, and the world benefited from the prosperity spawned by those policies. But a new era in world economic affairs is dawning. Nation-states have become truly economically interdependent. Unfortunately, the U.S. is the last developed country to acknowledge this for the very simple reason that, as the dominant economic power in the world, we did not have to. That has changed. To be sure, the U.S. is still very strong, but it is no longer alone.

In this new era of economic interdependence, our relationships with our allies and others are going to be defined more increasingly in economic terms rather than purely on the basis of our other geopolitical or strategic interests. For a substantial part of the post-World War II era, America's trade and economic interests were sub-

ordinated to the "larger foreign policy interests" of the U.S. I would submit that in many instances today, and particularly in the future, our trade and economic interests will be the "larger foreign policy interests" of the U.S.

It seems that the American people are ahead of their political leaders in understanding this new reality. Two major national surveys of the last few months have indicated that the majority of Americans think that the greatest long-term threat to America's national security is the economic prowess of Japan, rather than the military might of the Soviet Union. Those same surveys indicated that a country's prestige and influence on the world stage are more a function of its economic vitality than of its military prowess.

However, there seems to be little awareness of this within the executive branch, and perhaps within even the legislative branch. Specifically, there is no central forum or decision-making body within the executive branch whereby the economic and trade dimensions of foreign policy and national security policy can be joined. You may have seen the editorial in Monday's New York Times regarding the FSX issue. Although the editorial was essentially positive about the outcome of the FSX issue, it also noted that the FSX decision showed that there was no coherent policy toward Japan that integrated the economic dimensions of the U.S.-Japan relationship into both the national security and foreign policy decision-making. Our policies toward Japan remain ad hoc, and a dichotomy exists within the government between our economic interests with Japan on the one hand and our other strategic and foreign policy interests on the other hand.

But Japan is not the only country where the relationship must be seen more in economic terms. With the completion of the single European market exercise in 1992, the U.S. will no longer be the largest single market in the world. Although we remain very optimistic about the 1992 exercise, it is clear that America must be vigilant in ensuring that American companies will have access to that market that is equal to the access accorded European companies to the U.S. market. But the relationship with Europe is not going to be just 1992. There are clear signals that the Western European nations are seeking to increase dramatically their trade with the Eastern Bloc and the Soviet Union. There is a clear potential that their economic objectives could clash, over at least the short-term, with those of the U.S. Those clashes could occur over such issues as technology transfer and export credits to the Soviet Bloc. Although our strategic interests within the North Atlantic Treaty Organization (NATO) alliance are a high priority, the reality is that the economic dimensions of the relationship with NATO countries and Western Europe have also increased dramatically in importance in terms of America's interests. There is a need for the U.S. to reconceptualize its relationship with Western Europe in order to accommodate that reality.

Clearly there is much that also needs to be done by the American business community to match its foreign competition. Much progress has been made along these lines. There has been considerable restructuring of a great deal of American business, particularly in manufacturing, over the last five years with a much greater emphasis on quality, productivity, servicing of the product and other elements that make American companies more competitive. This process of restructuring will continue. Indeed, it needs to be recorded that perhaps the increasing competitiveness of American companies would not have occurred if it were not for the challenges posed by foreign competition. But even this lean and mean mentality of American executives will be limited in its outcomes if U.S. business is unable to make the necessary investments in plant and equipment to remain competitive. For example, this year Japan will spend as much in investment in plant and equipment in absolute terms as the U.S. even though the gross national product of the U.S. is roughly twice that of Japan. But it also needs to be noted that cost of capital in Japan is more than 50% less than in the U.S.

In summary, the U.S. must acknowledge that it really is entering into a new era whereby the economic vitality of a nation is an intrinsic component of its national security and its influence on the world stage. This means that the government itself must be aware of this reality and, as with all of our developed-country trading partners, must be willing to take a proactive stance toward inclusion of economic interests in foreign policy and national security decision-making. Asserting America's legitimate rights on the world economic stage is not protectionist. On the contrary, it is in the clear interests of not only the U.S. economy but also the world economy and trading system.

This concludes my testimony. I will be happy to attempt to answer any questions you may have.

PREPARED STATEMENT OF SENATOR MAX BAUCUS

On May 26th, the Bush Administration made a landmark decision.

After several weeks of heated internal debate, the Administration chose to identify Japan, Brazil, and India as priority countries under the Super 301 provision of the Trade Act.

The Administration will now begin discussions with these countries to open their markets to U.S. exports.

I hope this decision ushers in an era of cooperation between the Administration and the Congress on trade policy.

To its credit, the Bush Administration resisted heavy Japanese lobbying and made Japan a Super 301 priority country.

In so doing, it took a critical first step toward implementing the Trade Act of 1988 in the way that Congress intended.

Some of us have expressed regret that a more extensive list of cases were not initiated against Japan.

Personally, I believe that the three trade barriers isolated in Japan—barriers to forest product, supercomputer, and satellite exports—are good choices.

A longer list might have been preferable.

Certainly, there is no shortage of Japanese trade barriers.

But in addition to initiating these three cases, the Bush Administration announced that it was launching a structural initiative to address underlying economic and trade problems with Japan.

These underlying problems include the Japanese distribution system, low consumption in Japan, and Japanese toleration of anti-competitive practices.

While negotiations proceed on the three Section 301 cases initiated, the U.S. will also be negotiating with Japan to address these structural economic problems.

I have for several years urged the Administration to initiate such a broad discussion with Japan.

If the Administration is willing to seriously pursue it, this broader discussion could yield far larger results than the three cases initiated.

Rather than an afterthought, these broader negotiations should be treated as a critical element of a Super 301 package.

I urge the Administration to put in the effort necessary to make these negotiations a success.

If we are ever going to resolve the U.S.-Japan trade dispute, they must succeed.

The Bush Administration's implementation of Super 301 is an impressive start. Hopefully, the effort can be sustained.

 PREPARED STATEMENT OF SENATOR LLOYD BENTSEN

This hearing is the latest of a series on oversight of the 1988 Trade Act. Most members will likely want to use this hearing as an opportunity to examine the Administration's decision to designate Japan, Brazil, and India, and various trade practices of those three countries, as "trade liberalization priorities" of the United States under Super 301. We will also want to look at the decision under the Special 301 provision for intellectual property to set up a "watch list" of countries that need to improve their efforts in that area.

Prior to the decision, there was a great deal of pressure, both within the Administration and from lobbyists for foreign interests, to do little or nothing. What's most important now is that we have taken the first steps. We have set some trade liberalization goals for our country. The 1988 Trade Act calls for establishment of a comprehensive trade policy of opening foreign markets, and these decisions are an important part of that policy.

Obviously, there are still a lot of questions about where we are going from here. Particularly, I think we will be seeking greater detail about President Bush's call for the USTR and the Secretaries of State and Treasury to form an interagency task force to seek negotiations with Japan on structural impediments to trade, such as the rigid Japanese distribution system. This proposal goes to the heart of the problems most American firms have trying to do business in Japan.

Any success that may follow from this effort could be far more important to our trading relationship than the Super 301 designations on lumber, satellite and supercomputer trade practices. However, this negotiating effort, which is to take place outside of section 301, may lack the kind of leverage we can bring to bear under section 301. In addition, I think the members of this Committee will be interested in understanding who will lead the interagency effort and how it will be staffed among

the various agencies. The Trade Act makes clear that the USTR is the Administration's principal spokesman and coordinator on trade issues.

I am somewhat concerned that the Super 301 negotiations could become a throwback to the MOSS talks, which lacked that element of central coordination. As a result, the Japanese nearly talked us to death.

So, even though the initial decisions have been made, there's still a lot for us to discuss. Once again, I welcome Ambassador Hills back before the Committee for this latest hearing on oversight of the Trade Act, and I want to express for the Committee how much we appreciate these regular opportunities to meet.

PREPARED STATEMENT OF SENATOR DAVE DURENBERGER

Mr. Chairman, I want to commend you for scheduling this hearing so soon after issuance of the National Trade Estimate of Foreign Trade Barriers. After reading through parts of the report in the last few days, I am sure that Ambassador Hills will face a daunting and difficult task over the next four weeks in deciding which countries should be accorded priority status under the Super 301 procedure that was incorporated in last year's trade bill.

Mr. Chairman, for many of us who worked with you and Senator Danforth in crafting the trade bill, the litmus test for judging the success or failure of our effort will likely center on how aggressively our trade negotiators utilize the expedited and targeted procedures set forth under Super 301. And, most importantly, our nation's commitment to an aggressive and open trade policy will likely be judged by which countries are selected for inclusion on the Super 301 priority list.

From the comments that I have heard this morning and at earlier hearings in this Committee, it seems clear to me that there is a clear expectation that Japan must be included as one of the countries singled out under Super 301. While I am not convinced that our \$50+ billion dollar trade deficit with Japan would be substantially reduced if Japan fully opened its market to foreign imports, I think it would be a serious mistake for the United States to target smaller and less economically developed countries under Super 301 while ignoring the economic responsibilities that the Japanese have to open their market to their trading partners.

Mr. Chairman, Japan is an economic superpower whose industries are fully capable of challenging the United States and the nations of the European Community in every corner of the global market. And yet, when it comes to providing full and equal access to foreign competitors in such areas as telecommunications, supercomputers, medical devices, and other high technology products, Japan acts as if it were a Third World developing nation which believes it necessary to insulate its so-called "emerging technologies" from international competition. That protective and insular attitude in Japan must cease or else Japan will find itself more and more isolated from the world trading system.

Just recently, a major high technology company in Minnesota, Control Data, closed its ETA Supercomputing facility, causing the loss of at least 1,000 jobs in the state. The company had invested hundreds of millions of dollars in supercomputing but just could not hang on because of fierce competition from an American competitor and three giant Japanese competitors. But when it came to trying to sell supercomputers to the Japanese government, ETA did not merely face tough competition, it faced a *closed* market. Despite a supercomputer agreement between the government of the United States and the government of Japan entered into in 1987, not a single Japanese government agency has been willing to purchase an American supercomputer. Is that because our supercomputers are not up to the quality control and processing capabilities of their Japanese competitors? Of course not. Otherwise, our companies would not hold 80 percent of the world supercomputer market. The reason is quite simple: the Japanese government is ycommitted to fostering and developing a supercomputer industry and will exclude foreign competitors from their market until their companies have developed the capability to match our best producers. It is that type of protectionism and paternalism that must end.

Mr. Chairman, there are always economic and political risks that come when a nation decides to move aggressively to end unfair protectionism. However, there are even greater risks to the entire global trading network if we continue to allow our trading partners unlimited access to our market without receiving reciprocal treatment in their market. This country cannot afford to lose another supercomputer manufacturer and expect to rely on the Japanese for these high technology products as we do in the case of video recorders and fax machines. I hope we will not allow political considerations to override the economic judgments that the USTR must

make when it comes time to select the list of countries that will face intense scrutiny under Super 301.

PREPARED STATEMENT OF CARLA A. HILLS (MAY 3, 1989)

Mr. Chairman and Members of the Committee, it is a pleasure to appear before you to discuss implementation of the Omnibus Trade and Competitiveness Act of 1988. My statement today places particular emphasis on the *National Trade Estimate Report* (NTE) and those provisions of the Act known as "super" and "special" 301.

Two major provisions of the 1988 Trade Act—the authority for trade agreements and the amendments to section 301—encompass key Administration trade policy goals: to liberalize trade globally through the successful conclusion of the Uruguay Round negotiations; and to broaden access to foreign markets by removing formal and informal barriers to U.S. goods and services exports. The Administration will employ these two provisions, along with the other negotiating tools provided in the Act, to strengthen and expand the rules of the international trading system and pry open foreign markets.

U.S. trade interests are best served by a global trading system with clear, enforceable rules applied equally to all participants. Our Uruguay Round positions reflect this belief in our efforts to:

- achieve multilateral agricultural reform;
- expand the scope of international rules to include trade in services, protection of intellectual property rights and trade-related investment measures;
- reduce or eliminate tariff and non-tariff barriers; and
- strengthen and reinforce the credibility of the GATT by integrating developing countries into the trading system, addressing the problem of subsidies, improving the rules related to import relief and enhancing dispute settlement procedures and the GATT as an institution.

With the April conclusion of the Mid-term Review, we are poised to pursue vigorously these objectives over the next 18 months.

The global trading system today often is strained by disputes involving unfair trade practices, denial of market access and violations of trade agreement obligations. Such disputes occur most frequently where GATT rules are weak or non-existent. The Uruguay Round provides the United States' best opportunity to expand and clarify multilateral disciplines.

But until we can achieve our goals for the Uruguay Round, we must work within an imperfect system and take what steps we can on our own to improve the system and protect U.S. trading interests. That is why we will not hesitate to take selective unilateral actions to complement our multilateral objectives or open foreign markets and advance U.S. economic interests.

We will use the negotiating tools contained in the 1988 Act vigorously but constructively to open markets, combat unfair trade practices and persuade our trading partners to honor agreements. In administering these provisions, we will act as a surgeon using a scalpel to remove these trade barriers and promote a healthier trading system. We will not use these tools to butcher the rules of the system we are trying to strengthen.

Let me focus briefly on two underpinnings of our strategy to open foreign markets: (1) the *National Trade Estimate Report*; and (2) the super and special 301 processes for identifying "priority practices" of "priority" countries and for beginning investigations of denials of adequate and effective protection of intellectual property rights by "priority" countries.

THE NATIONAL TRADE ESTIMATE (NTE) REPORT

The NTE report identifies significant foreign trade barriers affecting goods, services, investment and intellectual property rights. The report provides, where feasible, quantitative estimates of the effect of foreign practices upon U.S. exports. Finally, information on what actions the Administration is taking to eliminate these barriers is also presented.

The NTE report results from a comprehensive interagency effort to gather information about foreign practices presenting significant barriers to U.S. exports. The report classifies trade barriers in eight different categories covering government-imposed policies that restrict or impede trade in goods and services. This year's report covers 34 countries and two regional trading bodies (the European Community and the Gulf Cooperation Council) which represent our largest or most promising overseas markets.

Each of the report's quantitative estimates indicates how removing a country's particular import-related practice could change U.S. exports of affected goods to that country. The estimates, however, are only approximations. In most cases, information simply is not available to permit calculation of the extra cost that a measure imposes on imports. Nor can the estimates be used to infer how removing the foreign practice would alter total U.S. exports either to the country or to the world of the goods the foreign practice affects.

This does not mean, however, that the quantitative analysis needed to pursue a trade action under section 301 is impossible to obtain. In the context of trade actions brought under U.S. law, estimates of the impact of foreign practices on U.S. commerce are substantially more feasible. Trade actions are generally product-specific and, therefore, are more tractable for estimating trade effects. The NTE report contains many generic government practices which are not product-specific. In addition, the process used when a specific trade action is brought frequently makes available data from U.S. companies or foreign sources which otherwise is not publicly available for use in the preparation of a broad survey like the NTE report. Investigations under section 302 of the Trade Act also enable us to work closely with a particular industry during the course of a year or more to assess the burden on U.S. commerce.

Despite its limitations, the NTE report has been and will continue to be a valuable source of information concerning the existence and extent of foreign trade barriers and a useful tool in helping the Administration identify which of those barriers we should devote our resources to trying to eliminate. It acts as a barometer for us in assessing the scope and severity of foreign trade practices.

SUPER AND SPECIAL 301

The NTE report is one of the sources of information we will be using to evaluate "priority practices" of "priority countries" for designation under the super 301 provisions of the 1988 Act. In addition, the USTR-chaired interagency process will review advice from the private sector and Congress, as well as the results of consultations with our trading partners, to determine which practices should be the subject of self-initiated investigations.

I will submit to the Congress by May 30 our list of "trade liberalizing priorities" as required by the statute. Without prejudging the outcome of the current interagency review, I can assure you that I intend to use the super 301 tool to pursue responsibly the elimination of egregious unfair trade practices.

I also will identify by May 30 the most onerous or egregious foreign country policies that deny adequate and effective protection of intellectual property rights or market access for intellectual property products. Again, while I will not prejudice the outcome of the Administration's current review, I will use this trade policy tool to obtain a level of protection for U.S. intellectual property right owners which allows them to run their businesses without the risk of losing the rich results of their research and development to rampant piracy.

I want to assure you that the Administration will use the new Section 301 provisions to maximum effect to pry open foreign markets for U.S. exports. I also want to assure you, and at the same time our trading partners, that we will administer the super and special 301 provisions in a manner which strengthens the global trading system and increases trading opportunities for all nations.

I view this hearing as an important continuation of the consultative process we have pursued since the day you approved my nomination. I welcome your views on how the new sections 301 provisions should be implemented.

CONCLUSION

Our actions under the super and special 301 provisions must fit into our overall trade policy and must be consistent with our related goals of a successful Uruguay Round and opening foreign markets. The 301 process should be used selectively as a fundamental element of our overall goal of supporting trade liberalization. Section 301 should—and will—be used where it can to persuade our trading partners to recognize that honoring agreements and abiding by multiple disciplines is preferable to unilateral U.S. action.

There is, however, a tension between our multilateral and bilateral objectives. When we fail to negotiate bilateral solutions in 301 cases we often face a Hobson's choice: inaction, or retaliatory action that is likely to be inconsistent with our GATT obligations.

On the one hand, unilateral retaliation can undermine the very system of international rules we are trying to promote and expand in the Uruguay Round. Yet re-

tialiation must be used to advance U.S. interests in some cases where multilateral rules are ineffective or non-existent or where the United States is frustrated in its efforts to enforce trade agreement rights. It is the Administration's job to reconcile this conflict. Such reconciliation can best be achieved through a balanced mix of the multilateral, bilateral and unilateral tools in our trade policy arsenal. Each type of action should complement, not undermine, the other types.

Specifically, this means exercising a steady, firm and reasoned hand on the section 301 tiller. We intend to use 301 as we believe it was meant to be used—as leverage to pry open foreign markets and not as a tool of protectionism.

PREPARED STATEMENT OF CARLA A. HILLS (JUNE 14, 1989)

Mr. Chairman and Members of the Committee, I am pleased to appear before you today to discuss implementation of the "Super" and "Special" 301 provisions of the Omnibus Trade and Competitiveness Act of 1988.

On May 26 I forwarded to you the Administration's report of trade liberalization priorities, as required by the Super 301 statute. I would like to highlight some important aspects of that report in my testimony today.

First, I would like to emphasize that our identification of priorities in both the Super and Special 301 exercises was part of our overall trade strategy: to open markets and expand international trade. We will use Super and Special 301, like other trade policy tools at our disposal, to create an ever-expanding multilateral trading system based upon clear and enforceable rules.

RECENT USE OF EFFECTIVE LEVERAGE

In that regard, we have already used the leverage afforded by both of these tools in the months preceding our Super and Special 301 decisions. Bilateral negotiations with the Republic of Korea resulted last month in significant trade liberalization by Korea in areas of priority to the United States: investment, localization, and agriculture.

In investment,

- the Korean government will no longer impose performance requirements on foreign investment, either formally or informally, except under some very limited and well-defined exceptions.

- The government will replace its current case-by-case investment screening process with a notification system that will not require Korean government approval for most foreign investment in both the manufacturing and service sectors.

In localization (a system of import barriers),

- the Koreans agreed to product standards, technical regulations, testing requirements, and customs procedures that will bring them in line with internationally accepted procedures.

- They will also repeal "border closure provisions", which include import bans designed to encourage local production.

In agriculture, the Koreans announced a significant agricultural liberalization proposal on April 8 which includes approximately 70 items requested by the United States.

- They have agreed to accelerate the liberalization of products originally scheduled for 1990 and 1991.

- They will reduce tariffs on seven products of importance to U.S. exporters.

- They will eliminate their quota on whiskey and an orange juice blending requirement as well as substantially increase the orange juice concentrate quota.

While the Koreans' agriculture liberalization package fell short of all that we had sought, we will continue to press Korea for further liberalization of agriculture—particularly in the context of the GATT Balance of Payments Committee review of Korea, which takes place later this month.

Korea has agreed to take these steps toward trade liberalization, not only for U.S. exporters and investors, but for the benefit of firms around the world.

Similarly, the authorities on Taiwan consulted closely with U.S. negotiators to develop an action plan that liberalizes trade and promotes the opening of the Taiwan market to all exporters.

- In May, Taiwan's cabinet submitted to the Legislature a proposal for tariff reductions on 4,700 items, including reductions on most of the manufactured items we requested. Effective May 1, the cabinet reduced tariffs on 378 industrial items using their administrative authority.

• Taiwan has also proposed a simplification of import licensing procedures and a removal of certain restrictions on the distribution of consumer products.

In services,

• Taiwan's cabinet proposed liberalizing revisions to the Insurance Law and the Banking Law scheduled to be implemented by spring 1990 and the end of 1990 respectively.

I stressed to Taiwan officials that we based our decision not to identify Taiwan as a Super 301 priority trading partner on the expectation that they will vigorously implement this trade action plan and maximize trade liberalization. Improved access for agricultural products remains a matter of major concern. We intend to raise this issue bilaterally and expect to see additional improvements in market access for agricultural products of interest to the United States.

Our negotiators have also made substantial progress in obtaining improvements in intellectual property protection from various trading partners in connection with the Special 301 provisions of the Trade Act. Significant agreements have recently been achieved with the Peoples' Republic of China, Colombia, and the authorities on Taiwan.

• In May, the Chinese government agreed to submit copyright legislation to their Congress by the end of this year which will include copyright protection for computer programs. We also made some progress for patent protection in China.

• The Colombian government resolved various access issues affecting the motion picture industry including the remission of royalties. From now on, the motion picture industry can remit royalties based on actual earnings rather than on the basis of the more subjective title-by-title approval by Colombia's Royalty Committee.

• The Taiwanese will revise their Copyright Law to protect translation rights in copyright and to strengthen protection for films, videocassettes, and other audiovisual works. In June, we will begin intensified discussions aimed at improving the enforcement of all intellectual property laws.

These initiatives underscore the value of bilateral negotiations on particular practices to complement multilateral negotiations on generic rules to discipline such practices. And that is the approach we will take as we continue our implementation of Super and Special 301.

SUPER 301 PRIORITIES

In identifying our trade liberalization priorities, we have given highest priority to a successful conclusion of the Uruguay Round negotiations by December 1990. We will use Super 301 negotiations to support and complement our Uruguay Round initiatives. Thus we will focus on the elimination of *specific* practices which, in addition to being serious barriers to trade, are emblematic of *broader* areas of concern to the global trading system.

By now you are probably quite familiar with the six priority practices and three priority countries we have identified. The countries we have identified for priority attention are Japan, India, and Brazil. The specific practices we have identified as trade liberalization priorities can be grouped into five broad categories, corresponding to the categories of barriers we have used in our annual trade barriers report. They are:

Quantitative restrictions and import licensing	
1. Restrictive licensing of agricultural and manufactured products	Brazil
Exclusionary government procurement	
2. Satellites	Japan
3. Supercomputers	Japan
Standards and technical barriers	
4. Forest products	Japan
Trade-related investment measures	
5. Performance requirements	India
Barriers to trade in services	
6. Insurance	India

In identifying these priorities, we considered comments received from a number of American firms, from this Committee and from other members of Congress. We also sought the advice of our private sector advisors. We also took into account:

—the potential to increase U.S. exports if these practices are eliminated;

- the precedential effect of seeking and obtaining their elimination;
- the likelihood that 302 investigations would advance our efforts to eliminate these practices; and
- the compatibility with our objectives in the Uruguay Round.

These generic categories of trade barriers, and the six individual priority practices they encompass, obviously do not represent all of the major trade barriers facing American exporters, but they are among the most important.

Other trade barriers, including those listed in the National Trade Estimate Report, are and will continue to be addressed in on-going negotiations with our trading partners. Principal among them are trade-distorting subsidies and agricultural policies. These practices are no less important than those identified as priority practices under the statute. However, we have determined that their elimination can be better pursued at this time outside of section 301, especially through multilateral negotiations in the Uruguay Round.

We will also continue to pursue trade barriers already the subject of investigations, negotiations, and action under section 301, including, for example, Japan's practices affecting construction services and semiconductors.

Finally, as part of the Super 301 exercise next year, we will reevaluate the status of certain practices not identified this year, in light of progress made in bilateral and multilateral negotiations.

By June 16 we will initiate investigations under section 302 of the Trade Act on all six priority practices, and we will request consultations with our trading partners. At the OECD meeting held in Paris two weeks ago, our Japanese counterparts objected strenuously to the Super 301 rubric but did indicate a willingness to talk to us about our complaints. We view this as a positive sign. Our negotiators will strive to reach a satisfactory solution to all of these generic and specific problems, seeking the removal of trade barriers and distortions to strengthen the multilateral trading system.

In addition, the Japanese agreed in Paris to begin discussions on a broad array of structural impediments to trade. Officials from both countries are meeting this week at the biannual U.S.-Japan Economic Subcabinet Consultations. On that occasion, we will hold separate discussions with Japanese officials regarding how we might begin to address various structural impediments to trade, balance-of-payments adjustment, distribution systems, pricing mechanisms, and anti-competitive practices such as bid-rigging, market allocation, and group boycotts. This Structural Impediments Initiative will take place outside section 301. USTR, Treasury, and the State Department will lead the discussions, with participation by other interested agencies.

Our approach to Super 301 consists of a number of components that are integral parts of a comprehensive package. Our implementation of the Super 301 provision is not simply an exercise in identifying specific practices or countries; rather it is one element of a broader strategy aimed at economic growth through trade expansion. The Super 301 process supports this strategy by concentrating our efforts this year on the elimination of practices that, in addition to being serious barriers in themselves, are indicative of broader areas of concern. This approach will enable us to advance general trade policy objectives through concrete, focused initiatives.

SPECIAL 301 PRIORITIES

Because we have made considerable progress to date in on-going bilateral and multilateral negotiations with respect to intellectual property protection, we did not identify any countries at this time as "priority countries" under Special 301. Instead, we have created a "Priority Watch List" upon which we have placed the following: Brazil, India, Republic of Korea, Mexico, People's Republic of China, Saudi Arabia, Taiwan and Thailand. An additional 17 countries have been placed on a "Watch List" for special attention.

For those eight countries on the Priority Watch List we have developed an accelerated Action Plan for resolving outstanding issues. By November 1 we will review the status of each of the eight under Special 301. Progress in negotiations is essential, for the denial of adequate and effective protection of intellectual property rights is not only harmful to the economic interests of the United States, but much denial also undermines the creativity, investment and invention that are the essential to the economic and technological growth of all countries.

Enclosure.

RESPONSES TO QUESTIONS SUBMITTED BY SENATOR JOHN HEINZ

Question. Although the European Community was not placed on your Special 301 watch list, recent actions by the Council suggest that the EC may be a prime candidate for Special 301 action. I am referring to the planned imposition of a quota aimed at limiting the amount of U.S. television programs that can be broadcast within the EC. Would you agree with me that it is exactly this type of blatant protectionism and denial of market access to U.S. intellectual property that the Special 301 was designed to combat?

Answer. The Administration is extremely concerned about the local content requirements included in the European Community's proposed broadcasting directive. We particularly object to those provisions of the directive which would require that member states take appropriate measures to ensure that a major proportion of television programming is reserved for works of European origin. We believe that the directive, if adopted, could have an adverse effect on the U.S. industry's substantial European earnings. Moreover, we believe that the directive would violate the European Community's obligations under the GATT.

In order to be formally adopted, the broadcasting directive must be approved by the EC Council of Ministers. At a meeting on July 17, there was insufficient support among the EC member states for the current draft of the directive to enable its adoption. We understand that the EC ministers will vote on the directive at their next meeting, on October 2.

We have communicated the U.S. Government's serious concerns with the broadcasting directive to European officials. In that connection, we have indicated that the enactment of restrictions on American producers' right to market their product for broadcast on European television could easily be construed as a denial of market access actionable under the "Special 301" provisions of the 1988 Trade Act.

Question. Your Special 301 decision focuses largely on intellectual property protection. The Special 301 provision of the 1988 Trade Act also specifically mentions denial of market access to U.S. intellectual property industries. The very recent adoption by the European Council of a broadcast quota aimed at denying U.S. television programs access to EC markets illustrates why we felt market access as well as copyright protection should be given special attention in the 1988 Act. Will your future Special 301 decisions address market access denial, and specifically, will you be taking a close look at the EC broadcast quota?

Answer. If enacted, the proposed EC broadcasting directive would represent a barrier to market access at least as damaging to U.S. industries dependent on intellectual property than inadequate copyright, patent or trademark protection. Should the Community formally adopt the broadcasting directive in its current form, we will take appropriate steps to protect U.S. trade rights, pursuant to the relevant provisions of both the GATT and U.S. law.

 PREPARED STATEMENT OF STEPHEN M. LOVETT

The U.S. Trade Representative should identify Japan's restricted wood products market, created by barriers which restrict imports directly and indirectly (by limiting consumption) as a priority practice for trade liberalization under Section 310 of the Trade Act of 1974, as amended. Recognizing the competitiveness of the U.S. industry and its potential for increased exports, the United States has, in the past, made wood products market access a U.S. trade priority. Thus, for example, wood products was one of the sectors involved in the MOSS (Market Oriented Sector Selective) talks with Japan.

Nonetheless, despite initial progress in increasing wood products exports after the MOSS talks (progress partially undermined by Japanese Government actions), imports of U.S. wood are still substantially restricted. Moreover, Japan's consumption of wood products is seriously restrained. Thus, both for U.S. wood exporters and Japanese wood consumers, there is an urgent need for liberalization of Japan's wood products market.

(1) The unreasonable practice to be identified as a priority for trade liberalization is Japan's closed wood products market. Alternatively, the specific barriers to imports and consumption, listed below, could be identified as priorities.

(2) The U.S. products affected by Japan's actions are solid wood products, including (softwood and hardwood) logs, lumber, plywood, veneer, millwork, laminated wood products (including glulam and laminated veneer lumber), waferboard (including oriented strand board) and particleboard.

(3) The value of imports effectively blocked by Japan's closed and constricted wood products market is very substantial. Japan's imports of U.S. wood products would

increase by \$1.2 billion annually, based on 1988 data, were Japan's consumption and imports to increase to more reasonable levels. Given the relative uncompetitiveness of the Japan's industry, this conservatively estimates the potential gains for the U.S. industry.

SUMMARY

I. Japan's Closed and Restricted Wood Products Market Should be Identified as a Priority for Trade Liberalization

Put simply, the United States should be selling more solid wood products in Japan and is fully capable of doing so. The U.S. industry would be selling more but for barriers which inhibit imports, increase prices and severely limit consumption of wood products. Those barriers are unfair, unjustifiable and unreasonable impediments to U.S. trade. Lack of access to and constraints on the Japanese wood products market should be identified as a priority practice for trade liberalization.

The potential for increased consumption of wood products in Japan is enormous, with current consumption materially below consumption in other developed countries. Japanese homes, the primary users of wood, tend to be small, despite the fact that Japan's per capita income exceeds that in the United States.

Similarly, while U.S. exports of wood products to Japan are significant, those exports could be much higher. For example, of the \$2.2 billion in exports in 1988, over 70% were raw materials (with additional processing done in Japan), Table 1, even though the Japanese industry is not cost competitive with the U.S. industry. Through unreasonable and unjustifiable market protection, the Japanese industry continues to produce far more than would be appropriate in an open market.

If Japan's unreasonable nontariff wood product barriers were eliminated or reduced, the possibility for increased imports of U.S. wood products would be immense. If its anticonsumption policies were modified, the expansion of consumption of wood products would be further multiplied.¹

It is wholly appropriate to identify the closed Japanese market generally as a trade priority under Super 301. Indeed, it was precisely to address far-ranging, systemic barriers that Super 301 was enacted. As Senator Byrd indicated in introducing the original version of § 310, the "list of barriers must go beyond mere tariffs and quotas to include structural conditions that effectively bar imports." Congressional Record, S9639 (July 10, 1987).

II. Japan's Barriers to Wood Products Imports Should be Identified as Priority Practices for Trade Liberalization

Japan utilizes a number of specific mechanisms to protect its wood products industries, practices which, if USTR is unwilling to identify lack of access to Japan's wood products market generally as a trade priority, should be identified individually as priorities for trade liberalization. These include direct and indirect limitations on imported wood products:²

A. Direct Barriers to Wood Products Imports.—(1) Japan's effective rate of tariff protection for solid wood products and tariff escalation (increasing tariffs as the level of processing increases) are unreasonable. Japan's tariff structure is intended to impede imports of further processed products to protect an uncompetitive industry.

(2) Japan misclassifies a number of U.S. wood products for customs purposes, thereby artificially increasing their duty.

(3) Subsidies to otherwise noncompetitive Japanese wood products firms keep Japanese operations running which should, based on market forces, stop or restrict production. As a result, imports from competitive U.S. mills are discouraged.

(4) Japan's use of antitrust and fair competition codes effectively to protect its wood industry is unreasonable and unjustifiable and should be identified as a priority practice.

¹ Indeed, with respect to solving the trade imbalance between Japan and the rest of the world (including the United States) the anticompetitive policies of the Japanese Government which limit housing construction should be among the highest U.S. negotiating priorities. It is arguable that were Japan to expand its stock of housing, it and the countries with which it trades (and U.S. forest products exports) would benefit very substantially. Indeed, the Maekawa Report recognized the pivotal role of increasing consumption in addressing Japan's trade imbalance. The barriers to consumption are appropriate subjects for U.S. negotiating priorities. It is clear, for example, that land use policies have at least as restrictive an effect on consumption as a high tariff.

² Indirect barriers restrict consumption of wood in Japan and indirectly restrict imports (often by design).

(5) Japan adopted counter-liberalization measures intended to offset the effects of Japan's MOSS wood products concessions. This action is inconsistent with the MOSS process and should be identified as a trade liberalization priority.

(6) Japan's failure to abide by its MOSS commitment to engage in bilateral access negotiations when the results of the MOSS concessions became known should be identified as a trade liberalization priority.

(7) Japan's government procurement and buy-Japanese policies unreasonably promote the use of domestic wood products to the detriment of imported products.

(8) Unreasonable and unjustifiable building and fire codes, unsupported by technical data, inhibit imports and consumption.

(9) Japan maintains unreasonable and unjustifiable standards which can have the same effect.

B. Indirect Barriers to Wood Products Imports.—Japan's land and housing policies effectively discourage consumption of housing, implicitly impeding imports (especially wood products) in favor of domestic goods (such as steel and concrete). The policy of intentionally restricting consumption is unreasonable, particularly given Japan's emerging role as a major economic power.³ For example, while Japan is now the world's second largest economy, it imports only 10% of the traded good from developing countries. This lack of consumption is largely at the root of Japan's trade imbalance.

III. Measure of the Lost Export Sales

"High tariffs, restrictions on use of wood for construction and other purposes and discriminatory regulatory procedures have all hampered U.S. sales of processed wood . . . products [to Japan]." *1987 National Trade Estimate Report on Foreign Trade Barriers*, 174 (1988). Combined, these practices are currently costing the U.S. industry approximately \$1.2 billion per year in potential imports annually.

Expanding the market for imported wood products in Japan could be a great success for U.S. trade policy. The Japanese people want and need more wood products at lower prices. The U.S. industry is capable of providing the wood products. Japanese trade barriers and government constraints on wood products consumption are preventing the marketplace from operating. Free market access for U.S. wood products and unrestricted consumption in Japan would increase Japan's domestic demand (to the benefit of both the U.S. and Japanese industries), increase the quality of the Japanese home, and increase U.S. exports of wood products, particularly further processed products. This would preserve and promote U.S. jobs, particularly in the Pacific Northwest.

This submission addresses each of these issues in turn.

PREPARED STATEMENT OF ROBERT A. PERKINS

Thank you and good morning. I am Robert Perkins, Vice President-Washington Affairs for Chrysler Corporation. Chrysler Corporation is pleased to have the opportunity to appear before the Senate Finance Committee as you continue oversight of the 1988 Trade Act.

Last year the U.S. trade deficit was *\$138 billion*. Our deficit with Japan was *\$55 billion*, or *39% of the total*. If you take a look at what constitutes our deficit with Japan, it becomes clear that the automotive sector is the single largest part of that \$55 billion, accounting for \$35 billion, or 64%. (See Attachment 1.)

Given the importance of this industry to the overall economy and the trade figures, we were disappointed to see that the Trade Representative made only minimal mention of the automotive sector in this year's National Trade Estimates Report for Japan—to be exact, three sentences on the effects of the closed distribution system! We are hopeful that the Japanese distribution system will be listed in the Trade Representative's Super 301 report.

We have made a commitment, as have our competitors, GM and Ford, to try to break into the Japanese market. We have encountered numerous and significant distribution barriers which will limit our market penetration. We have documented these for the Trade Representative's Office. We fail to understand why these barriers are not viewed as important.

³ Japan chooses to limit housing construction through land and housing policies which have a disproportionate effect on imports—the wood products industries in Japan could not supply on a competitive basis a significant increase in demand. Further, the multi-family homes encouraged by Japan's housing and land policies require use of steel and concrete instead of wood because of unreasonable building and fire code requirements.

Super 301, as Chrysler understands it, is meant to address priority countries and priority practices. If the country with which we have the single largest trade imbalance and the sector which accounts for 64% of it are not priorities, then Chrysler has misunderstood the objective of the 1988 Trade Act. It is clear to us that Japan was intended by Congress to be the principal priority country for our negotiators' efforts. It is also clear that Japan's distribution system is, by itself, the world's largest non-tariff barrier, not only for the auto sector, but many others. Frankly, we believe that if you don't solve the automotive sector problem, the U.S. will not solve its trade imbalance with Japan, or its overall trade deficit.

A good first step to expanded U.S. exports to Japan would be an open distribution system. This would send a strong message to U.S. auto manufacturers that we are welcome there.

Looking at distribution practices in Japan, we find that the "Big Three" in Japan are Toyota, Nissan and Honda. Together they account for 77% of the Japanese car market. In 1988, imports into Japan accounted for 2% of the total market from all sources. Total market import penetration in the U.S. from all sources was 23.6%. (See Attachment 2.) Last year U.S. exports total led 14,511 units—5,395 of those were Hondas shipped in from their Ohio operations. These vehicles went to the closed Honda distribution network, a network like Toyota and Nissan which sells no imports other than those they control. As a result, last year Chrysler, Ford and General Motors sold a grand total of only 9,116 vehicles out of a total market of over 6.7 million units. Simply put, unless we have access to the volume distribution networks of Japan, we can never hope to achieve meaningful results.

In 1988, Japanese companies captured 19.2% of the U.S. car industry and 13.2% of the U.S. truck industry, for a total industry penetration of 17.2%. If you add in the vehicles they are now assembling here, it totals 23.1%. Reciprocity really hits home when you compare that 23.1% to 0.2% (including Hondas) or 0.1% (excluding Hondas) U.S. market penetration in Japan. (See Attachment 3.)

Some of the Japanese success in the U.S. is due to the fact that they have had a strong product line to sell. But, of equal importance, they have been able to take advantage of the most open distribution system in the world. When they came to the U.S. in the early 1960's, their products were not "barn burners," in fact they had lots of problems. But they got launched in the U.S. by dualling or "piggybacking" their lines with existing U.S. dealers of domestic makes. Over time, these manufacturers have sold millions of their cars and trucks each year. For example, Chrysler has a total of 5,317 Chrysler-Plymouth, Dodge and Jeep-Eagle dealers. All of them sell Japanese "captive" imports, a logical step we took to keep our dealers competitive. In addition to the "captive" import line, 438 of them carry at least one or two competing Japanese product lines. By that I mean a Chrysler-Plymouth dealer will also sell Toyota, Nissan or Honda products under the same roof. *The "Big Three" in Japan do not sell any imports at all, except those they control*, like Honda USA's 100%-owned subsidiary. We think it is a positive step that Honda is taking 100% left-hand-drive, 62% North American content Hondas back to Japan. But how about their dealers putting out the welcome mat for Ford, GM and Chrysler as well!

A January 24, 1989 Wall Street Journal article described the situation in the U.S. very well.

"Times have changed since dealers carried a single line of cars, all of which were made in Detroit. Now more than half of the [National Automobile Dealers Association's 20,000+] members hawk imports right along with their Chevys and Plymouths . . ."

In addition, in the United States there are now big auto malls and other facilities which have created separate showrooms and common service areas, creating supermarkets of many different makes. There are no such facilities in Japan that are open to U.S. manufacturers.

Since Chrysler does not have access to Japan's domestic dealer body, we have to approach the market in a more expensive, complex and limited manner. We have just reestablished distribution in Japan with an excellent import group. This distributor, J. Osawa, is part of the giant Seibu Saison group. Chrysler has a small minority holding in this company, Chrysler-Japan. We would like this aggressive distributor to have access to dealers across the nation, regardless of franchise held or, failing that, access to at least one of the major distribution networks controlled by a Japanese manufacturer. In a word, we want true reciprocity.

One example which is often cited as a success story is BMW's experience in Japan. BMW realized some years ago that they couldn't beat the Japanese distribution system, so they joined it. Despite spending over \$100 million to establish dealerships, BMW achieved only a 0.7% share of the Japanese car market in 1988.

For a number of reasons, the BMW case study is not applicable to Chrysler. First, BMW produces high-end, high-profit, status-symbol products. Chrysler competes head-on in the mass market, both in Japan and the U.S. Second, timing. It doesn't make economic sense to spend hundreds of millions of dollars in Japan's current inflated real estate market. Therefore, we obviously will go there we are welcome and leave the Japanese real estate market to the speculators. Our money is better spent on North American jobs and facilities. Third, BMW doesn't have much of a reciprocity leg to stand on, because West Germany also has a closed distribution system. BMW dealers in Germany won't sell imports either!

Chrysler has made a commitment to export vehicles from the U.S., and we believe we have competitive, world-class products to sell. We are the world leader in sport utility vehicles, we created the minivan market and brought back the convertible after a long absence. We are prepared to do what it takes to compete, but we need the same access to Japan that Japanese companies have had in the United States for the past 20 years.

I want the Committee to know that there is some good news on the trade front. Chrysler was the number one U.S. exporter of vehicles to Europe last year, shipping 31,169 vehicles worth \$543 million. We were zero in sales to Europe in 1986. There are some things that could help us sell more in Europe, among them reducing the 10% duty on cars to the equivalent U.S. level of 2.5%. Notwithstanding that barrier, Chrysler anticipates that this year, with a total of 875 dealers in Europe, we will be able to ship about 50,000 vehicles. With a reduction in the duty to the U.S. level, our international division estimates we would be able to sell up to 50% more than our current projections, increasing our dollar exports by \$300 million.

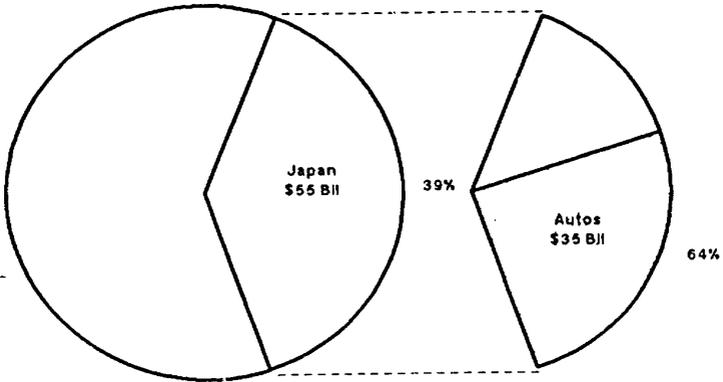
Chrysler is bullish on EC 1992 and, by utilizing principles of reciprocity, as included in the 1988 Trade Act, we can and will gain good results. The single European Market, we believe, presents opportunities for economies of scale previously not able to be achieved with harmonization of 12 different national specification requirements, some of which are very restrictive.

We also mentioned South Korea in our report to the Trade Representative in hopes that over time we could achieve the same level of success that Chrysler has had in Taiwan. Last year, Chrysler sold 1,584 vehicles in Taiwan, which was an increase of over 50% from 1987. In 1989 we are anticipating another 50% increase to 3,300 vehicles. We recognize that South Korea is a newly-developed automobile producing country and that it has begun to reduce barriers to its domestic market. We are hopeful of achieving results in Korea similar to our experience in Taiwan over time.

We recognize that trade barriers aren't the only problem. We have a lot to do on this end of the Pacific as well. For example, Chrysler has advocated tough domestic action to address our budget deficit for the past seven years. And we continue aggressively to address our industry's competitiveness in terms of productivity and quality. (See Attachment 4.) Nonetheless, these efforts will not solve our trade problem without reasonable access to foreign markets.

To summarize, there are great opportunities for U.S.-designed and manufactured cars and trucks around the world. There are three great auto markets in the world, the United States, Western Europe and Japan. We would like to participate with high-volume shipments to all three of these trade groupings, not just North America and Europe. This will not happen, however, if U.S. trade negotiators continue to ignore the primary barrier to the sale of competitive U.S. autos in Japan.

U.S. Trade Deficit, 1988

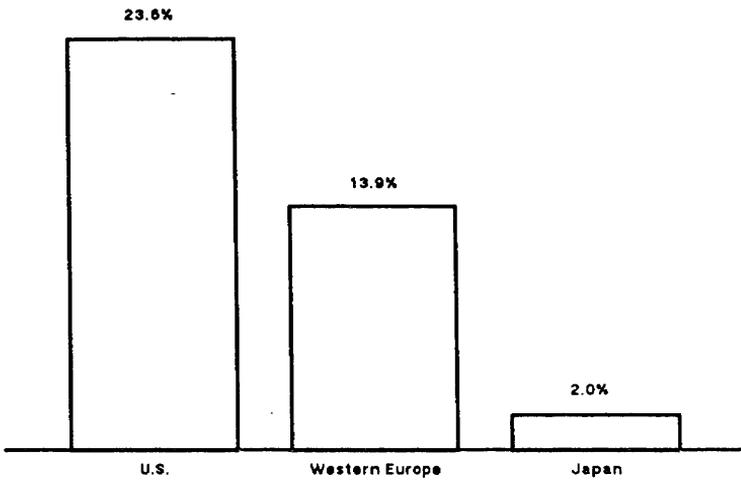


**Total
\$138 Bil**

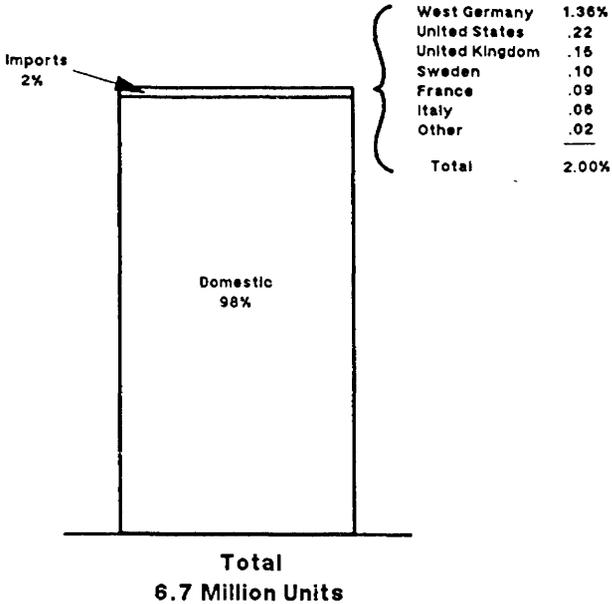
Note: Exports f.a.s., Imports c.i.f.

Import Penetration

In Selected Auto Markets, 1988



Auto Sourcing Pattern In Japan, 1988



Attachment 4

ACTIONS TAKEN TO IMPROVE CHRYSLER'S COMPETITIVENESS

1. Productivity Improvements

Since the early 1980's, Chrysler has committed major new investment to improved factory productivity; robotics, automation and processing improvements have led this effort.

- Robot usage has increased from 600 in 1984 to over 2,000 currently.
- Process improvements have increased First Time Capability from 39% in 1981 to 82% in 1988.
- New automation in the body stamping area has increased output by 78% and labor productivity by 35%.
- The number of vehicles produced annually by each employee has increased by 54% since 1982.

2. Quality Improvements

Chrysler has immersed all of its operations in a Total Quality Improvement Process (QIP) to improve quality, reduce costs and to meet or exceed foreign and domestic competition.

- In 1981, a vehicle produced by Chrysler had to undergo over five dealership repairs during its first year of operation; by 1988, the figure had dropped to below three visits per year and is headed to two by early '90 . . . a 46% improvement.
- Outside research by Rogers Research confirms a quality improvement of 49% since 1981.
- Customer Satisfaction, as measured by J. D. Power, has improved 61% in the last four years and leads domestic manufacturers. Working with major suppliers, defective materials received at our plants have been cut by 95% during the last four years.

- Dedicated Statistical Process Control (SPC) engineers have been added to 24 manufacturing locations; \$21 million has been invested in SPC thus far.

3. Improved Training and Education

Chrysler spends over \$100 million per year in employee training and education.

- In conjunction with the UAW, a National Training Center has been established to administer our extensive training programs including TechPrep, which provides workers with basic skills in reading, writing and mathematics.

- Over 20,000 employees have been trained in the use of computers in our Computer Awareness Training Program.

- Management from first-line supervisors to officers are undergoing training in cross-functional education, communication and supervisory skill development.

- Over one million hours of training has been completed at each of our plants that has undergone extensive modification.

4. Health Care Cost Containment

Chrysler currently incurs approximately \$700 per vehicle in total health care costs. Reducing this level is essential for improved international competitiveness. Since 1982, Chrysler has reduced the rate of health care cost increases to 8.5% compared to a national rate of 16.1% for U.S. businesses.

- Employees are being enrolled in managed care programs (HMO's/PPO's); fee for service coverage is being discouraged.

- Specialized single PPO's are being used for such services as outpatient diagnostics, vision care, mental health and substance abuse.

- Fee controls have been established for physicians, hospitals and dental services.

- Pre-certification is required for hospital admissions, and length of stay is assigned at admission.

5. Modern Labor Agreements Modern and/or Progressive Operating Agreements have been initiated at twelve major installations. These agreements increase operational flexibility and decrease the restrictions from and numbers of job classifications.

- Overtime restrictions at one plant were modified under a new Progressive Operating Agreement which resulted in the production of 40,000 additional units without major capacity expansion.

- Teamwork concepts, essential to highly productive factories, are now possible under these new agreements.

- Economic settlements have been cut from an annual rate of increase during the 1970's of over 11% to a rate of 7.7% in the 1980's.

6. Operational Improvements

- Improved inventory turnover rate . . . from 5.2 turns in 1980 to 23.9 turns in 1988 . . . a 360% improvement.

- Improved tooling design in some plants has allowed for 100% production flexibility between different body types.

- New model pricing has been restrained to a total cumulative increase of approximately 11% since 1985 compared to an over 30% average increase for Japanese imports.

7. Technology

- Have committed over \$1 billion investment for the construction of a new "World Class" Technology Center that will house state-of-the-art equipment designed to make Chrysler technologically competitive into the 21st century.

- Pioneered mass application of turbochargers to gain "large" engine performance from smaller, more fuel-efficient, 4-cylinder engines.

- Developed an entire new class of family vehicles . . . the minivans . . . which maximize interior space in a compact exterior size . . . annual Chrysler sales approaching 500,000 units.

- Pioneered fully adaptive all-electronic, 4-speed automatic transmissions for improved fuel efficiency, smoothness and performance.

- Invested in only made-in-house convertible; achieved dominant position in this segment overshadowing all domestic and foreign entries.

PREPARED STATEMENT OF ANDREW A. PROCASSINI

The Semiconductor Industry Association (SIA) is pleased to have the opportunity to testify at this oversight hearing on the Trade Act of 1988, and, in particular, the Super 301 provisions. My name is Andrew A. Procassini, President of SIA.

The Semiconductor Industry Association, which represents U.S.-based semiconductor manufacturers, was created in 1977 to address the public policy issues confronting U.S. semiconductor manufacturers. SIA has of necessity focused much of its attention on seeking solutions to problems involving unfair trade practices and access to world markets. SIA member firms represent over 90 percent of the American semiconductor industry. A list of member companies is attached.

My testimony will address SIA's recommendation to the U.S. Trade Representative that Japan should be identified as a priority country for trade liberalization under Section 310 of the Trade Act of 1974, as amended; and, that Japan's continuing failure to abide by the market access provisions of the 1986 U.S.-Japan semiconductor Trade Agreement should be named as a priority practice under the statute. As a businessman who has had many years of experience dealing with the Japanese market, I believe that America's interests in the field of semiconductors can only be served by taking these steps.

Placing Japan on the Super 301 list is not retaliatory or protectionist. It demonstrates firmness of purpose of the United States. It informs the Government of Japan that the Administration considers access to Japanese markets to be a priority area of concern and also finds failure by Japan to abide by its commitments as unacceptable. More is at stake than just America's commercial interests. The U.S. Government's credibility is also at stake.

MANY U.S. INDUSTRIES INVOLVED

Unfair trade practices including lack of access to Japanese markets is a problem for many U.S. industries, including but not limited to semiconductors, telecommunications equipment, supercomputers, and others. I am here as one representative of the electronics industry. The impact of Japan's market structure is felt by the entire U.S. electronics industry and is a major source of the overall trade deficit with Japan. The U.S. trade deficit with Japan was \$55 billion in 1988. Electronics products accounted for \$20 billion of that deficit. The American Electronics Association (AEA), which is the source of this figure and the attached chart (figure 1), has also filed a comment with the U.S. Trade Representative. AEA indicated that designating Japan as a "Super 301 priority country is a way of highlighting the importance the U.S. attaches to the goal of access to [Japan's] markets." AEA has requested that the Administration develop an overall plan for access to the Japanese market in conjunction with Super 301 identification.

Japan's reluctance to opening its markets is clearly shown in the imbalance between its exports and imports of electronics products. The United States is highly competitive in semiconductors, supercomputers, cellular phones, and satellites. Korea, Taiwan, Singapore and Hong Kong are highly competitive in consumer electronic goods. However, as indicated in my recent paper, "Open Markets and Financial Leadership," Japan imports only 6% of its total consumption of electronics products, while it exports 36% of total Japanese production. Japan's approach to trade is based on a pattern of restricting imports and sacrificing the welfare of its consumers for the sake of exporting.

1988 TRADE ACT

The Omnibus Trade and Competitiveness Act of 1988 attempted to make trade policy formulation less ad hoc and more coherent. Super 301 was to be an integral part of the development of that trade policy. The goal is to identify those countries and practices which are, in fact, priorities for U.S. trade policy. Super 301 is intended to clear away the underbrush and, thus, reveal the most important issues. Trade problems with Japan dwarf America's problems with any other nation. If there is to be an effective U.S. trade policy, Japan must be front and center.

Japan satisfies the statutory test for a priority country. Identification of priority countries is to be based on the "number and pervasiveness" of trade barriers in a particular country and the "level of U.S. exports . . . that would reasonably be expected from full implementation of existing trade agreements." Section 310(a)(2) of the Trade Act of 1974, as amended. The pervasiveness of Japan's barriers has been documented in numerous petitions and studies, in the National Trade Estimates report release last week, as well as in countless negotiations, including but not limited to semiconductors, telecommunications equipment, automotive parts and supercomputers.

Japan's treatment of the U.S. semiconductor industry is a prime example of the adverse impact on America's interests of Japanese trading practices. Japan's failure to abide by the market access provisions of the Semiconductor Agreement should top the list of specific practices to be identified under Super 301.

U.S. SEMICONDUCTOR INDUSTRY

The U.S. semiconductor industry is the nerve center of the U.S. electronics industry. Its research and technology are the foundation for tomorrow's new technology developments. The vitality of the semiconductor industry and its technological competitiveness is critical to the economic strength and national security of the United States.

Semiconductor producers are interdependent with both equipment and materials suppliers, as well as with users. The dependencies run in both directions. The health of upstream as well as downstream industries is vital to the semiconductor industry, and vice versa. These industries form an interdependent electronics technology chain (see figure 2). Access to state-of-the-art semiconductor technology is, for example, essential to the success of the computer and telecommunications industries.

HISTORY OF TRADING RELATIONSHIP WITH JAPAN

The U.S. semiconductor industry has continued to seek access to foreign markets, specifically what is now the world's largest semiconductor market, Japan. We do not seek protection. The need to improve access to the Japanese market and prevent Japanese dumping of semiconductors has its roots in the 1960s and early 1970s when Japan's markets were formally closed. In response to objections from the international trading community, Japan finally "liberalized" its semiconductor market in the mid-1970s. However, Japan's Ministry of International Trade and Industry (MITI) implemented a "counter liberalization" strategy which as designed to hinder access by U.S. industry as it promoted a policy to rationalize and restructure its industry. It accelerated its policy to target the semiconductor industry as the crucial element to dominate electronics as the largest manufacturing industry of the next century.

America's efforts to increase access to the Japanese market was at odds with Japan's view of its self-interest, and little progress has been made. After years of unsuccessful efforts by U.S. industry to gain full access to the Japanese market, it became clear that government action was necessary. Thus, in 1983, the United States and Japan established a High Technology Working Group (HTWG), which reached agreement on semiconductor market access (HTWG Agreement).

However, by 1985, no further access had been achieved. SIA was forced to file a Section 301 petition with the U.S. Government.

In 1986, Japan entered into the five-year Semiconductor Trade Agreement with the United States. In exchange for U.S. Government suspension of the Section 301 case and two semiconductor antidumping trade cases (including the suspension of an estimated \$2 billion in potential duties) the Japanese Government committed to halt dumping in the United States and Third Countries, and recognized as reasonable, given America's competitiveness, the U.S. expectation that foreign access would increase gradually and steadily from the 8.5 percent level in 1986 to a 20% share of the Japanese market by 1991.

This semiconductor market access target is not managed trade. There are structural problems in Japan which prevent competitive forces from having free play. Japanese companies have buying arrangements which prevent outsiders from exceeding more than a residual supplier status. The 20 percent commitment is an attempt by the U.S. and Japanese Governments to effect a transition from the current restrictive buying arrangements toward the free operation of the market. (I would commend to your attention an article by Jim Fallows in the current issue of *The Atlantic*, which describes the general problem of Japanese market access.) Had the Japanese market been truly open, it has been estimated that, based on the U.S. industry's proven competitiveness, it would hold a share greater than 30 percent of the Japanese market.

Unfortunately, the Agreement was not honored by Japan. Dumping continued and the Japanese market was not opened. In early 1987, the President found that Japan's failure to abide by its commitments was "inconsistent with the provisions of, or otherwise denies benefits to the United States under, the (Agreement); and is unjustifiable and unreasonable, and constitutes a burden or restriction on U.S. commerce." In response, the President imposed \$300 million in sanctions. This action was an unprecedented step in modern times.

Thereafter, the DRAM and EPROM (both high density memory devices) dumping did cease, but not before most U.S. DRAM producers had exited the DRAM arena and the Japanese producers had gained the dominant position in DRAMs throughout the world. Sanctions with respect to market access remain in place because there is not, in President Reagan's words, "firm and convincing evidence" of Japan complying with the Agreement.

It is now the mid point of the Agreement. Linear progress would place foreign market share at above 14 percent, although as of January 1989 it is only 10.16 percent. In fact, at this point foreign market share in Japan is backsliding from a high of 11.1 percent in November of 1988 (see figure 3). There has been no gradual and steady growth to foreign share of the Japanese market, since it remains at the 10 percent that it has averaged for the last two decades, including the period when imports into Japan were formally controlled. Despite Japan's commitment, U.S. and other foreign producers are still being confined to residual supplier status. There has been some progress with Japan's five largest producers, whose purchasing policies do reflect an effort to make the Agreement effective.

The U.S. semiconductor industry seeks unrestricted access to Japanese markets. It is not our objective to witness round after round of sanctions being put into place. But unfortunately, in order to seek compliance with the Agreement, the U.S. Government has already had to impose sanctions once. The choice that the Administration faces today is stark: (1) do nothing and watch a sharp erosion of the U.S. industry; (2) impose further sanctions under the existing Section 301 determination; or (3) place Japan and semiconductor market access on Super 301 and make every effort through continued negotiations to obtain implementation of the Agreement. Listing under Super 301 is the only alternative to ensure that Japan takes U.S. concerns seriously and complies with its commitments.

FIVE REASONS TO IDENTIFY SEMICONDUCTORS AS A PRIORITY PRACTICE

Japan's failure to abide by the market access provisions of the Semiconductor Agreement is a trade priority, and should be so identified, for at least five reasons:

1. Japan's failure to abide by the Agreement although directly actionable under Sec. 301, meets all of the criteria of Sec. 310 and should perforce be considered by the plain meaning of the statute a priority practice. As former President Reagan indicated in adopting the semiconductor market access sanctions in early 1987, and again in late 1987 when he refused to lift those sanctions, Japan "has not fully implemented" the market access provisions of the Agreement.

The actions which were the object of the 1985 Sec. 301 petition have not changed, and Japan is currently still in violation of the agreement it entered into. U.S. Trade Representative Carla Hills agreed that she saw no evidence that market access had improved when she recently reaffirmed that the sanctions would be maintained until there was "firm and continuing evidence. that access to the Japanese market has improved."

2. The U.S. semiconductor industry which is vitally important to the nation's health and security, is losing billions of dollars in sales and hundreds of millions in R&D because of Japan's closed markets and failure to abide by the Agreement. In 1988, Japan's failure to abide by the market access provisions of the Semiconductor Agreement cost U.S. producers about \$490 million in lost sales, an amount projected to grow to \$1.6 billion annually by 1991. Even this data substantially understates the effects on employment, investment in R&D, technological leadership and competitiveness, and national security that results from lack of access to the world's largest semiconductor market.

3. Japan's failure to provide market access pursuant to the Agreement has a serious adverse effect on the competitiveness of America's electronics industries, an important part of the foundation of our economic well-being and national security in the 1990's. Semiconductors are the heart of the computer technology and numerous related electronics fields, such as defense equipment, workstations, supercomputers, high definition television (HDTV) robotics and automotive technology.

4. Failure to address Japan's breach of the Semiconductor Agreement at this time will seriously injure the credibility of U.S. trade policy and could undermine the U.S. Government's ability to resolve other important trade disputes.

5. The semiconductor case is a paradigm of the trade problems facing numerous U.S. industries in Japan. The type of industrial targeting and closed markets which caused the semiconductor crisis also threatens American production of workstations, fiber optics, supercomputers, telecommunications and a number of other industries. As the Analysis of the U.S.-Japan Trade Problem by the Advisory Committee for Trade Policy and Negotiations concluded, some of these matters are not ripe for resolution. These industries rely on resolution of the semiconductor problem to point

the way. The policy of resolving trade disputes through negotiations is no longer credible if, after successful negotiation of an agreement, the other party fails to abide by the agreement with impunity.

ACTIONS NEEDED

In his Inaugural Speech, President Bush stated, "Great nations . . . must keep their word." Japan needs to comply with its previous commitments, including the Semiconductor Agreement, if there is to be any credibility in the future to U.S.-Japan trade agreements.

There is no good alternative for the U.S. Government to making this Agreement work, just as there is no good alternative for the U.S. semiconductor industry to continuing to press for full access to the Japanese market. Given the size of the U.S.-Japan trade relationship, and the size of its gross imbalance, there is also no good alternative to identifying Japan as a priority country for trade liberalization under the Super 301 provisions.

This is not a retaliatory action, but rather it is the U.S. Government standing firm and indicating to the Government of Japan that noncompliance with its agreements is unacceptable. Japan—the Japanese media, industry, and government—will simply not understand the nuance of not identifying Japan as a priority country and semiconductors as a priority practice under the statute, while the United States maintains that it still cares whether the Agreement is honored. Japan will treat as trade priorities what the United States treats, and identifies, as trade priorities.

SIA MEMBER COMPANIES

Advanced Micro Devices, Inc.
 AT&T Technologies, Inc.
 Electronic Components Division
 Bendix Microelectronics Center
 Cherry Semiconductor Corporation
 Cirrus Logic, Inc.
 Coors Components, Inc.
 Digital Equipment Corporation
 Ford Microelectronics, Inc.
 General Electric Company
 Solid State Division
 General Semiconductor Industries, Inc.
 GigaBit Logic, Inc.
 Gould Inc. - Semiconductor Division
 Harris Corporation - Semiconductor Sector
 Hewlett-Packard Company -
 Systems Program Planning
 IBM Corporation
 Intel Corporation
 International Rectifier Corporation
 Lansdale Semiconductor, Inc.
 Linear Technology Corporation
 LSI Logic Corporation
 MemTech Technology Corporation
 Motorola, Inc. - Semiconductor
 Products Sector
 National Semiconductor Corporation
 NCR Microelectronics Division
 Northern Telecom Electronics Inc.
 Powerex, Inc.
 Precision Monolithics, Inc.
 Raytheon Company - Semiconductor
 Division
 Rockwell International Corporation
 Semiconductor Products Division
 Silicon Systems, Inc.
 Sprague Electric Company
 Texas Instruments, Inc. -
 Semiconductor Group
 TriQuint Semiconductor, Inc.
 United Technologies Corporation -
 Microelectronics Center
 VLSI Technology, Inc.
 Xilinx, Inc.
 Zilog, Inc.

The Warning Signs: The Eroding Electronics Trade Balance with Japan

In the past five years alone, there has been a \$20 billion swing in the electronics trade balance. The important point to keep in mind about this enormous shift is that if Japan is excluded from the figures, the U.S. electronics industry actually has a net trade surplus with the rest of the world (see Figure 9). In short, global competition in electronics is currently primarily a U.S.-Japan competition. However, an increasing role for Europe and other Pacific Rim countries is expected in the 1990s.

Electronics trade balance

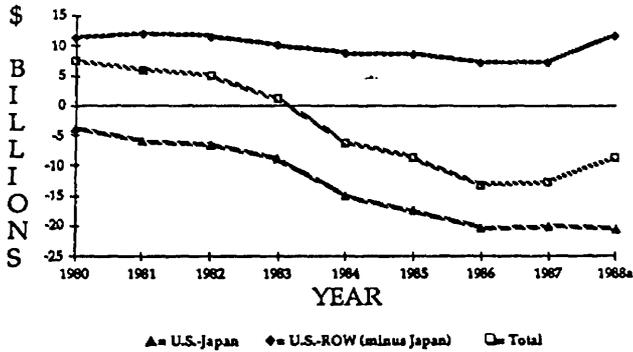
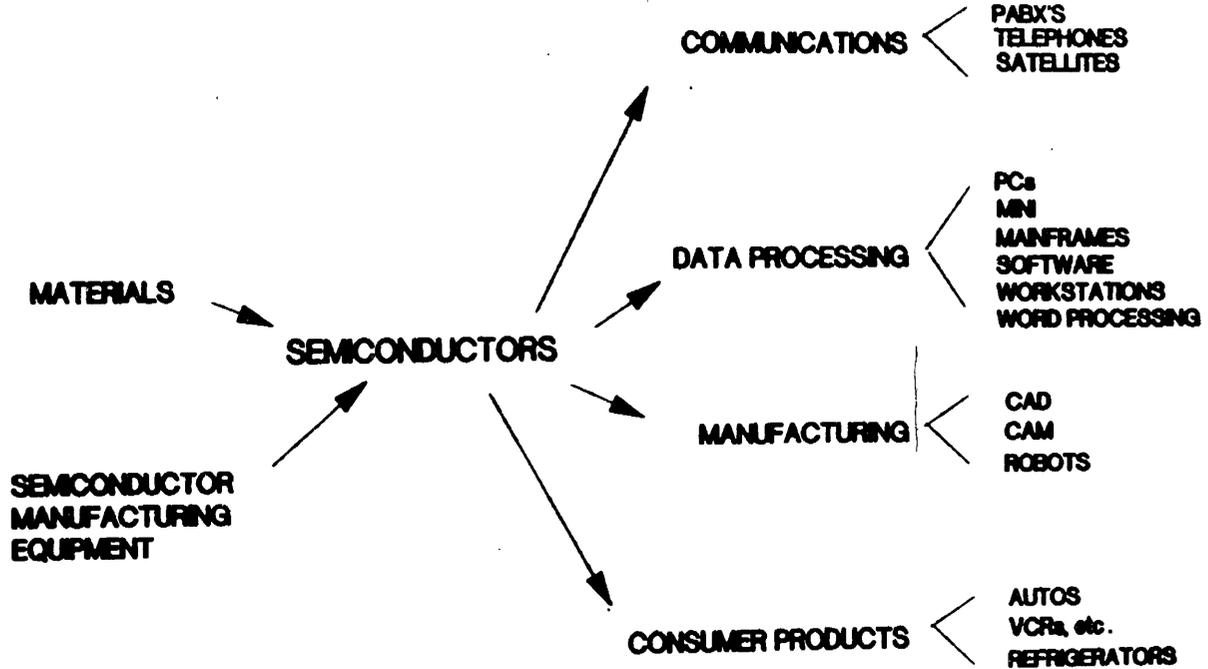
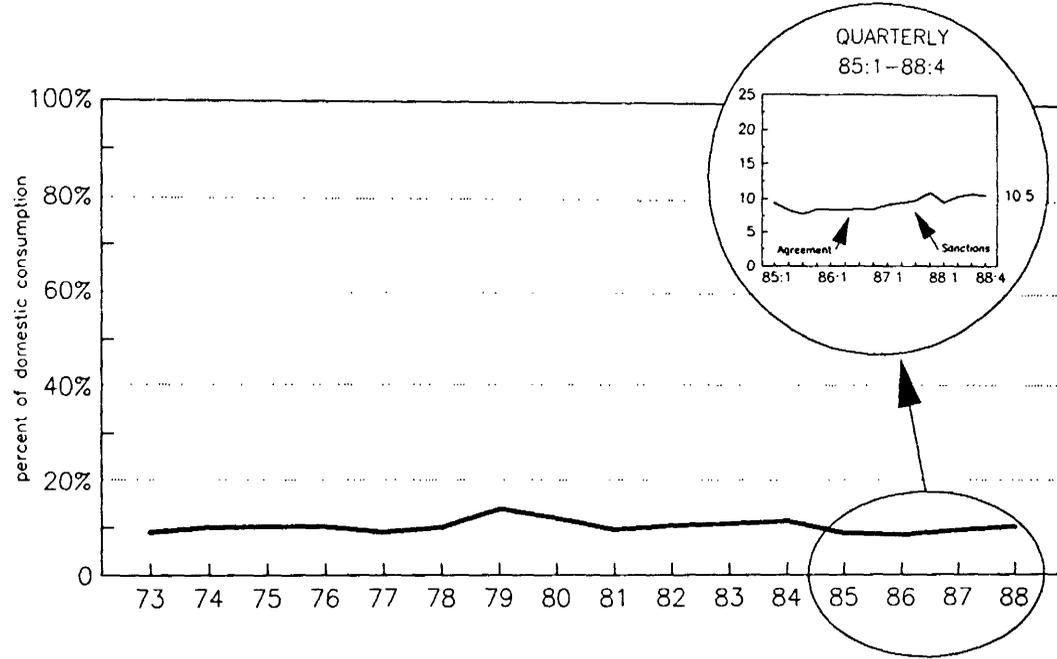


Figure 9. Source: AEA

SEMICONDUCTOR LEVERAGE



U.S. PENETRATION OF THE JAPANESE SEMICONDUCTOR MARKET



Source: SIA/WSTS.

PREPARED STATEMENT OF SENATOR DONALD W. RIEGLE, JR.

Madam Ambassador, your decision as to which countries and practices will be the focus of Super 301 may be the most important you will make as United States Trade Representative.

This Committee passed Super 301 in the strong belief that we cannot afford business as usual, particularly with Japan.

The list of groups calling for a clean break with traditional ways of dealing with Japan is impressive. Former Secretaries of State Kissinger and Vance, the Emergency Committee for American Trade, the AFL-CIO and your own private sector advisory group have all pointedly called for a dramatically different approach.

The reason for this consensus is not so much that Japan fails to play by the rules of the game—we know from the semiconductor and telecommunications cases that it sometimes does not. The real problem is that Japan is not even playing the same game.

The very structure of the Japanese economy stacks the deck against consumers and foreign exporters to the benefit of domestic producers. The OECD estimates that average consumer prices are 41% higher in Japan than in the United States.

How is the deck stacked against consumers and foreign exporters? There are two primary means: (1) land and tax policies which induce people to save more and consume less; and (2) lax enforcement of antitrust law which results in a lack of arms-length relationships among businesses.

Mrs. Hills, your own private sector advisory group estimates that land and tax reforms alone could cut Japan's global trade surplus in half by reducing its unusually high savings rate.

As for antitrust policy, in an economy half the size of ours, Dai Ichi Kangyo has four times the sales of the largest American company, General Motors; Mitsubishi's sales are three times greater; Sumitomo's are two times larger. Each operates in nearly every big industry. Moreover, seventy percent of stock in Japan's manufacturing companies is held by other companies and rarely trades. Four huge trading companies, each affiliated with manufacturing conglomerates, handle half of all non-oil imports. And an estimated seventy-five percent of all products sold in Japan are sold through captive retail outlets.

In Japan, the producer is king; the consumer is an afterthought. And any U.S. policy toward Japan that fails to take aim at these two anti-consumer policies—land and tax policy and antitrust policy—is missing the point. Indeed, it is beside the point.

Ambassador Hills, you have a golden opportunity as well as responsibility to improve the lives of Americans and Japanese alike. Japan must be convinced to play the same game as other industrialized countries.

I urge you to use Super 301 to end Japan's toleration of systematic anti-competitive practices, among other unfair trade practices. In addition, the Administration ought to seek the early reform of Japan's land and tax policies.

I look forward to hearing your thoughts on these important issues.

Thank you.

PREPARED STATEMENT OF STEVE SYMMS

Mr. Chairman, I want to compliment you for these hearings this month. With the publication of the *Foreign Trade Barriers* volume last week, and the scheduled publication of the "Super 301" list at the end of this month, the issues we are examining in these hearings are certainly very topical.

I am concerned about the ultimate effect of the "Super 301" process. I would like to insert in the Hearing Record immediately following my remarks an article that appeared in *The Wall Street Journal* yesterday, reporting on the comments of the Chairman of the President's Council of Economic Advisors.

The statement of Chairman Boskin is very clear: there are unfair trade practices around the world, but if we allow ourselves to get carried away with this enthusiasm for retaliation and bashing every friendly nation that has trade statistics we don't like, we will end up hurting ourselves as well as our friends and allies.

I am particularly concerned about the way we might mistreat those among our trading partners who have been doing very heroic things to improve their trade balance with the United States. I have in mind, in particular, the Republic of China on Taiwan.

Let me cite some statistics that I think demonstrate that Taiwan *should not* be included in the "Super 301" list at the end of this month.

- In 1987, the Republic of China on Taiwan initiated several measures including:

- Opened its market to U.S. wine, beer, and tobacco
- Reduced tariffs on over 2,000 items
- Lifted controls on individuals purchasing foreign exchange, facilitating foreign investment in the U.S.
- Cancelled the "Duty Paying Value List," which artificially set the value of imports, and allowed customs on goods to be based on their actual transaction value
- Lifted local content requirements on exports and eliminated Export Performance Requirements on foreign investment
- Removed import quotas and special taxes on U.S. film distribution
- Allowed free growth of American fast food chains
- Simplified import procedures

In 1988, the Republic of China continued her efforts to improve the trade imbalance: Reduced tariffs on over 3,800 items by an average of 50 percent, which brought down the nominal tariff rate to 12.5 percent, and the effective tariff rate to 5.2 percent

- Fully opened its market to U.S. fruits, though fruits from other countries are still banned or face quotas
- Reached an agreement with the U.S. on quotas on turkey meat, following extensive negotiation; the market will be fully opened on September 1, 1989
- Opened its service industry to insurance by allowing two life and two non-life insurance companies to establish business each year in Taiwan

In this year of 1989, the Republic of China on Taiwan has

- Graduated from the General System of Preferences on January 1
- Completed a "Detailed Action Plan," specifically designed to improve measures aimed at reducing the trade imbalance with the United States
- Removed the daily "Weighted Average Rate" (WAR) system, thereby lifting the control on the exchange rate between the NT\$ and the US\$, which had been in place since 1971
- Enacted a further reduction in tariffs on 4,737 items at an average of 23 percent, bringing the nominal tariff rate down to 10.25 percent and the effective tariff rate to 4.7 percent
- Allowed foreign ownership of local insurance companies up to 49 percent

In addition to making the formal changes in trade policy I have enumerated above, Taiwan has shown results. Its trade performance for 1988, compared with 1987, shows that exports to the United States fell by one percent. Imports from the United States grew by 63.5 percent. Taiwan's trade surplus with the U.S. fell by 25.6 percent, from \$19 billion to \$14.1 billion.

Bush Adviser Says That U.S. Punishment Of Trade Partners Could Cause Recession

By ALAN MURRAY
And PETER TRUPELL

Staff Reporters of THE WALL STREET JOURNAL

WASHINGTON—Michael Boskin, chairman of the president's Council of Economic Advisers, warned that U.S. efforts to retaliate against its trading partners could cause a "world-wide recession."

Mr. Boskin's strong comments, coming in the midst of an administration debate over trade policy, seemed to be aimed at other administration officials as well as at members of Congress and business groups pushing for tough trade action.

"While there are some unfair trading practices out there and those need to be rooted out," Mr. Boskin said, "they are not the cause of our trade deficit, other than a small part of it. And it is my view that if we wind up with a series of these retaliatory measures with our trade partners . . . it will not only cause a recession in the United States, it will cause a world-wide recession."

Trade Representative Carla Hills announced on Friday that the U.S. may retaliate against Japan for limiting U.S. access to its telecommunications market. In addition, taking the first step in a new trade process that eventually could lead to retaliatory action against a number of major U.S. trading partners, the trade representative released a review of foreign trade barriers.

Mr. Boskin has argued within the administration to tone down attacks against foreign trading practices. "I think we are starting to see an immense amount of bashing of our allies and trade partners," he said yesterday. "I think far and away the biggest danger to the economy is the incredible gathering momentum that could well produce a trade war," he said.

Mr. Boskin made the comments at the annual meeting of the U.S. Chamber of Commerce.

Speaking to the same group earlier in the day, President Bush said his administration is "committed to securing an open and fair world trading system." He said he will "work vigorously to break down barriers abroad while keeping markets open here at home."

Within the administration, the toughest talk on trade issues has been coming from Mrs. Hills and Commerce Secretary Robert Mosbacher. In a speech yesterday,

Mrs. Hills stressed that she is committed to "free" and "fair" trade. She said the "large and persistent trade deficit is creating mounting pressure for some kind of a trade solution," but added: "We know that our \$130 billion trade deficit is the product not of any particular trade barrier, but rather broader economic factors."

The trade representative stressed that her goals are to open foreign markets. "Our trade strategy is to open markets, to expand and liberalize trade and to adopt clear and enforceable rules," she said. She also said the administration wants to expand the coverage of the General Agreement on Tariffs and Trade, the international body established to reduce trade barriers.

Mrs. Hills decided to move against Japan because, she said, it is violating bilateral agreements on telecommunications trade. Mrs. Hills said, "My hope is that the Japanese government will remedy the violations so that retaliation will be unnecessary."

But the 1988 trade law may force Mrs. Hills to move against U.S. trading partners. In answer to a question on a trade dispute with Brazil, she said, "I am pleased to consult and talk," but she added: "I have to uphold the law."

Japan's foreign minister, Sousesuke Uno, said in a statement yesterday that the U.S. action on telecommunications agreements is "extremely regrettable." He said Japan has "endeavored to liberalize its telecommunications market," and he said it is "highly possible" that any retaliatory actions by the U.S. would violate GATT agreements. While suggesting that Japan wants to resolve the issue cooperatively, he warned that it will appeal to GATT if the U.S. takes "any GATT-inconsistent actions."

On other matters, Mr. Boskin said that the administration believes interest rates "have peaked or are close to peaking" and will continue to decline during the rest of the year. The administration's chief economist also said that he expects the U.S. economy to grow this year at a rate of "around 3%, or a hair under." The administration's budget and the recent budget agreement with Congress are based on the assumption that the economy will grow at a 3.5% pace for the year.

COMMUNICATIONS

STATEMENT OF THE AMERICAN ASSOCIATION OF EXPORTERS AND IMPORTERS

The American Association of Exporters and Importers (AAEI) is a national association comprised of 1200 U.S.-company members. Our members export, import, distribute and manufacture the complete spectrum of products, including chemicals, electronics, textiles and apparel, machinery, footwear, food, and automobiles, wines and specialty items. AAEI members also include many companies which serve the international trade community, such as customhouse brokers, freight forwarders, banks, attorneys and insurance carriers.

AAEI members include exporters who benefit from increased foreign market access. Trade expansion and fair trade have been cornerstones of AAEI's philosophy for the 68 years of its existence. AAEI's members understand the necessity of a strong negotiating position. However, AAEI's experience has shown that unilateral retaliation does not benefit U.S. exporters, U.S. businesses that import, or U.S. consumers.

STRENGTHENING THE GATT

The U.S. has been and is a strong advocate of strengthening the GATT dispute settlement mechanism. In the current Uruguay Round of Multilateral Trade Negotiations, more countries than ever before have recognized the need to "put more teeth" into the GATT. As a prime force behind the development of a more effective multilateral trading system, the U.S. can ill afford unilateral trade retaliation at this time. If a trade agreement has been breached, as the U.S. alleges, the GATT allows for the aggrieved party to seek and gain redress if not market access, then compensation for the lost sales. AAEI urges the U.S. to bring its complaints over foreign market access or unfulfilled trade agreements with its trading partners to the GATT.

INEFFECTIVENESS OF RETALIATION

U.S. retaliation under section 301, super 301 or special 301 whether in the form of higher duties, quotas or other trade restrictions, will do nothing to open foreign markets further. In fact, several trading partners have stated their intentions to file complaints with the GATT over the U.S. use of § 301, which if they were found to be valid, would pressure the U.S. to either lift the restrictions or pay compensation to those retaliated against.

Retaliation will harm U.S. businesses, employees and consumers. Many U.S. companies use imported components (targeted for retaliation) in their final products. Restrictions or higher duties on such parts will render the U.S.-made completed products uncompetitive, in the U.S. and overseas.

For the production in the U.S. which depends on imported components, higher prices for those components would make such production economically unfeasible, endangering the jobs of many U.S. workers.

AAEI supports the further opening of foreign markets and protection of intellectual property rights, not through retaliation but rather through direct negotiations and the multilateral process.

NATIONAL INTEREST

AAEI believes that the U.S. and U.S. industry would be better served by U.S. adherence to U.S. international obligations. The current emphasis on country-by-country retaliation is not a "major victory for U.S. manufacturers", rather it undercuts the U.S. negotiating leverage in the Uruguay Round. AAEI believes that the Admin-

istration must not be swayed by the breeze of the moment but must ensure the long term trade interests of the U.S. through the multilateral process.

STATEMENT OF THE AUTOMOTIVE PARTS AND ACCESSORIES ASSOCIATION, INC.

Mr. Chairman and Members of the Committee:

As president of the Automotive Parts & Accessories Association (APAA), I welcome this opportunity to present our views on the new 1988 trade act process for identifying countries and practices that block trade of competitively priced, world-class U.S. automotive parts and accessories—the same countries whose industries exploit the open U.S. market for cars and parts.

APAA appreciates this chance to discuss the question of fair play in a high-stakes world game governed by unfair rules and different business systems, and increasingly dominated by those who follow them. With U.S. exports slowing and no breakthrough on our budget deficit-fueled desire for more imports, it is time to give serious thought and energy to developing sound U.S. trade policy for the 1990's. The contrast between current U.S. automotive trade policy and the policies of our trading partners is acute and troubling: Our policies tend to be passive or absent, while theirs tend to be aggressive and targeted.

When the architects of the 1988 trade act built the Super 301 no-nonsense, results-oriented approach to market access negotiations, America laid the foundation for a stronger U.S. trade policy approach towards correcting trade abuses.

In APAA's March 23, 1989 submittal to the USTR, attached as Appendix A for the Committee's reference, we identified six major trading partners—Japan, Canada, Korea, Taiwan, Brazil and Mexico—whose government and/or business policies and practices impede U.S. parts exports.

Super 301 assures our partners that the U.S. can come to the negotiating table with more than just talking points. We would caution, however, that America's long term negotiating strength depends on the development of a cadre of career negotiating experts who will bring to the table the same industry depth, institutional memory and skill long enjoyed by other nations' career negotiators. By pressing a strong, steady offensive in pursuit of U.S. trade objectives, we would not be forced to rely solely on the market closing weapon.

In the course of this review we will comment on USTR's disposition of our primary recommendations; suggest refinements to the Super 301 and general National Trade Estimate (NTE) report process; look at the implications of countries and practices not selected; discuss the new Structural Impediments Initiative's potential for reducing Japanese industry structural barriers to trade; comment on Super 301's potential impact on progress in the Uruguay Round; and touch briefly on Special 301 implementation.

APAA/INDUSTRY BACKGROUND

The Automotive Parts & Accessories Association (APAA) is a trade association representing some 2,000 manufacturers, manufacturers' representatives, wholesalers, distributors, export management companies, and retailers. Our members make and sell the entire spectrum of automotive parts, accessories, tools, equipment, chemicals and supplies.

APAA's 1,000 U.S.-based manufacturing members represent a very significant share of the universe of 2,000 firms cited by USDOC as being engaged primarily or solely in automotive parts and accessories production. Thus, when I speak of APAA as industry's representative, the term refers to this vast number of firms. It does not imply that APAA speaks for every firm in the industry universe nor that APAA is the only group representing America's large and diverse auto parts industry.

According to *A Competitive Assessment Of The U.S. Automotive Parts Industry And The U.S. Aftermarket for Japanese Cars And Light Trucks*, International Trade Administration, U.S. Department of Commerce, March 1985, "about 50 percent of U.S. parts manufacturers supply both the OE and aftermarket, while the remaining 50 percent supply only the aftermarket."

APAA's membership includes broad representation of both types of firms. For example, our member firms form a substantial contingent of America's leading independent parts makers of all sizes, supplying components for engines, drive trains, electrical, steering, suspension, all other automotive systems, and the gamut of accessories, for U.S.-based vehicle assembly by U.S. OEM's.

PARTS INDUSTRY'S PRIORITIES MET SUPER 301 CRITERIA

Industrial powers and emerging countries alike have a common commitment to protecting their auto/parts making industries. A table of non-tariff government and industry barriers compiled from U.S. parts makers' responses to the USITC's 1987 investigation of the U.S. parts industry's global competitiveness provides an excellent summary of the leading protectionist tactics (Appendix B).

Since the first NTE was instituted by the 1984 trade act, APAA has worked with USTR and USDOC to ensure that it provide thorough coverage of tariff and nontariff barriers to U.S. automotive products trade. The 1989 NTE was especially important since its preparation was the first step in the Super 301 process. In addition to our regular NTE input, APAA submitted comments as part of the prioritization process.

We identified the practices of six countries: Japan, Canada, Korea, Taiwan, Brazil and Mexico. Our top tier rankings featured Japan, Canada and Korea.

In emphasizing Japan both in our remarks and in follow-up meetings with the Office of USTR, we reiterated our chief objective: to break the chains binding Japanese car companies and Japanese suppliers to the exclusion of U.S. companies. APAA doggedly has pursued this objective through Market Oriented, Sector Selective (MOSS) talks on auto parts and more than a decade of discussion with U.S. trade leaders.

We also contended that Canada's longstanding automotive policies—such as vehicle assembly and local content rules—present the greatest proof that such strings will skew parts procurement and investment away from the entire range of U.S.-based automotive suppliers.

Rounding out our top three was Korea with practices that combine Canadian style content rules with government/industry targeting resembling Japan.

Taiwan, Mexico and Brazil, as important emerging auto and parts making nations were cited for a myriad of unfair practices and investment distortions. Past NTE's have discussed these barriers but have not shown U.S. success in securing their abatement.

Ambassador Hills set four Super 301 selection criteria:

- (1) the potential to increase exports in the absence of barriers;
- (2) precedential value in achieving similar reductions elsewhere;
- (3) the likelihood of success; and, (4) compatibility with America's Uruguay Round objectives.

APAA believes its recommendations measured up to this yardstick in the following key ways:

(1) The potential for significant sales increases should we succeed in loosening Japanese OEM/supplier bonds is enormous. More U.S. parts sales to Japan-based OEM's would spur exports while more U.S. firms' sales to Japanese transplant assemblers would cut Japanese parts imports. These factors working together could shave the automotive products half of our bilateral trade deficit. The following statistics are evidence of the staggering challenge we face in cutting the parts trade deficit with Japan:

- Japan's parts trade surplus increased five-fold between 1982 and 1988, from \$1.6 billion to more than \$9 billion.
- Japanese OEMs' almost total reliance on Japanese suppliers holds U.S. sales to \$300 million, less than one third of one percent of Japan's \$85 billion market.
- Japan's transplant assemblers in the U.S. source only 25 to 35 percent U.S. value added in parts, a growing share of which is made by Japanese migrant suppliers.
- The true parts trade deficit includes that quarter of Japan's \$85 billion parts market devoted to building \$24 billion in cars and light truck exports to the U.S.

Indeed, with cars and parts imports totaling one-sixth of the U.S. world trade deficit it also is crucial that Canada, Korea and other automotive producing nations provide reciprocal access.

(2) By breaking through the shell surrounding Japanese OEM/supplier families to the exclusion of U.S. suppliers, we could establish a significant precedent and send a warning for emerging auto producing nations to steer clear of tight car maker/supplier family ties.

(3) Similarly, by successfully taking on Canada's Trade and Related Investment Measures that now discriminate against the use of U.S.-made parts, we would complement American negotiators' efforts through GATT to curb the use of TRIM's and other unfair trade and investment distorting practices. The value of the precedent also would be manifest in bilateral trade talks.

(4) As to the likelihood of success, APAA believes that all nations cited depend on continued U.S. market access, giving America the most potent market opening tool. As former Undersecretary Smart said at the August 1986 opening MOSS round, Japanese auto makers who benefited the most from access to the vast U.S. market also stood to lose the most unless Congress saw tangible market opening results. It is a sound maxim to apply in the Uruguay Round and in all bilateral dealings.

For APAA the significant factor is that USTR has initiated the Super 301 program and taken important first steps. While we are disappointed by the omission of the Japanese practices we named, it is significant that Japan at least was selected. While we agree that it is vital to challenge the type of trade and investment distorting practices for which India was selected, APAA would have preferred to include Canada's practices. We do credit USTR for making one important match for our industry in identifying Brazilian import licensing requirements now impeding U.S. cars and parts.

Since these early Super 301 steps will set the direction for the mission, APAA is eager to participate in the process. In light of our industry's \$14 billion export volume, and given the economies of scale that production for Japanese and other foreign based auto assembly could provide were these markets open, the potential for parts export growth appears unlimited. Therefore, APAA believes that a course of action that includes automotive products barriers is the only course that will lead to attainment of America's mission objective—significantly improved U.S. export opportunities.

RECOMMENDED REFINEMENTS

To ensure that America moves steadfastly towards our free trade objectives, we suggest the following steps to enhance the process for next year's Super 301 exercise as well as for NTE report preparation in subsequent years:

(1) The Super 301 public comment period should commence much earlier next year, and a Federal Register notice and comment period for NTE preparation in subsequent years is strongly recommended. The comment period should last at least two months. The responsible industry sector staff within USTR, and others in the interagency process should seek and incorporate more public comment, supplementing the important, albeit limited, ISAC level participation.

(2) Strong USTR coordination of the interagency process should begin with the publication of key contacts named by each agency at both the staff and policy making levels.

We stress the need for contacts because the process is best served by industry and government knowing one another and exchanging information. It also builds an important element of public accountability into the process.

(3) Industry sector contacts should make preliminary report copy available to all extent possible to interested parties. Material available only to ISAC members should be more easily accessible to members wishing to contribute to the report drafting process. Of course, the aspect of accountability hinges on agencies providing some indication as to the disposition of industry recommendations.

(4) Federal Register notice of interagency hearings should provide all interested parties the opportunity to testify or participate in a second round of written comments. Through past experience APAA finds the give and take of interagency hearings to be invaluable in gaining the viewpoint of various policy makers. This public airing of issues, unlike the closed ISAC process, stimulates discussion and enhances policy making.

(5) Finally, we believe that when the final selections are made, interagency contacts should provide interested parties with some rationale for excluding major items.

(6) The Congressional hearing review process provides a final and very important safeguard to ensure Administration responsiveness to American industries and workers.

Mr. Chairman, APAA has worked with this Committee and others in Congress to define trade objectives with respect to Japan, Canada and other countries. Administration trade leaders should stand ready to discuss the disposition of these common objectives.

INDUSTRY'S CASE FOR CITING JAPANESE SOURCING PRACTICES

Beginning with Japan, I will review major practices which were not identified by USTR yet continue to have tremendous negative ramifications for American industry, workers and the national economy.

Foreign car makers who can secure a significant share of the rich, open U.S. market while protecting their home market from import competition, always enjoy the upper hand in economies of scale and gain a global competitive advantage. For over 10 years and three Administrations America's auto parts industry has warned that this is the case with the Japanese.

APAA consistently has warned of the threat of market erosion for American made original equipment and aftermarket sales. Japanese auto/parts inroads in the U.S. through (1) direct and captive imports bearing little U.S.-made content, (2) transplant assembly using largely Japanese content and (3) greater Japanese-controlled parts in Big Three production could give Japanese auto/parts makers the potential to control between 40% and 50% of the content of all cars sold in America in the 1990's.

APAA similarly has predicted significant downstream erosion for American parts distributors, retailers and importers as they increasingly are displaced by new Japanese controlled sourcing and distribution channels.

U.S. GOVERNMENT STUDIES DOCUMENT JAPANESE STRUCTURAL BARRIERS

The structure of Japan's automotive industry long has excluded U.S. firms from equipping Japanese cars that dominate the world market: The International Trade Commission's December, 1987 report, *Global Competitiveness: The U.S. Automotive Parts Industry*, (USITC Publication 2037) provides an extensive discussion of the various Japanese industrial groupings, or keiritsus, each of which includes an auto producer, bank, related parts makers, and other financial and industrial operations.

The fact that keiritsus interweave companies "through equity exchanges, interlocking directorates, intra-group financial commitments, joint R&D efforts, and membership to exclusive management councils or clubs" has the reported, well-known effect of making it "difficult for potential outside suppliers (domestic or foreign) to sell to companies in the group."

While U.S. government and industry experts may characterize Japanese OEM/supplier links in warm and fuzzy terms such as "family ties," the 1987 Japan Economic Almanac, published by Nihon Keizai Shimbun, coldly and clearly portrays Japanese suppliers as "vertically integrated Japanese parts companies." Further, the Almanac explains how tight these ties are, likening Japanese parts producers to "faithful servants of a feudal warrior chief," the automakers.

PARTS PROCUREMENT BARRIERS IMPORTED

In its discussion of nontariff trade barriers, the USITC report cites former Commerce Assistant Secretary H.P. Goldfield's testimony that traditional Japanese family-like manufacturer-supplier relationships, and not the Japanese government, pose the primary barrier to U.S. auto parts sales to Japanese OEM's. Explaining that relationships are rooted not only in the Japanese market but also in the transplanted Japanese assembly operations here, Mr. Goldfield noted that these ties "have effectively precluded many U.S. suppliers from participating in this huge, fast-growing market."

Already vulnerable, our industry now faces the prospect of permanent preclusion from the transplant assembler market. Hundreds of Japanese suppliers are moving on-shore. Moving here originally to keep tight ties with Japanese car makers, these companies have set their sights on selling to traditional car making customers, and to cracking the lucrative U.S. aftermarket.

While the falling dollar should have sharpened the competitive edge of American companies seeking transplant sales, in many cases it turned against us by casting the U.S. as an investment bargain for the Japanese. Japanese car companies pass over attractively priced quality U.S. parts for parts from related Japanese supplier plants set up here. And these parts plants, like their car company customers, continue to import capital goods and subcomponents for their assembly operations and thereby contribute to the U.S. trade deficit. *Indeed, Japanese automotive investment in the U.S. appears to be increasing, rather than trimming, the trade deficit.*

CLOSED PARTS DISTRIBUTION WEB IMPORTED

Japan's closed parts distribution web has joined the closed parts buying system in the U.S. It is getting harder for America's independent aftermarket retailers and service outlets to provide replacement parts to owners of Japanese nameplate cars. Tightly controlled OE producers generally restrict replacement parts sales to the car dealer network only. And, since most U.S. and other independent parts makers do not have the economies of scale that OE sales provide, tool up costs for purely replacement parts production can be prohibitive.

MOSS INITIATIVE FALLS SHORT

While the 1986-1987 auto parts Market Oriented, Sector Selective (MOSS) demonstrated the sound economic and political reasons for Japanese OE and replacement parts buyers to purchase products outside of their supplier families, its two overriding goals of gaining U.S. competitors a fair shake at supplying Japanese car building and aftermarket service parts markets were not reached.

Today, nearly two years after the concluding MOSS round, little U.S. sales progress is evidenced in significantly cracking Japanese parts markets for high value-added components and systems. Japanese reports crediting billions of dollars in post-MOSS parts purchases from U.S. firms belie the progress made by non-family suppliers in cracking new business. Japan's data mostly reflects Japanese car company purchases from hundreds of Japanese supplier family members relocating in the U.S., ironically perpetuating the same tight bonds that the MOSS negotiations sought to loosen.

USTR RESPONSE

The 1989 NTE pronounced this diagnosis of the problem:

A prerequisite for selling most functional auto parts to Japanese vehicle makers is to become part of their supplier "family." "Nonfamily" suppliers are precluded from both the original equipment and replacement (aftermarket) auto parts markets for Japanese vehicles. *The United States is trying to persuade Japanese vehicle manufacturers to increase their purchases of competitive, high quality U.S. auto parts.* (Emphasis added.)

While APAA vigorously supports continued, intensified government to government pressure for increased sales, we believe the 1989 language should have incorporated the following strong statement which the USTR made in the 1987 NTE: The "United States is trying to persuade Japanese manufacturers to give fair consideration to competitive, high-quality U.S.-made parts." (Emphasis added.)

APAA sees the statements as complementary, in that it should not be difficult to get Japanese OEM's to increase their purchases of U.S. parts once our industry firms get fair consideration.

With Japanese cars taking increasing shares here and globally, American trade leaders should take very serious note of the USTR's 1989 NTE finding that Japan's automotive industry structure "precludes," or rules out in advance the use of U.S. OE and aftermarket suppliers.

Yet, the Administration's prescribed regimen as stated in the 1989 NTE offers two post-MOSS tonics which hardly fit the malady diagnosed: Japanese self-monitoring of U.S. parts purchases and greater Japanese government assistance with trade promotion events. Had the MOSS talks spurred significant restructuring of the Japanese procurement system, then Japanese industry monitoring of its purchases and greater Japanese trade promotion efforts could be helpful in sustaining the improving health of our bilateral parts trade relationship.

As subsidiary goals, however, they can support but never substitute for the primary goals of reforming Japanese parts sourcing practices. That these secondary issues continue to be emphasized as America's post-MOSS policy tools attests to the control Japan exerted over the MOSS agenda itself.

Sidestepping America's primary MOSS objectives, Japan cherry-picked lesser items such as trade promotion and sales monitoring from our negotiators' list of objectives. In the case of post-MOSS monitoring five of seven negotiating sessions were mired down by the issue of how Japan would self-monitor.

Rather than crafting a meaningful system that measures the genuine MOSS-related sales improvement of traditionally excluded U.S. firms, the agreed to method is geared to give Japan credit for purchasing from their transplanted traditional suppliers. Therefore, the U.S. effectively is rewarding Japanese OEM's for keeping the same tight structural tethers that MOSS was intended to unleash.

STATUTORY TOOLS SHOULD ENHANCE NEGOTIATING EFFORTS

Having shared the frustration borne of a decade filled with promise but little serious purchasing performance, Congress has not lost sight of our MOSS goals. They tailored three 1988 trade act provisions that go to the heart of the structural barriers.

(1) A sense of Congress resolution, adopted during the MOSS talks, calls on U.S. negotiators to overcome unacceptable Japanese barriers to U.S. OE and aftermarket sales, and asserted Congress' intention to judge the success of MOSS by a significant increase in U.S. parts sales and a significant increase in the number of long-term sourcing relationships initiated.

(2) The APAA-backed Quayle amendment mandates a five-year commitment to an Administration/industry/Congressional MOSS-like Japanese parts market opening initiative.

(3) With auto parts in mind, the Representative Levin/Senator Riegle amendment permits swift S. 301 retaliation against a foreign government's toleration of an unfair practice, rather than against the practice itself.

In pressing for Senate passage of this last provision, Senator Riegle was joined by Senator Wallop. As these sponsors explained, a government's toleration of discriminatory industry practices "*is just as damaging to U.S. exports as a direct action by the government.*" (Emphasis added.)

With the new Riegle/Levin provision the U.S. now may signal Japan and other foreign governments that they will be held accountable for the lack of fair commercial consideration for U.S. products.

To begin putting these statutory tools to work at prying open Japanese parts markets we believe the Administration should promptly form the new auto parts industry advisory committee. Directed by the Quayle amendment this committee is to help the Commerce Secretary shape an initiative to open Japanese parts markets in the U.S. and Japan.

Due to the lack of USDOC initiative to date 10% of the program's five year life has been lost and many market opening opportunities missed. APAA fears that those Japanese industry and government leaders who originally chafed at the continued political pressure brought to bear by the Quayle amendment now may question the seriousness of U.S. market opening intentions.

APAA believes that the implementation of a solid initiative and the ongoing MOSS follow-up talks should dovetail and bolster one another. The success of both efforts is to be judged by Congress who have resolved that significant new sales opportunities must be opened for U.S. parts firms.

APAA also applauds the novel Structural Impediment Initiative, which is to be chaired by USTR and includes the secretaries of Treasury and State. We see this effort as a vital separate approach to tackle the goals of structural change in Japanese parts procurement practices, goals that heretofore have eluded the MOSS process.

APAA also feels that this new initiative has tremendous potential to reinvigorate the remaining years of post-MOSS bilateral negotiations, and to redirect those discussions to overcoming private industry barriers.

Our potent new weapon for attacking foreign government toleration of anticompetitive private practices should fortify the new initiative as well as enhance all aspects of the Quayle initiative and the post-MOSS bilateral talks.

CANADA

Under their FTA maintained unilateral protectionism, Canada has carved out vehicle assembly and content shares, hoping to escape the ravages of an onslaught of car and parts imports.

In addition to providing unrivaled federal and provincial investment bounty Canadian policies provide two key reasons for foreign owned parts makers to invest there and gain a decided advantage over U.S.-based suppliers: (1) qualification as a Canadian-made part gives a preference, because Auto Pact savings are tied to Canadian parts purchases; and (2) similar duty remission benefits granted to Japanese and Korean transplants are contingent on use of Canadian parts.

Key provisions of our FTA legislation require swift action:

- (1) Study of the Auto Pact rules' impact, and proposed reforms.
- (2) A fresh approach to correct trade distorting production based duty remission programs. In March 2 testimony, Ambassador Hills promised to study the production-based remission program and its consequences for U.S. based suppliers. We await her report.

CLOSE MONITORING OF KOREA URGED

We have commended ROK's recent steps to lift import license restrictions and slash parts and car duties. But we must caution that these moves will mean little to our long term objectives if the overriding thrust of Korean automotive parts trade policy is an aggressive parts localization program.

USITC reports that "about 1,800 auto parts and components (estimated value at \$1.1 billion) that are currently imported will be localized during 1987-91." Indeed, in 1988 Duck-Soo Han, the key Ministry automotive industry official told Automotive News that "Absolute reduction in the level of the import bill will not be significant,

but at the present stage it may be meaningful because there has been no year when requirements for imports have been reduced."

It would appear that Korea has turned the corner and is heading down the home stretch towards attaining localization goals. The impact of recent ROK automotive trade distortions, noted in Appendix B, compels our continued watchfulness. Bilateral progress towards long-term reform of Korean TRIM's and other non-tariff impediments will enhance our important bilateral trade relationship. The results of these efforts should form the basis for whether or not Korea is named in the 1990 Super 301 process.

IMPACT ON URUGUAY ROUND

Strong GATT rules for all players coupled with firm, frequent bilateral talks that continue well beyond Super 301 are crucial. APAA believes this is a sound strategy for meeting our industry's top objectives: (1) ultimate dismantling of foreign impediments to American OE sales and (2) access to the global aftermarket.

SPECIAL 301 PROVISION

Two key APAA objectives, a global accord and tough bilateral negotiations with piracy havens, are within reach thanks to Special 301 and Ambassador Hills' swift, thorough implementation. Those nations that are indifferent to the plundering of U.S. intellectual property rights, sales, jobs and R&D should take action to reform their systems or face certain U.S. retaliation.

In closing, APAA stands ready to work with your committee, and to support Ambassador Hills and other Administration leaders in advancing free trade on three tracks: Super 301 related bilaterals, the Uruguay Round, and the new Structural Impediments Initiative to improve our relationship with Japan.

Enclosure.

APPENDIX A

PUBLIC VERSION

5100 FORBES BLVD. LANHAM, MD 20706. 301/459-9110. TELEX 4990739-APAAI (VIA ITT)



March 23, 1989

Ms. A. Jane Bradley
 Associate General Counsel
 Chairman, Section 301 Committee
 United States Trade Representative
 600 17th Street, N.W.
 Washington, D.C. 20506

RE: COMMENTS ON IDENTIFICATION OF PRIORITY PRACTICES TO BE CONSIDERED UNDER SECTION 310 OF THE TRADE ACT OF 1974, AS AMENDED (19 U.S.C., 2420)

Dear Ms. Bradley:

As president of the Automotive Parts & Accessories Association (APAA), I welcome this opportunity to discuss government and business policies and practices of nations that (1) block trade of competitively priced, world-class U.S. automotive parts and accessories, and (2) continue their exploitation of the open U.S. market for cars and parts.

APAA/Industry Background

The Automotive Parts & Accessories Association (APAA) is a trade association representing some 2,000 manufacturers, manufacturers' representatives, wholesalers, distributors, export management companies, and retailers. Our members make and sell the entire spectrum of automotive parts, accessories, tools, equipment, chemicals and supplies.

APAA's 1,000 U.S.-based manufacturing members represent a very significant share of the universe of 2,000 firms cited by USDOC as being engaged primarily or solely in automotive parts and accessories production.

According to A Competitive Assessment Of The U.S. Automotive Parts Industry And The U.S. Aftermarket for Japanese Cars And Light Trucks, International Trade Administration, U.S. Department of Commerce, March 1985: "about 50 percent of U.S. parts manufacturers supply both the OE and aftermarket, while the remaining 50 percent supply only the aftermarket."

APAA's membership includes broad representation of both types of firms. For example, our member firms form a substantial contingent of America's leading independent parts makers of all sizes, supplying components for engines, drivetrains, electrical, steering, suspension, all other automotive systems, as well as the gamut of accessories, for U.S.-based vehicle assembly by U.S. OEM's.

According to the United States International Trade Commission report, U.S. Global Competitiveness: The U.S. Automotive Parts Industry, Investigation No. 332-232, USITC Publication 2037, December 1987, independently owned parts makers produced between 38.0% and 48.0% of total parts shipments between 1982 and 1986.

While we do not know the OE versus aftermarket parts production breakout for either independent (or captive) parts makers, the USITC report underscores the fact that Big Three auto assembly operations rely on APAA members and other independent parts makers (foreign and domestic) for varying degrees of their OE needs: GM (30%), Ford (50%), and Chrysler (70%).

Moreover, USITC reports domestic OEM moves to reduce vertical integration. GM is leading the way, USITC explains, with "plans to increase outsourcing by 10%."

I would submit that America's independent parts makers, APAA members and nonmembers alike, play the predominant role in supplying at least 73% of the aftermarket needs for domestic nameplate vehicles, as determined by USDOC research.

U.S. Government Analyses

Since the first National Trade Estimate Report on Foreign Trade Barriers was instituted by the 1984 trade act, APAA has worked with USTR and USDOC to ensure that it provide thorough coverage of tariff and nontariff barriers to U.S. automotive products trade.

We urge the Section 301 committee to consider additional U.S. analyses, which expand on the 1987 National Trade Estimate Report country discussions, and/or provide entirely new discussions, on myriad specific tariff and nontariff barriers, as well as foreign industrial targeting, and the effects on U.S. automotive product sales. These reports include: USDOC's new Compilation of Foreign Automotive Barriers, December 5, 1988; USITC's 1985 report on Foreign Industrial Targeting And Its Effects On U.S. Industries Phase III, (USITC Publication 1632); and the USITC December 1987 report, Global Competitiveness: The U.S. Automotive Parts Industry, (USITC Publication 2037).

My comments will parallel APAA's testimony before House and Senate committees in addressing six priority nations: Japan, Republic of Korea (ROK), Taiwan, Canada, Mexico, and Brazil.

Concerning these six priority nations, I have attached pertinent excerpts from the Compilation of Foreign Automotive Barriers and the two USITC reports, as Appendices A, B, and C respectively.

Japan

1. Nature and Significance of Problems

Let me quote a leading Japanese industrialist. "In order to conquer the world, you have to secure the U.S. market." While the head of a leading Japanese chemical company is speaking, I believe his prescription for global success also sums up the game plan of Japan's car companies.

Foreign car makers who can secure a significant share of the rich, open U.S. market while protecting their home market from strong import competition, always will enjoy the upper hand in economies of scale and thus gain a global competitive advantage. Such is the case with the Japanese.

The Japanese have set their sights on the world's auto parts industry by securing the U.S. market, following the path that lead to their global car sales success. Japanese auto/parts inroads in the U.S. market through 1) direct and captive imports bearing little U.S.-made content, 2) transplant assembly using largely Japanese content, and 3) greater Japanese-controlled parts in Big Three production could give Japanese auto/parts makers the potential to control between 40% and 50% of the content of all cars sold in America by 1990.

Japanese Sourcing System Differs

The structure of Japan's automotive industry long has excluded U.S. firms from equipping Japanese cars that dominate the world market.

The 1987 National Trade Estimate Report on Foreign Trade Barriers, the U.S. Trade Representative's latest report to Congress on the costliest barriers facing U.S. parts sales, says of Japan:

The prerequisite for selling most functional auto parts to Japanese auto makers is to become, in effect, part of their supplier "family." "Family" suppliers work with auto makers from design and development stage to develop "genuine" or "original equipment" (OE) parts. The United States is trying to persuade Japanese manufacturers to give fair consideration to competitive, high-quality U.S.-made parts. (Emphasis added)

The International Trade Commission's December, 1987 report, Global Competitiveness: The U.S. Automotive Parts Industry, (USITC Publication 2037) provides an extensive discussion of the various Japanese industrial groupings, or keiritsus, each of which includes an auto producer, major bank, affiliated parts makers, and other financial and industrial operations. The fact that keiritsus interweave companies "through equity exchanges, interlocking directorates, intra-group financial commitments, joint R&D efforts, and membership to exclusive management councils or clubs" has the reported, well-known effect of making it "difficult for potential outside suppliers (domestic or foreign) to sell to companies in the group."

In its discussion of nontariff trade barriers, the report cites former Commerce Assistant Secretary H.P. Goldfield's testimony that traditional Japanese family-like manufacturer-supplier relationships, and not the Japanese government, pose the primary barrier to U.S. auto parts sales to Japanese OEM's. Explaining that relationships are rooted not only in the Japanese market but also in the transplanted Japanese assembly operations here, Mr. Goldfield noted that these ties "have effectively precluded many U.S. suppliers from participating in this huge, fast-growing market."

While U.S. government and industry experts may characterize Japanese OEM/supplier links in warm and fuzzy terms such as "family ties," the 1987 Japan Economic Almanac, published by Nihon Keizai Shimbun, coldly and clearly portrays Japanese suppliers as "vertically integrated Japanese parts companies." Further, the Almanac explains how tight these ties are, likening Japanese parts producers to "faithful servants of a feudal warrior chief," the automakers.

Japan's closed parts distribution web has joined the closed parts buying system in the U.S. It is getting harder for America's independent aftermarket retailers and service outlets to provide replacement parts to owners of Japanese nameplate cars. Tightly controlled OE producers generally restrict replacement parts sales to the car dealer network only. And, since most U.S. and other independent parts makers do not have the economies of scale that OE sales provide, tool up costs for purely replacement parts production can be prohibitive.

2. U.S. Interests Affected by the Practices

The bonds between Japanese car companies and Japanese parts suppliers significantly reduce the potential for original equipment sales of parts by U.S. firms for cars built by the Japanese for the U.S. market. The increasing role of Japanese parts suppliers in the U.S. market also is expected to erode the independent aftermarket.

Responding to the seemingly impenetrable barriers posed by Japanese industry structure, Mr. Goldfield told the Joint Economic Committee of Congress in April 24, 1986 testimony that "We intend to convince the Japanese vehicle manufacturers that sourcing from U.S. parts producers makes good business sense, and, it has the added advantage of making good political sense."

Market Oriented, Sector Selective (MOSS) talk status for auto parts trade was pursued to demonstrate the sound economic and political reasons for Japanese OE and replacement parts buyers to purchase products outside of their supplier families.

U.S. trade leaders, confident in U.S. world class competitiveness -- across the entire spectrum of components, accessories, chemicals, tools and other automotive supplies -- made the auto parts MOSS talks the focus of America's drive to open Japanese OE and replacement parts markets wherever Japan builds and sells cars.

Accordingly, we support the continuation of the U.S. initiative to open Japanese parts markets, as authorized in the new trade law. The MOSS talks have put Japan on notice that reciprocal treatment for U.S. automotive product sales is a top trade priority. Congress, the Administration and industry all agree that the ultimate objective of the MOSS negotiations is to significantly increase the purchases of competitive U.S. auto parts by the Japanese.

3. Volume of Trade

In 1987, Japan enjoyed a \$7 billion parts trade surplus with the U.S., a five-fold increase over its 1982 surplus. The components of this imbalance are striking:

In Japan, the Japanese auto makers rely almost exclusively on their traditional suppliers of parts. Of the \$85 billion parts market there, U.S. firms sell less than \$300 million. This means that U.S. suppliers hold less than one third of one percent market share (.0033) of the Japanese market.

In the U.S., transplanted Japanese auto makers assembling cars continue to import a high volume of parts and subassemblies, using only 25 to 35 percent U.S. value added in parts. Moreover, a growing share of those local parts sources are traditional Japanese suppliers now operating in the U.S. Hence, little of this estimated \$4 billion market is supplied by American owned parts makers

To get an even clearer picture of the true parts trade deficit, one must consider that more than a quarter of Japan's largely exclusive \$85 billion parts market is devoted to building \$24 billion in cars and light truck exports to the U.S.

Fully one half of America's 1987 trade deficit with Japan can be attributed to imbalances in car and parts trade.

Today, eighteen months after the conclusion of the MOSS talks, American suppliers face the prospect of substantially closed Japanese auto maker/supplier families controlling the majority of the content of cars sold not only in Japan but in America as well.

Japanese reports crediting billions of dollars in post-MOSS parts purchases from U.S. firms belie the limited progress made by non-family suppliers in cracking new business. In reality, Japan's data mostly reflects Japanese car company purchases from hundreds of Japanese supplier family members relocating in the U.S., ironically perpetuating the same tight bonds that the MOSS negotiations sought to loosen.

Supplier Migration Endangers U.S. Economy

Moves by Japanese OEM's that directly or indirectly encourage relocation of their supplier families to the U.S. could further decimate American parts sales. Bringing closely related Japanese parts manufacturers to America is not a market opening gesture. Independent studies show, and Japan's car manufacturers know, that there are highly competitive U.S. manufacturers in every automotive product category. The capacity to supply parts already exists in the U.S. It is not necessary for the Japanese vehicle assembly plants in the U.S. to build a base of Japanese owned parts suppliers as well. Indeed, Japanese OEM's should show good faith by averting this migration and turning to existing American sources.

We believe Japan's frontal assault on our industry would prove disastrous for America's economy. Japanese automotive investment in the U.S. appears to be increasing, rather than trimming, the trade deficit.

Transplanted Japanese auto makers and migrant parts makers retain ties to their traditional suppliers of components, subparts, materials, and capital goods. As the output of Japan's transplanted auto industry essentially adds to, rather than displaces, torrents of Japanese vehicle exports, the red ink will continue to worsen.

The fact that Japan's direct automotive investment operations in the U.S. do "final assembly, putting together components or subassemblies mainly imported from Japan" is the chief reason for why the transplants here have not created massive unemployment in Japan according to a recent Japan Economic Institute analysis.

Japanese takeover of the American automotive industry also would come at the cost of further deterioration in our balance of payments account with Japan. Billions of dollars of U.S. industry profits would move to foreign hands, while the control of much of America's industrial base, wealth and jobs would move offshore.

American workers must face the worst consequences. Recent projections by USDOC, GAO, and the United Auto Worker Union cite auto making and supplier sector job losses ranging from 100,000 to 500,000 by 1990, attributed largely to growing Japanese market predominance.

Republic of Korea (ROK)

1. Nature and Significance of Problems

Similarly tight OEM/supplier linkages engendered by the government/industry policies and practices of ROK present a significant Japan-like assault on U.S. firms' OE and aftermarket parts sales at home and abroad. While absorbing relatively few U.S. parts imports, Korea expects the U.S. to soak up their finished car and parts exports.

Concerning nontariff barriers, while no formal domestic content requirements exist, the ROK government sets local content requirements on a company by company basis, according to USDOC.

Cartel and Monopoly Practices

AFAA worked with Congress to include in the trade bill, for the first time, a credible statutory threat of swift retaliation against a foreign government's toleration of an unfair practice, rather than the unfair practice itself. Members of Congress pioneered this change based on experiences of parts firms denied fair commercial consideration in markets whose governments countenance anticompetitive systems.

We would note that ROK, according to USITC's 1985 targeting report, "is trying to eliminate cartel arrangements and other

monopolistic practices," but permits such arrangements and practices in the auto industry and others where mergers are "considered necessary or beneficial to the rationalization of the industries concerned."

ROK Government Automotive Industrial Policy

The USITC's 1985 targeting report concluded that the Korean government has designated the auto industry a "strategic export industry."

Accordingly OEM's have priority access to the nation's limited credit and export incentives. ROK protectionism, the commissioner concluded, began in 1966 and required domestic content of 20 to 90 percent in vehicle production, and limited foreign investment to 50 percent in an auto manufacturing facility."

While ROK recently liberalized trade by lifting import license restrictions on a number of auto parts imports, APAA fears this represents a hollow victory.

Of chief concern to our industry and nation is ROK's recently instituted five-year localization plan for parts import substitution. Its primary objectives are (1) more complex parts production and (2) reduction of ROK's parts trade deficit with Japan. Since many Korean cars are of Japanese design, Japanese parts makers traditionally have had market access.

2. U.S. Interests Affected by the Practices

USITC reports that "about 1,800 auto parts and components (estimated value at \$1.1 billion) that are currently imported will be localized during 1987-91." That ROK's government and industry will meet or beat their goal is not in serious doubt. Consider the fact that the USITC targeting report completed in late 1984 observed that "Korea is not yet a major exporter of automobiles, but it is reportedly making plans to break into the U.S. auto market with Daewoo and Hyundai cars." Next year Korean car exports to the U.S. could hit 500,000 units.

American OEM's have ROK-based production and will continue those plants according to their competitive strategies. As they responded to Canadian automotive protectionism, so they establish operations in response to protectionism in the subject countries. Longstanding Canadian automotive policies have demonstrated that those nations that tie strings to car sales in its market, such as Canadian assembly and value added safeguards, skew parts procurement and investment away from the entire range of U.S. parts, accessories, and other automotive supply sources.

The impact of ROK distortions is revealed in survey findings of USITC's global competitiveness study, attached as Appendix D. Ten percent of U.S. parts manufacturers cited ROK local content barriers and nine percent alleged restricted South Korean business practices and discriminatory purchasing -- placing ROK right behind Japan.

3. Volume of Trade

Given ROK government/industry commitment to parts localization, APAA fears that the current window of opportunity for U.S. parts imports to displace Japanese imports will not be open very wide or very long.

ROK government and business barriers are converging to lock in sales for local auto parts suppliers, and to bar the door to U.S. made parts. The resulting automotive products trade imbalance in car and parts will continue to worsen.

--ROK car production soared from 162,000 in 1982 to more than 900,000 units in 1987, while car exports surged from 20,000 units in 1982 to some 600,000 in 1987. ROK parts exports followed suit, increasing from \$68 million in 1982 to \$247 million in 1987. Of the steadily declining ROK

parts imports, \$300 million in 1987 vs. \$340 million in 1983, Japan dominated, leaving little share for U.S. suppliers.

--To get an even clearer picture of the true parts trade deficit, one must consider that as early as 1986, one-sixth of ROK's largely exclusive \$2.3 billion domestic parts market was devoted to building 100,000 car exports to the U.S., and another one-third equipped cars destined for third markets. With ROK car shipments to the U.S. seen rising to more than 300,000 units this year, an increasing portion of our total bilateral trade imbalance with ROK will be attributable to imbalances in car and parts trade.

Taiwan

1. Nature and Significance of Problems

Prior to 1985 Taiwan's 70 percent duties on auto parts and other products could be raised or lowered 50 percent at the discretion of officials. Because Taiwan is not a GATT member, its tariffs are not bound by international accord.

The USITC's global competitiveness report explained that prior to 1985:

Taiwan authorities provided incentives for foreign auto makers to construct assembly plants in Taiwan by creating import barriers and levying a 70 percent domestic content requirement on the auto assemblers in order to develop the Taiwanese automotive parts industry.

Taiwan's automotive industrial policy worked: eight assembly plants were established in Taiwan by 1985, as represented in the table attached as Appendix E.

The 1987 USITC report goes on to cite Taiwan's new auto industry development plan, targeted at encouraging more competition by lowering auto parts duties from 70 percent to the continued 50 percent rate. The most recent Taiwanese plan calls for auto parts tariff cuts to 20 percent by 1991. According to USDOC local content rates were liberalized modestly in 1987 from 70 percent to 50 percent.

2. U.S. Interests Affected by Practices

As a targeted industry, defined by growth pace and export potential, Taiwan's automotive industry qualifies for a myriad of tax benefits, including corporate income tax exemption for nine years and import duty rebates.

Now that many U.S. and other foreign investors have access to target industry perks, some of the sting of domestic content and other trade distorting practices may be lessened. However, as the target market, the vast majority of America's independent automotive parts industry and its workers face the barrage of imported auto/parts created by these distortions.

From our perspective we also must ask the ultimate value of Taiwan's import liberalization plans: are there serious intentions to buy?

3. Volume of Trade

Taiwan amassed a huge \$450 million 1986 parts trade surplus with the U.S. according to USITC reports. The vast, open U.S. market absorbed nearly two-thirds of Taiwanese parts exports, up from the high 42 percent ratio of 1982, and in stark contrast with the two percent absorbed by Japan.

According to Taiwanese auto export plans, summarized in Appendix F, by 1990 American industry could face Taiwanese car imports bearing little U.S. content. We would note that in 1986 Japan supplied 80 percent of Taiwanese parts imports used for vehicle assembly, compared with a 6 percent U.S. share.

Canada

1. Nature and Significance of Problems

In Canada protectionistic assembly and value added rules effectively pull parts sales away from U.S. sources. APAA's one FTA objective to end these sales and investment distorting practices was thwarted when the Administration accepted a lopsided agreement allowing unilateral Canadian protectionism.

Canada came to the FTA negotiating table with a long term strategy designed to escape the ravages of an onslaught of car and parts imports. Moreover, they insisted on keeping protectionistic schemes that can take foreign automotive investment now threatening to choke North American markets with excess capacity, and exploit it to Canada's advantage, at least in the short term. Indeed, Canadian government policies reward the Japanese both for bringing their sourcing system to North America and for making duty-free inroads into the vast and unprotected U.S. market and its open, competitive sourcing system.

Summary of Trade/Investment Distortions

In addition to providing unrivaled federal and provincial bounty to attract foreign parts making investment, Canadian policies provide two key reasons for foreign owned parts makers to invest there:

- 1) Qualification as a Canadian-made part gives a discriminatory edge, because Auto Pact tariff savings are tied to Canadian parts purchases.
- 2) Similar duty remission benefits granted to Japanese and Korean transplants are contingent on use of Canadian parts.

U.S.-based parts companies are at a decided disadvantage, as supplier migrants lock up long term sourcing agreements

Auto Pact/Multilateral Sourcing

In addition to promoting unrivaled bounty, deep currency discount, and other Canadian advantages, Canada also provides a springboard for Japanese, Korean and other foreign owned suppliers to ship OE duty free to both domestic and transplant assemblers in the U.S. And that is the kind of production scale that makes the investment pay.

Under Auto Pact, Canada lets its Big Three car makers import parts and cars duty free from any country. Such multilateral sourcing is a privilege that saves hundreds of millions in annual duty dollars for the Big Three OEM's who qualify as Pact participants. That sounds like free trade, but it isn't. Because the membership rules for this powerful club require Pact manufacturers to produce one car in Canada for each car sold there and to create 60¢ worth of Canadian cars and parts for each dollar's worth of vehicles sold there.

We wanted Canada to end this multilateral sourcing privilege and to implement the Auto Pact, as the U.S. does, on a bilateral basis, with only U.S. and Canadian firms enjoying the preference. As it stands, Canadian parts makers would continue to get preferred treatment here, while U.S. exports would end up sharing the benefit of duty-free access with third country competitors.

Because the use of Canadian parts earns credit towards continued use of these huge sourcing benefits, the Auto Pact safeguard is a major reason for foreign parts makers to plant stakes in Canada.

Duty Remission

The 1986 Canadian task force report (excerpt attached as Appendix G) reiterates Canadian industry's 1983 call for imposition of Universal Auto Pact. By 1990, all OEM's selling vehicles in Canada would be required to "create Canadian value-added (CVA) in vehicle or parts production equal to 60% of their cost of sales in Canada."

We are pleased that the FTA freezes Auto Pact membership, thereby blocking imposition of Universal Auto Pact. However, APAA objects to FTA's treatment of non-Auto Pact companies, and its continuation of Canadian duty remission schemes for as many as 10 more years. These programs grant similar benefits to non-North American companies that commit to increased export of Canadian parts, or agree to Canadian vehicle assembly and increased Canadian parts procurement for assembly there.

Speculation is that these latter production-based deals are especially close to Auto Pact rules and benefits. We are not sure --- because U.S. negotiators generously agreed to their continuation without ever seeing them. The bottom line is that Canada ensures that non-Pact members who cannot escape the duty nevertheless would enjoy the fruits of this trade distorting duty rebate program for as many as seven more years.

This program provides yet another powerful investment lure for Japanese and Korean parts makers to follow their car maker customers to Canada.

2. U.S. Interests Affected by Practices

U.S. parts companies are at a decided disadvantage in competing for business in Canada. Canadian policies' impact on supplier migration will cast sourcing decisions based on high value-added, engineered drivetrain, engine and other components for many years, perhaps permanently. Thus, the negative effects for U.S. firms will drag on long after the FTA's seven year extension of production based duty remission programs, and will continue as long as Canada ties Auto Pact benefits to use of Canadian made parts.

I want to comment on two common misperceptions about Auto Pact. First, the assertion that the Pact's safeguards really make no difference. While it is true today that the Big Three easily exceed the rules, recent Congressional testimony revealed that two OEM's failed to meet the safeguards as recently as 1980.

Rather than pay duties on their imports into Canada, they undertook additional investments there. One auto maker experienced similar problems during 1973-75, and had to add truck production.

It was at that time the U.S. International Trade Commission (USITC) was warning the Senate that North American auto assembly decisions were being guided not by the invisible hand of market forces, but by the very visible hand of Canadian protectionism.

USITC's judgment of 10 years of Canadian Auto Pact implementation and APAA's views on the FTA are roughly the same: neither the Pact nor the FTA is free trade, neither the Pact nor the FTA is mutually beneficial. While we concur with industry experts' projections that overcapacity could close 20 North American auto assembly plants, APAA expects U.S. plant closings before any Canadian production is jeopardized.

The second contention is that over ten years, the FTA would gut the Auto Pact by eliminating all car and parts duties. Without tariffs, it is argued, Canada's Big Three would abandon the Pact and its rules. Both assertions miss the point: the FTA does not alter the real hook that will keep them in the Pact, global duty free sourcing of cars and parts.

By combining the Canadian content rules and the duty-free ride accorded other countries' suppliers, picture cars built in Canada without a dime's worth of U.S. content and meeting the "North American" rules for duty free access here.

3. Volume of Trade

Given duty remission's similarity to Auto Pact, it is fair to say that Canada has approximated its goal for 1990. It also is fair to give Canadian industry's scenario for 1990 under a regime of Canadian content and production rules. Although vehicle imports into North America would rise to 28 percent, "primarily because of the unrestricted U.S. market," the 1986 report contends that Canadian value added requirements would prevent increased imports from having "significant negative impact in Canada."

Rather, "because of the value added requirements and because the additional investment by offshore producers would stimulate increased Canadian auto parts production that might feed U.S. plants," Canadian auto industry would outperform the U.S. industry, as shown in Appendix G data. Because of this "vastly different trade strategy," the leaders project 45 percent growth in net auto industry shipments from 1984 to 1990.

Precedent Setting

Other corners of the globe pose similar hurdles to U.S. parts sales. Industrial powers and emerging nations alike have a common commitment to protecting their auto/parts making industries -- be it Mexican and Brazilian content rules or stiff EC car import quotas to name but a few.

Domestic content/performance requirements continue to pose the gravest peril to U.S. automotive product exporters, denying them the benefits of OE/aftermarket production economies for cars that will be sold in the U.S. and other markets. Moreover, U.S. parts makers' sales are further slashed as America's open market soaks up imported cars, thereby displacing domestic production of high American value added cars.

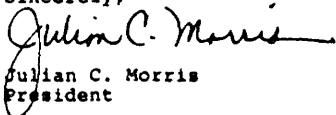
Accordingly, APAA urges a fresh approach to correct trade distorting Canadian Auto Pact and production-based duty remission programs, as a precedent upon which U.S. negotiators may seek the elimination of similar trade and investment barriers in Mexico, Brazil and other emerging auto/parts producing nations.

We commend the USTR for its annual attention to Brazilian and Mexican domestic content/export performance requirements, and other impediments to U.S. parts exports, as set forth in Appendix H. We believe that successful resolution of Canadian trade barriers could pave the way for progress. Given the fact that the FTA-created binational blue ribbon panel on automotive products trade is charged not only with ensuring greater free trade between our nations, but also greater access for U.S. and Canadian automotive product exports in third markets, it is especially vital that we make the attainment of reciprocal, bilateral free trade in autos and parts a top negotiating priority.

In closing APAA stands ready to work with your committee, and to support Ambassador Hills, in gaining our very vital industry and its hundreds of thousands of American workers their fair chance to compete and succeed in global markets.

Please let me know if you have any questions or desire further information.

Sincerely,



Julian C. Morris
President

FILED WITH APPENDIX A

TO JULY 5, 1989 STATEMENT
OF MR. JULIAN C. MORRIS

Summary of Foreign Motor Vehicle Trade Restrictions¹

Country	LCR	IR ²	ER	Operations:		
				Japanese	U.S.	EC
Algeria	No	Yes	No	No	No	Yes
Argentina	Yes	Yes	Yes	Yes	Yes	Yes
Australia	Yes	No	No	Yes	Yes	No
Austria	No	No	No	No	Yes	Yes
Belgium	No	No	No	No	Yes	Yes
Bolivia	No	No	No	No	No	No
Brazil	Yes	Yes	No	Yes	Yes	Yes
Canada	No	Yes	No	Yes	Yes	No
Chile	Yes	No	No	No	No	No
China	Yes	Yes	Yes	Yes	Yes	Yes
Colombia	Yes	Yes	Yes	Yes	Yes	Yes
Denmark	No	No	No	No	No	No
Ecuador	No	Yes	No	No	No	No
Egypt	Yes	Yes	No	No	Yes	Yes
France	No	No	No	No	Yes	Yes
Germany	No	No	No	No	Yes	Yes
Ghana	No	No	No	Yes	No	Yes
Greece	No	No	No	Yes	No	Yes
India	No	Yes	No	Yes	No	Yes
Indonesia	Yes	Yes	No	Yes	Yes	Yes
Israel	No	Yes	No	No	No	No
Italy	No	Yes	No	No	No	Yes
Japan	No	No	No	Yes	No	No
Kenya	Yes	Yes	No	Yes	Yes	Yes
Kuwait	No	No	No	No	No	No
Malaysia	Yes	No	No	Yes	Yes	Yes
Mexico	Yes	Yes	Yes	Yes	Yes	Yes
Morocco	No	No	No	No	Yes	Yes
Netherlands	No	No	No	No	No	Yes
New Zealand	Yes	Yes	No	Yes	Yes	Yes
Nigeria	Yes	No	No	No	No	Yes
Norway	No	No	No	No	No	No
Pakistan	Yes	Yes	No	Yes	No	Yes
Peru	Yes	Yes	No	Yes	Yes	Yes
Philippines	Yes	Yes	Yes	Yes	No	No
Portugal	Yes	Yes	No	Yes	Yes	Yes
Romania	No	Yes	No	No	No	Yes
Saudi Arabia	No	No	No	No	Yes	Yes
Singapore	No	No	Yes	Yes	Yes	Yes
South Africa	Yes	No	No	Yes	No	Yes
South Korea	Yes	No	No	No	No	No
Spain	Yes	Yes	Yes	Yes	Yes	Yes
Sweden	No	No	No	No	No	No
Switzerland	No	No	No	No	No	Yes
Taiwan	Yes	No	No	No	Yes	No
Tanzania	No	Yes	No	No	No	Yes
Thailand	Yes	No	Yes	Yes	Yes	Yes
Turkey	Yes	No	No	No	Yes	Yes
U.K.	No	Yes	No	Yes	Yes	Yes
U.S.A.	No	No	No	Yes	Yes	Yes
Uruguay	Yes	No	Yes	No	No	Yes
Venezuela	Yes	Yes	Yes	Yes	Yes	Yes
Yugoslavia	No	Yes	No	No	No	Yes

NOTE: LCR = Local Content Requirements
IR = Import Restrictions
ER = Export Restrictions

¹ The measures cited in this chart are for new cars. Trade restrictions on used cars are not reflected.

² Import restrictions apply to non-tariff measures maintained by a country which deal solely with imports. Tax measures which apply to both imports and domestically produced products are not included.

FOREIGN INDUSTRIAL TARGETING AND ITS EFFECTS ON U.S. INDUSTRIES PHASE III: BRAZIL, CANADA, THE REPUBLIC OF KOREA, MEXICO, AND TAIWAN

Temporary employer cartels.--Due to the shortage of skilled workers in Korea, particularly in electronics, the Electronic Industry Association of Korea (EIAK) has established a temporary coordinating committee to prevent the unfair recruitment of skilled workers from competitors that EIAK feared would occur as new conglomerates entered the electronics business in Korea. The Government did not oppose EIAK. Also the Government has acceded to overseas construction industry efforts to reduce competition among Korean firms when demand in overseas construction markets lessened.

Wage controls.--The Korean Government has used wage controls to help maintain the competitiveness of Korean products in international and domestic markets. 1/ A wage council was formed in June 1983 to assist in implementing the Economic Planning Board's wage guidelines, which are intended to lower Korean wages to levels existing in rival exporting countries.

Targeting Techniques for Specific Korean Industries

Automobiles

The Korean Government has designated the auto industry a "strategic export industry." Auto manufacturers, like other so-designated industries, will receive priority access to the Republic of Korea's limited credit facilities and other export incentives. Also, automobiles and auto components are on the restricted product import list and require prior approval by the Korean Auto Industrial Cooperative (KAIC) trade association before licenses are approved, "in accordance with the supply and demand situation in Korea." Consequently, import licenses are rarely issued and the domestic industry is effectively protected from imports.

Since 1966, Korea has protected its home auto market and stimulated domestic production by requiring a certain proportion of local content, varying from 20 to 90 percent. (Today, most cars have 60 to 95 percent local content.) Korea also limits foreign ownership investment to 50 percent in an auto manufacturing facility.

In 1981, the Government tried unsuccessfully to merge three major carmakers (Hyundai Motor Co., Kia Industrial Co. and Sashan Motor Co.) in order to rationalize the industry. Under one restructuring plan, the Daewoo group was to give up one-half of its auto company and take over Hyundai's heavy construction and power-generating equipment business. Sashan and Hyundai were then to merge into a single company. Kia was to exit from the passenger car business and concentrate on trucks. 2/ The merger was not successful because the companies involved could not agree on the terms. 3/ Sashan Motors later became Daewoo Motors under another restructuring plan in which General Motors reduced its equity in Sashan to 50 percent and gave management control to the Daewoo group.

Korea's vehicle industry is composed of nearly 600 parts manufacturer and 6 major assemblers. The largest company is Hyundai, followed by Daewoo Motors. Hyundai has connections with Mitsubishi and Ford, and Daewoo is a

1/ Reorwin, op. cit., p. 23.

2/ Koo, op. cit., p. 48.

3/ Business Week, Oct. 13, 1981, pp. 56-57.

50/50 joint venture with General Motors. Korea is not yet a major exporter of automobiles but it is reportedly making plans to break into the U.S. auto market with Daewoo and Hyundai cars. 1/ To date, most exports go to Africa, Latin America, and the Middle East. European countries receive about 25 percent of Korea's auto exports.

Computers, semiconductors, and telecommunications

The computer and semiconductor industries in Korea were designated as "strategic industries" by the Government in the early 1980's. Consequently, these industries have received a number of incentives to promote growth and development such as import protection, and Government support for R&D, credit allocations, tax breaks, and exemptions from military service for research employees.

Import restraints.--The Government has established criteria for importing computers into Korea. Imports of medium and larger sized computers are permitted, whereas imports of small personal computers have been banned since 1982. In this way, the Government hopes to encourage foreign suppliers to participate in manufacturing computers in Korea through technology transfer or through making computer parts in Korea. As a possible consequence of this policy, 23 foreign manufacturers have made technical agreements with Korean firms since 1980.

The import criteria for computers are determined by a computer import committee in the Electronics Industry Association of Korea and are subject to revision as market conditions dictate. The criteria have been changed gradually to allow for the import of some small computers.

Financial incentives.--Long-term, low-interest financing is available for the small- and medium-sized companies' R&D, primarily from the Electronics Industry Promotion Fund. The amount is \$2.5 million to be shared by 30 to 40 electronics companies. Loans are repayable over 3 years, after a grace period of 2 years at an interest rate of 6 percent per annum. Loans are available from the National Investment Fund, repayable over 10 years after an initial grace period of 2 to 3 years, at an annual interest rate of 10 percent. In addition, the Korean Government will provide up to 270 billion won to the semiconductor industry by 1986 under the Semiconductor Industry Fostering Plan introduced last year. 2/ These loan funds are to be accompanied by a wide range of tax breaks for the industry.

The Korean Institute of Electronics Technology (KIET) conducts basic research in semiconductor and computer systems. In 1983, its budget was \$20 million. The Korean Technology Development Cooperation (KIDCO), established in 1981 to facilitate financing for R&D, finances the development of new technologies, products, and processes. A total of \$70 million will be invested; \$8 million by the Government to cover research and development costs from 1981 to 1984. The KIDCO and the Korea Development Bank have a major role in the development of new technologies, products, and processes and granted the electronics industry (including computers and semiconductors).

1/ See John Burgess, "South Korea Eyes U.S. Auto Market," The Washington Post, Oct. 7, 1984, F-1.

2/ "Out of the Laboratories and into the Factories," BUSINESS KOREA, vol. 2, No. 2, August 1984, p. 27.

TAIWANESE TARGETING

The basic laws governing investment in Taiwan are the Statute for Encouragement of Investment, the Statute for Investment by Foreign Nationals and the Statute for Investment by Overseas Chinese. Foreign investment is generally allowed 1/ if it results in the establishment of (1) productive enterprises needed in Taiwan or firms that generally are conducive to the economic and social development of Taiwan; (2) enterprises which are totally export-oriented; or (3) enterprises which develop and improve domestic capabilities in specified "important" industrial, mining, and communications sectors. The authorities do not require foreign firms to form joint ventures with local interests, even in strategic sectors.

Export performance requirements.--Until recently, strict export performance requirements meant that foreign firms investing in Taiwan had to export half of their production. In early 1984, the Minister of Economic Affairs announced that in certain cases Taiwan would no longer hold foreign companies so strictly to this requirement. However, foreign investors in some targeted industries will still face such requirements. For example, according to Ministry of Economic Affairs officials, export requirements will still be rigidly enforced in autos. In other industries, the officials said, export quotas will be more flexibly applied. Few foreign firms have complained about the requirements because, with Taiwan's limited internal market, they usually invest for export purposes.

Local content and other requirements.--The authorities may also require specified technology transfer, local ownership, and local content before approving foreign investment applications. Local content requirements specifying a certain percentage of the final product's value that must be made in Taiwan are now in effect for a number of manufactures. These include automobiles, television sets, telephone equipment, motorcycles, and steelmaking equipment. The required local content varies by product, but usually ranges from 50 to 100 percent. Local content requirements for new investments are limited to four categories: VTRs, automobiles and trucks, televisions, and motorcycles. 2/ The local content ratio is measured by the value of completed knocked down parts less imported parts divided by the total price of the final good (labor content in the final assembly is not included in the calculation). If at least 50 percent of the value of a part is derived from locally procured materials, the part qualifies as locally made.

1/ No private investment is allowed in firms involved in producing military goods, or in the tobacco, wine, utility, and petroleum industries. Also, inland transportation is closed to foreign investment while foreign investment in trust companies and other nonbank financial institutions is limited to 40 percent of the registered capital. Foreign banks can establish branches in Taiwan if they have done over \$4 million in business with Taiwan financial institutions and they have been doing business with Taiwan banks for more than ten years. These conditions are dropped when Taiwan banks have branches in the home country of the foreign bank.

2/ For televisions, the Government requires 60 percent local content, but will eliminate that requirement in 2 years; for VTRs, local content requirements are 45 percent currently and will be increased to 55 percent in 2 years; for cars, required local content is 70 percent and for light trucks and heavy trucks 30-55 percent (at this time, neither is slated to be reduced or eliminated).

types of firms qualifying for special treatment are listed in implementing laws. These criteria are updated frequently to reflect changes in industrial policy and market conditions. 1/

The authorities use two approaches to promote industry through the tax system. First, they make incentives available to firms in the segments of existing industries which they feel will be competitive in the future. The specific eligibility criteria for such tax incentives are spelled out on an industry-by-industry basis in implementing resolutions to the Statute. 2/ Depending on the situation in the industry, tax incentives might be available for exporting, achieving economies of scale, increasing domestic content, or upgrading production technology. For example, in ethylene manufacture, only firms with a minimum capacity of 200,000 metric tons can qualify for incentives. 3/

The second approach to using incentives involves designating "strategic" industries. Unlike the above approach, which may apply to a few firms in most industries, this approach applies to most firms in a few, specially selected industries. These industries can broadly be described as growth industries with export potential such as automobiles, computers, electronics, and machinery. 4/

Firms that fall into these two categories qualify for numerous tax benefits, including up to 9 years of exemption from corporate income taxes, and rebates of import duties, transactions and excise taxes.

The main benefits for targeted industries are described below:

- New firms may choose either to take a 5-year tax holiday or depreciation of new, state-of-the-art equipment at a rate twice as fast as is normally allowed. 5/ The company may defer the start of the tax holiday for up to 4 years. In addition, revenues arising from subsequent increases in productive capacity are tax-free for 4 years, or further equipment

1/ The Statute was promulgated on Sept. 10, 1960 and amended in 1960, 1963, 1967, 1970, 1973, 1974, 1977, 1978, 1979, 1980, and 1981.

2/ Particular types of firms in the food processing; pulp and paper; rubber processing; chemicals; non-metallic mineral processing; basic metallic manufacturing; machinery; electrical equipment manufacturing; electronics; transportation equipment; textiles and apparel; other manufacturing; mining; agriculture; forestry; fishery; animal husbandry; transportation; warehousing; public utility; housing construction; technical services; tourist hotel; and heavy equipment construction industries qualify for "encouragement" in Taiwan. (As described in "Categories and Criteria of Productive Enterprises Eligible for Encouragement, May 1982.")

3/ As cited in the "Categories and Criteria for Productive Enterprises Eligible for Encouragement," as revised and promulgated by the Executive Yuan on Jan. 7, 1982.

4/ Many firms in the machinery; automobile parts; electric machinery; computer system products; consumer electronic products; electronic components; electronic communications equipment; electronic industrial systems; and computer software are considered "strategic" in Taiwan. As listed in "Applicable Scope of the Strategic Industry," Sept. 24, 1982.

5/ The normal service life of equipment for tax purposes is set out in Government guidelines.

expenditure may be depreciated at an accelerated rate. Almost all firms choose the 5-year tax holiday over accelerated depreciation. The Statute requires that domestically-made products be purchased, but exemptions are often made for sophisticated equipment. Therefore, the tax incentives may actually boost imports somewhat in the short run.

- Reduced income tax rates are also assessed for targeted industries. The maximum income tax rate is lowered from the normal rate of 25 or 35 percent to 22 percent.
- Firms in targeted industries often do not have to pay import duties or can pay them on a deferred basis.

Export tax incentives

Exporting firms also qualify for preferential tax treatment under the Statute. However, most of these measures--including the rebates of domestic business (transaction) taxes, commodity (excise) taxes, stamp taxes, and import duties--are intended to prevent double taxation. The following incentives are available to exporting firms:

- Business taxes ^{1/} are not applied to export sales.
- The enterprise may set aside a tax-free reserve for foreign exchange losses equaling up to 7 percent of the outstanding amount of foreign currency loans.
- The enterprise may set aside a tax-free reserve for losses arising from exporting not to exceed 1 percent of the prior year's export sales.
- Stamp taxes ^{2/} on exports and services which earn foreign exchange are reduced from 0.4 percent on domestically sold merchandise to 0.1 percent.
- The allowable income tax deduction for entertainment expenses is increased for export firms. ^{3/} This is designed to take into account the higher cost of international travel.
- A commodity tax, which ranges from 3 to 120 percent ad valorem, is levied on 19 types of commodities sold for consumption in Taiwan. The commodity tax is rebated if the goods are used in the manufacture of export items. To qualify for this rebate, the processed product must be exported within 1 year of the import. Commodity taxes are also waived if the goods will be used as raw material in the manufacture of another taxable commodity.

^{1/} Business taxes are assessed at a fixed percentage of gross revenues and are similar to transactions taxes.

^{2/} Stamp taxes are normally applicable to customs documents produced and receipts.

^{3/} Generally, companies may deduct 0.6 percent of the first NT\$10 million (approximately \$256,410 in 1983) of sales and 0.3 percent of the excess for entertainment expenses. Exporters can deduct an additional 2.0 percent of the total export sales for entertainment expenses. Furthermore, exporting companies can deduct an additional \$100 per day, per employee, as a per diem travel expense.

CANADIAN TARGETING

- (2) A joint plan between the Government and Bell Helicopter Textron to build a plant in Quebec. The Government's share is \$275 million (Federal Government: \$165 million, Provincial Government: \$110 million) and Bell's share is \$239 million;
- (3) A \$72.6 million understanding for the development and manufacture of light twin-engine helicopters in Canada between the Government (\$34.9 million) and Messer Schmitt-Bolkow Blohm GmbH (\$37.7 million).

Automotive

Prior to the signing of the Automotive Products Trade Act (APTA), the Canadian automotive sector was protected by a high tariff to prevent competition from entering the small Canadian domestic market. The high tariffs, plus an import duty remission to Canadian manufacturers, were designed to increase production, but this became a trade issue between the United States and Canada. The obstacle was resolved by the APTA which removed duties on trade in specified motor vehicles and original-equipment automotive parts.

APTA has been implemented differently by the two countries. Canada gives duty-free status on a most-favored nation (MFN) basis, whereas the United States applies this status only to Canada. Because the United States limited the duty-free status only to Canada, and not on an MFN basis, it was necessary for the United States to obtain a waiver from the GATT Council. The waiver was approved in December 1965.

It has been argued that APTA favors Canada at the expense of the United States. 1/ The Canadian Government sought, through the APTA, to help its industry adjust to a greater level of competition. Consequently, Canada applies a duty-free status only to automotive imports for bona fide manufacturers of motor vehicles. The United States, on the other hand, provides duty-free status to all new, automotive imports from Canada, whether for manufacturers or individuals. According to the agreement, the United States provides duty-free status for automobiles assembled in Canada with a 50-percent North American content. Therefore, Canada can incorporate duty-free parts from third countries into automobiles produced in Canada and export these products duty-free to the United States. Also, the Canadian manufacturers were required to increase production by at least a certain percent of the increase in sales. Furthermore, in "Letters of Understanding" Canadian manufacturers pledged to increase the Canadian value added by at least 60 percent by the end of 1968.

1/ Under the APTA Canadian manufacturers received favored status. In a previous report, the U.S. International Trade Commission stated that "the agreement as implemented by Canada is not a free trade agreement, and it has primarily benefited the Canadian economy." The report further states that the concessions provided through APTA are made by the United States whereas Canada made no substantive concessions except those in the Letters of Understanding. See Canadian Automotive Agreement, United States International Trade Commission, Ninth Annual Report, 1976.

Price controls tend to favor certain industrial activities. Low utility prices subsidize the costs of production for all industries, but those that are highly energy intensive, such as the metal industries, naturally benefit more. ^{1/} Controlled prices of raw agricultural products aid the food processing industries and cheap basic petrochemical products benefit the secondary petrochemicals industry. Unreasonably low prices and distorted prices caused by the controls are, however, suspected of contributing to the acknowledged inefficiency of Mexican domestic producers.

Recently, price increases and decontrol on some controlled products and the elimination of controls on other products have resulted in a lower degree of price subsidy than existed previously. Although price controls on a number of products were eliminated in December 1982, variable price controls are still in effect on many basic items such as primary petrochemicals, certain chemical products, steel, cellulose, fertilizers and automobiles. ^{2/} Official price controls are now maintained on only about 150 types of products.

Targeting Techniques in Specific Mexican Industries

Automobile Industry

Through a series of Government decrees, Mexico has attempted to generate a positive automotive trade balance by increasing the domestic content of cars, encouraging import substitution, and boosting exports. Since publication of the first automotive decree in 1962, the auto industry has remained an important industrial priority. In 1979, the auto industry was listed in the National Industrial Development Plan as an industry with potential for contributing to the Mexican priority of raising export revenue. Heavy protection from import competition has complemented Government policy aims and incentives for the automotive industry. Imports of finished automobiles were banned in 1965. However, a notable feature of Mexico's automotive industry is that most auto assembly operations are foreign-owned.

Companies that meet the automotive decree requirements are eligible for a wide range of incentives. These incentives include tax rebates, investment grants for automotive part plants and duty exemptions on imports of machinery, equipment, raw materials, and components not produced in Mexico. In 1979, the industry reportedly received more than 50 percent of all of the direct industrial subsidies given by the Mexican Government. ^{3/} Meanwhile, high

^{1/} Subsidized energy prices are among the major unresolved issues in U.S.-Mexican negotiations aiming at a bilateral agreement on Mexican subsidization and U.S. countervailing.

^{2/} Some key end products, such as household appliances, trucks, buses, tractors, soap, and paper are also under variable controls, and selected food items and medicines are still under rigid controls. Remaining price controls indirectly shape prices of other commodities by forward and backward linkages.

^{3/} Statement of Jesus Silva-Herzog Flores, undersecretary of finance and public credit, Jan. 28, 1980, as reported in Mercado del Valores, Feb. 4, 1980, pp. 97-98.

levels of import protection reserved the domestic market for autos produced in Mexico. In spite of this combination of incentives, the industry has not met the Mexican Government's expectations.

Although the output of the industry increased 40 percent from 1979 to 1981, as shown in Table 73 below, other policy objectives of the decrees, including import substitution and domestic content levels, were not fully attained. For example, instead of contributing to import substitution, the automotive industry was responsible for nearly 60 percent of the entire Mexican trade deficit in 1981. ^{1/} These imports of inputs for the industry reflected inadequate implementation of requirements to use domestic parts in auto production and the inability of the Mexican autopart industry to fully supply industry demand.

Table 73.--Mexico: Indexes of industrial production in the automotive sector, 1979-83

(1970=100)	
Year	Automobiles and trucks
1979-----	263.0
1980-----	300.3
1981-----	368.2
1982-----	269.9
1983 ^{1/} -----	160.2

^{1/} Preliminary.

Source: Banco de Mexico and Asociacion Mexicana de la Industria Automotriz.

Recognizing these shortcomings in the implementation of earlier decrees, the de la Madrid Administration issued a new automotive decree in September 1983, which provided for restructuring the industry. In August 1984, the regulations implementing the new decree were published. The new decree strengthened some provisions of earlier decrees and demonstrated new resolve to implement these provisions.

For the automotive assembly industry, the new decree strengthens domestic content and Mexican ownership requirements. The decree projects the raising of domestic content requirements above the 50-percent level specified in earlier decrees. The decree calls for domestic content levels of 60 percent for automobiles, and 70 percent for vans and light trucks by 1987. Under certain conditions, however, automobile lines destined primarily for export can gain exceptions to these domestic content requirements. In promoting expansion of the truck assembly industry, currently dominated by the Government-owned Daimler Nacional, the Government has granted Mexican-owned companies the exclusive right to assemble trucks and produce diesel engines.

The automotive decree also contains provisions to promote the national development of the autoparts-manufacturing industry. Autopart manufacturers are scheduled to be at least 60-percent Mexican-owned. ^{2/}

^{1/} Business Latin America, Sep. 28, 1983.

^{2/} Ibid.

At the same time, auto parts producers are expected to acquire 80 percent of their overall input requirements from domestic sources by 1987. Each separate input line also must have at least 60 percent Mexican content by that date.

To achieve efficiency through economies of scale, the decree calls for a drastic reduction in the number of basic lines and limits the number of models per line that carmakers may manufacture. Exceptions are made if more than 50 percent of the production of that model is exported.

The decree does allow the Government some discretion in allocating incentives to particular firms. Negotiations are conducted between individual automakers and the Mexican Government on the applicability of the decree to their particular case, and the Government may waive certain requirements if the company will help support other economic goals, such as increasing national foreign exchange earnings through automotive exports. For example, the Secretariat of Commerce and Industry (Secofin) negotiates a foreign currency allotment separately for each company based on export revenue, direct investment, and financing from abroad. Secofin must also establish maximum volumes of production for each assembly plant and adjust these levels every quarter, taking the above factors into consideration.

Computer and electronics industry

In September 1981, the Mexican Government adopted an ambitious plan to establish a domestic computer industry and to reach 70-percent self-sufficiency by 1985. Though the Government is currently considering a revised and more restrictive plan for the computer and electronics sector, the highly controversial proposed plan is not considered close to adoption. The main goal of regulation of this industry is to promote import substitution to offset high import levels of computers, peripherals, and software. Such imports amounted to \$141.8 million in 1983. Although imports fell by almost 38 percent to \$88.5 million in 1983, they still accounted for 70 percent of national consumption of these products.

Since demand is expected to remain strong, the 1981 plan applies fiscal incentives and import and investment restrictions to achieve the goal of limiting imports. Incentives granted to Mexican and foreign manufacturers of computer and electronic equipment include tax credits for purchases and investments, duty reductions for the import of components and export incentives.

To implement the plan, agreements were negotiated with foreign manufacturers of computer systems and related equipment which require them to use a certain ratio of Mexican-made components in production and to gradually decrease the ratio of imports to domestic production. These imports are controlled by licensing and selective Government procurement. However, a greater number of import permits for computers and related equipment were allowed in 1984, and tariffs on these types of items are being lowered.

Implementation of the plan has progressed more slowly than originally stated. The de la Madrid administration has altered the earlier emphasis on developing sufficient domestic capacity to meet domestic demand to one of balancing computer industry imports and exports. Some Mexican computer makers

BRAZILIAN TARGETINGTargeting Techniques in Specific Brazilian IndustriesAerospace

Targeting in the aerospace industry has taken place through financial support for the privately owned but Government-controlled company, Embraer. Furthermore, through its science and technology spending, the Government has trained aerospace engineers and has built a research center devoted to aerospace. Lately, another private company, Avibras, has received Government support for its sales of missiles to overseas markets.

The centerpiece of the airplane industry in Brazil consists of Embraer and the Brazilian based companies that supply its parts. 1/ From 1969, when Embraer was founded, to 1984, it produced over 3,100 airplanes, and since 1977, an increasing percentage of Embraer's sales have gone to overseas markets. To help promote the capitalization of Embraer, the Brazilian Government allows 1 percent of the corporate income tax owed by companies in Brazil to be applied to the purchase of stock in Embraer. As a result, over 90 percent of Embraer is owned by almost 200,000 private firms. 2/

Though Embraer was not founded until 1969, the Brazilian Government was involved in this industry many years before when it trained a substantial number of aerospace engineers at Government expense and created the Aerospace Research Center (CRA) in 1954. In addition to promoting aircraft, the Aerospace Research Center has also been active in carrying out R&D on launching space vehicles. The Government has allocated approximately \$20 million for this purpose in 1984.

The Brazilian Government also promotes a private company, Avibras, to make ground-to-ground missiles. Avibras is supposed to receive \$500 million from a contract with Iraq to develop a missile launching vehicle similar to the Soviet Katucha. At present the project is still in the research stage. The project is conducted under the auspices of a joint program between Avibras and Contraves (a subsidiary of Oerlikon of Switzerland). Contraves will supply all the launching control systems.

Automobiles

The Brazilian Government targeted the automobile industry through incentives for import substitution and through export promotion. Both measures were designed to increase the level of local auto production.

1/ Of the approximately 24,000 items incorporated in Embraer's advanced planes, such as the popular Bandeirante model, about 17,000 items are locally manufactured. However, the most costly items, such as the avionics equipment, engine, and propellers, are usually imported from North America.

2/ World Bank, Op. cit., pp. 125-130. U.S. Department of Commerce, Brazil: A Survey of U.S. Export Opportunities, 1978, pp. 231.

Before the mid-1950's, Brazil had a small domestic automobile industry. ^{1/} However, about 1955, to attract international automobile firms the Government offered the following special incentives and conditions:

1. Duty-free import of capital goods and essential components,
2. A gradual "nationalization" requirement to reach a local content of 95 percent by 1960,
3. Prohibition of imported vehicles,
4. Fiscal, financial, and foreign-exchange advantages to the firms that participated in the program.

Table 17 shows the amount of foreign investment, approved by CDI, which these incentive packages attracted to Brazil. Not surprisingly, within a few years eleven companies, including Ford and General Motors, were producing automobiles in Brazil.

Table 17.--Brazil: Automobile investment approved for CDI and BEFIX incentives, 1965-78

(In millions of U.S. dollars)

Year	Approved by CDI	Approved by BEFIX	Exports
1965-----	59.9	1/	-
1966-----	39.2	1/	-
1967-----	128.9	1/	-
1968-----	-	1/	-
1969-----	83.0	1/	4.1
1970-----	308.4	1/	8.8
1971-----	1.4	1/	11.3
1972-----	777.0	1/	51.7
1973-----	87.0	211.3	54.9
1974-----	-	647.8	179.4
1975-----	-	79.3	324.9
1976-----	-	2,188.2	350.5
1977-----	-	20.7	493.7
1978-----	-	-	690.7

^{1/} Not applicable.

Source: Eduardo Augusto de Almeida Guimaraes, "A Dinamica de Crescimento da Industria de Automoveis no Brasil: 1957/58," Pesquisa e Planejamento Economico 10(3) (dezembro, 1980), p. 791.

In the early 1970's, to encourage exports, subsidies and import tariff reductions were awarded to auto manufacturers through the BEFIX program in exchange for commitments to export. Table 11 shows the dramatic increase in exports between 1972 and 1976 largely promoted by the benefits of the BEFIX program.

^{1/} World Bank, Op. cit., pp. 116-124.

To raise the quality of the product and make exporting easier, the amount of local content required by the Government was lowered to 85 percent for passenger cars and 75 to 80 percent for trucks. To the extent imported components came from country members of the Latin American Integration Association, the levels of local content were even lower.

The 1972 BEFIEK agreements, which originally were to have lasted for 10 years, were extended in 1982. According to the latest statistics from BEFIEK, the automobile manufacturers committed themselves to export about \$17 billion in exchange for easier access to about \$4 billion of imported capital and components and subsidies.

Computers

The principal technique used by Brazil to target computers is to reserve the production and sale of certain products to Brazilian "national firms." ^{1/} This market reserve policy relies heavily on the prohibition of foreign direct investment and on import controls to entice local investors to enter the market. The policy is accompanied by incentive programs of subsidies and tax relief tied to achieving local content.

Another major element of the policy was the establishment of a national computer firm, COBRA, owned by the Government. COBRA has developed several small computer models, but the company has yet to have a profitable year since it was founded.

In the early 1970's, the Brazilian Government formed two agencies to promote a domestic data processing industry. One was CAPRE, a coordinating agency to oversee the development of a computer industry, and the other was DIGIBRAS, a funding agency to provide capital for joint ventures with foreign firms. CAPRE eventually helped form COBRA, which used U.S. and British technology to become the first Brazilian computer manufacturer in 1974.

In 1977, while U.S. firms still dominated the Brazilian computer market and supplied 90 percent of imports, CAPRE invited all foreign computer firms in Brazil to submit proposals for creating joint ventures to produce minicomputers. In their proposals CAPRE required all minicomputer manufacturers to plan to (1) completely transfer technology within five years, (2) achieve export sales greater than imports, and (3) evolve to eventual Brazilian majority ownership. Under this plan CAPRE authorized four joint ventures between Brazilian and West German, Japanese, and French firms. CAPRE rejected the U.S. company proposals because all U.S. manufacturers refused to form joint ventures. Nonetheless, CAPRE allowed IBM and Burroughs to build large-scale computers locally.

^{1/} United Nations Center on Transnational Corporations, Transborder Data Flows and Brazil, 1983, pp. 60-102.

APPENDIX C

U.S. GLOBAL COMPETITIVENESS

THE U.S. AUTOMOTIVE PARTS INDUSTRY

**Report to the Committee on Finance,
U.S. Senate, Investigation
No. 332-232 Under Section
332 (g) of the Tariff Act of 1930.**

JAPAN

Import duties on selected automotive parts entering France range from about 5 to 14 percent ad valorem; the value-added tax ranges from almost 19 percent to 33 percent, as shown in the following tabulation: 1/

	<u>Import duty</u>	<u>Value-added tax</u>
Bearings: iron, self-lubricating, and porous...	4.9	
Shock absorbers.....	8.2	18.6
New car tires.....	5.8	18.6
Car radios with speakers....	14.0	33.3

Government programs.--Although the industry does not receive direct Government assistance, the Government is nevertheless present through the nationalized automaker, Renault. Industry sources indicate that there is some discussion of changing Renault's legal status from "state agency" to "nationalized company." The change may be one step towards the company's privatization.

Japan

Industry structure.--There are over 10,000 producers of automotive parts in Japan employing some 600,000 persons. Approximately 8,000 of these producers are small firms having 29 workers or less, about 1,300 are medium-sized firms having 30 to 99 workers, and about 600 are large companies having 100 or more workers. 2/

Most Japanese auto parts producers are affiliated with one of the 11 Japanese automakers. Most of the auto producers are linked to larger networks of Japanese companies representing a wide range of industries. These networks are known as "keiritsu" industrial groups. The keiritsu structure links firms in different industries to form conglomerations of companies. The keiritsu structure is an interweaving of companies through equity exchanges, interlocking directorates, intra-group financial commitments, joint R&D efforts, and membership to exclusive management councils or clubs. The objective of these groups is to work collectively to increase total group sales and employment. Member companies generally have a strong tendency to purchase from other member companies; this structure makes it difficult for potential outside suppliers (domestic or foreign) to sell to companies in the group. 1/

1/ According to an April 1987 report from the U.S. Embassy.

2/ The Structure of the Japanese Auto Parts Industry, Dodwell Marketing Consultants, 1986, and Stephan S. Wickman, "The Character and Structure of the Economy," JAPAN: A Country Study, ed. Fredericks Sunde (Washington, DC: The American University, 1983), pp. 141-196.

1/ The Structure of the Japanese Auto Parts Industry, Dodwell Marketing Consultants, 1983.

There are six major keiretsu groups in Japan. At the core of each is a major Japanese bank. 1/ Tied to the bank and to each other are such diverse operations as raw material producers, manufacturers of intermediate and final products, and service providers such as trading companies, insurance firms, shipping lines, construction companies, and other ancillary service providers. In 1984, these six groups accounted for almost 18 percent of net profits of all Japanese businesses, almost 17 percent of total sales, over 14 percent of paid-up capital, and almost 5 percent of the Japanese work-force (fig. 4-4). 2/ The groups and their affiliated auto producers are Mitsui (Toyota Motor Co.) 3/, Mitsubishi (Mitsubishi Motors), Sumitomo (Toyo Kogyo, commonly known as Mazda), Fuyo (Nissan), 4/ Sanwa (Daihatsu), 5/ and Dai-ichi Kangyo (Isuzu Motors). Other Japanese auto producers are associated with smaller, less organized industrial groups such as Suzuki Motors, part of the Tokai group. The largest Japanese auto producer that has no apparent group affiliation is Honda Motor Co.

The Japanese auto producers, together with their affiliated auto parts producers, are typically large enough to be considered "keiretsu" style groupings. 6/ The major auto producing groups are the Toyota group (includes Daihatsu Motors and Hino Motors through equity interest), the Nissan Group (includes Fuji Heavy Industries Group and the Nissan Diesel Group through equity interest), the Toyo Kogyo Group, Honda Motors, Mitsubishi Motors, Isuzu Motors, and Suzuki Motors.

Japanese auto producers rely more heavily on noncaptive suppliers than U.S. auto producers. The U.S. average for outsourcing of parts by automakers is 50 to 55 percent; for Japanese automakers, the average is about 75 percent. The auto producers typically set up associations of their parts suppliers known as "Kyoryokukai" to enhance cooperation and solidarity. Although the recent trend has been towards a slight relaxation of group ties, members of these associations typically sell most of their output to their one, affiliated auto producer. Parts producers are usually very specialized, and produce only one or two types of parts. On the other hand, each particular automobile part used by an automaker is typically produced by several companies within each Kyoryokukai, so that the auto producer has multiple suppliers, thus encouraging competition in price and quality. 7/

The Toyota Motor Co., Japan's largest auto producer (with 3.7 million vehicles produced in 1985), has 220 primary auto parts suppliers and over 1,000 secondary and tertiary suppliers. Toyota has formed two auto parts

1/ Henry C. Wallick and Mable Wallick, "Banking and Finance," Asia's New Giant. How the Japanese Economy Works, ed. Hugh Patrick and Henry Rosovsky (Washington, DC: The Brookings Institute, 1976) p. 294.

2/ Masachi Hiozami, "Industrial Groups," Japan Economic Yearbook, 1986.

3/ Toyota is a significant grouping unto itself and only loosely connected to the Mitsui Group.

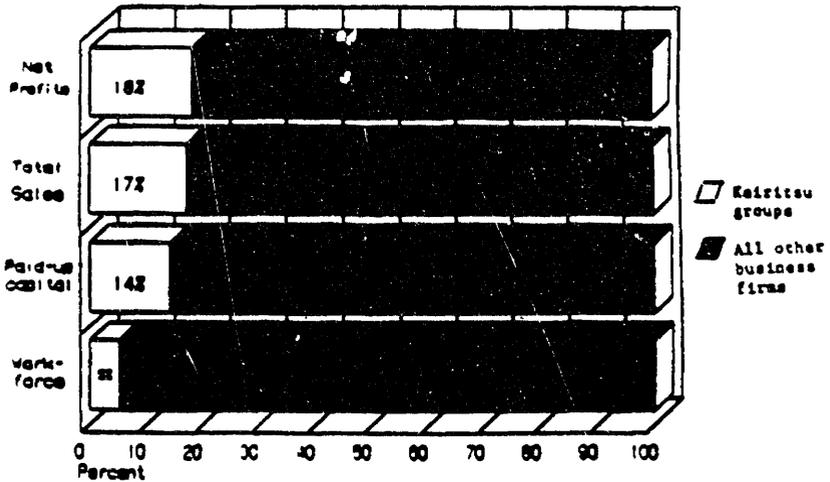
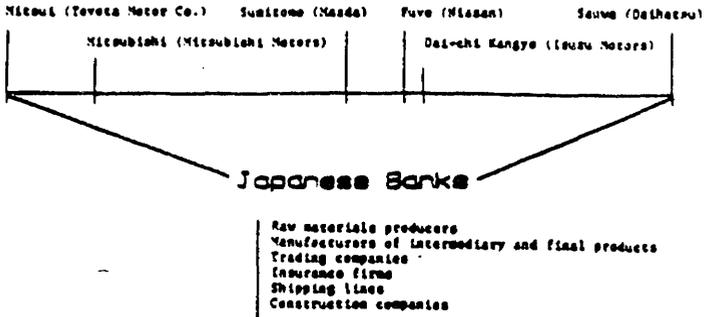
4/ Nissan is also a significant group unto itself and only loosely connected to the Fuyo Group.

5/ Toyota has equity interest in Daihatsu.

6/ Industrial Groupings in Japan, Dodwell Marketing Consultants, 1985.

7/ "The Relationship Between Japanese Auto and Auto Parts Makers," prepared by Mitsubishi Research for the Japan Automobile Manufacturers Association, 1987, and USITC staff interview with the Ministry of International Trade and Industry officials, Tokyo, Japan, Apr. 20, 1987.

Figure 4-4
Keiritsu groups: Structure of the six Keiritsu groups and their role in the Japanese economy, 1984.



Source: Masachi Hiogami, "Industrial Groups," *Japan Economic Yearbook*, 1986.

supplier groups: Kyoho-Kai and Eiho-Kai. Toyota's equity interest in its affiliated suppliers ranges from 1.4 percent to 60.4 percent, with the average around 25 to 30 percent. Toyota has a 14.6 percent interest in Daihatsu, Japan's ninth largest automaker (with 1985 production of 579,000 vehicles), and a 10.4 percent interest in Hino Motors, a leading Japanese truck manufacturer (with 1985 production of 69,063 vehicles). Daihatsu Motors has approximately 140 primary suppliers, and its parts association is called Daihatsu Kkoyu-Kai. Hino Motors has some 220 primary suppliers that form the parts association Hino Kyoryoku-Kai. 1/

The Nissan group is comprised of Nissan Motor Co., Nissan Diesel, and Fuji Heavy Industries. Nissan Motor Co., the second largest Japanese auto producer (with production of 2.5 million vehicles in 1985), has about 160 primary auto parts suppliers and some 800 secondary and tertiary suppliers. Nissan's two supplier associations are Takara-Kai and Shoho-Kai. Nissan Diesel has 60 parts suppliers that form the association Nissan Diesel Yayoi-Kai. Nissan Diesel produced 36,351 trucks and buses in 1985. Fuji Heavy Industries, which ranked eighth in vehicle production in 1985 with 584,384 vehicles, has a total of more than 700 suppliers that are divided into three Kyoryokukai's: Gunma Kyoryoku-Kai, Kyoryoku-Kai, and Isesaki Kyoryoku-Kai. 2/

The Toyo Kogyo group, which ranked third in production of automobiles in 1985 (with almost 1.2 million vehicles), has some 250 primary suppliers that form two supplier associations, Yoko-Kai and Toyu-Kai. Mitsubishi Motors, the fourth ranking Japanese auto producer in 1985 (with almost 1.2 million vehicles), has 340 primary parts suppliers that form the Kashiva-Kai association. Honda, ranked fifth in 1985 (with production of slightly more than 1.1 million vehicles); has some 400 to 500 suppliers, but does not have them grouped into supplier associations like the other major auto producers. Suzuki Motors has some 101 primary suppliers grouped into the Suzuki Kyoryoku Kyodo Kumiai auto parts association. In production, Suzuki was ranked as the sixth largest Japanese auto producer in 1985 (with production of 781,901 vehicles). Isuzu, the seventh largest Japanese producer of automobiles in 1985 (with 587,015 vehicles), has 279 primary suppliers grouped into the Isuzu Kyowa-Kai parts association. 3/

Even though there seems to be some movement in Japan to relax the relationship between parts producers and automakers, each parts supplier is still heavily dependent on purchases from the patron automaker. This whole concept of industrial grouping along the lines of the keiretsu structure has caused problems for foreign producers trying to penetrate the Japanese market. 4/

1/ World Motor Vehicle Data, 1987, Motor Vehicle Manufacturers Association; and The Structure of the Japanese Auto Parts Industry, Dodwell Marketing Consultants, 1983.

2/ World Motor Vehicle Data, 1987, Motor Vehicle Manufacturers Association; and The Structure of the Japanese Auto Parts Industry, Dodwell Marketing Consultants, 1983.

3/ Ibid.

4/ Indicated from responses to Commission questionnaires. See also Rodney Clark, The Japanese Company (New Haven, CT: Yale University Press, 1979) pp. 73-87.

The Japanese Auto Parts Industries Association (JAPIA) has about 300 members who account for approximately 80 percent of industry production. 1/ Most member companies have direct transactions with major automakers. JAPIA members' production increased by 50 percent during 1982-85 to \$49.1 billion in 1985 (table 4-6). Production of original equipment parts increased at a faster rate than did production of aftermarket products; production for export rose by 131 percent to \$3 billion in 1986 (fig. 4-5). The total number of employees increased from 280,000 in 1982 to 329,000 in 1986; the number of production workers rose by 14 percent during 1982-86 to 199,000 in 1986. In addition, shipments and R&D expenditures increased during 1982-86, as did R&D as a percentage of sales (table 4-7).

Table 4-6
Automotive parts: JAPIA members' production and employment, 1982-86

Item	1982	1983	1984	1985	1986	Annual average, percentage change, 1986 over 1982
Total production (billion dollars).....	32.7	38.0	43.3	49.1	1/	10.7
Employment:						
Production workers (number).....	173,912	174,377	182,192	192,105	198,702	3.4
Office workers (number).....	105,737	113,412	112,930	125,943	130,269	5.4

1/ Not available.

Source: Report from the U.S. Embassy, Tokyo, Japan, March 1987.

1/ USITC staff interview with JAPIA officials, Tokyo, Japan, Apr. 20, 1987.

KOREA

Source: U.S. GLOBAL COMPETITIVENESS: THE U.S. AUTOMOTIVE PARTS INDUSTRY
USITC PUBLICATION 2037 4-20 DECEMBER 1987

Trade.--According to JAPIA, Japanese exports of all automotive parts rose from \$4.5 billion in 1982 to \$8.2 billion in 1985, as shown in the following tabulation:

<u>Year</u>	<u>Exports 1/</u> <u>(Million dollars)</u>
1982.....	4,518
1983.....	5,851
1984.....	7,353
1985.....	8,200

1/ Publication of the Japan Auto Parts Industries Association.

During 1984-85, the bulk of Japanese exports (47 percent) went to North America, followed by Europe (11 percent) and Southeast Asia (9 percent) (figure 4-6 and 4-7, table 4-9).

Japanese imports of automotive parts have increased from \$150 million in 1982 to \$491 million in 1986 (table 4-9). As a share of the market, imports have increased irregularly from 0.3 percent in 1982 to 1.1 percent in 1986. The largest source of such imports in 1986 was the United States (\$145 million) followed closely by West Germany (\$142 million).

Government programs.--In an effort to address the growing U.S. trade deficit with Japan in automotive parts, provide U.S. parts makers greater access to the Japanese market, and promote better understanding of the role of the keiretsu system, in May 1986, the Japanese Government and the United States Government agreed to add auto parts to the so-called market-oriented sector-selective (MOSS) talks, a higher level forum than previously accorded auto parts talks (see description of MOSS talks, p. 6-16).

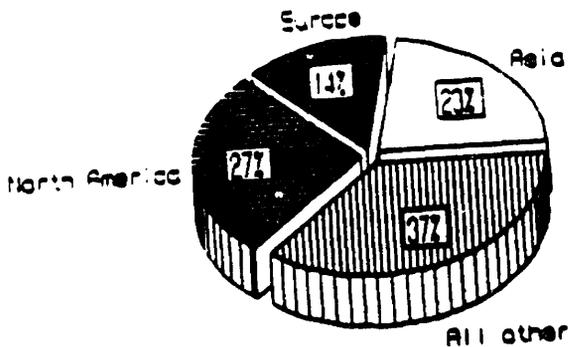
Korea

Industry structure.--Industry sources indicate that about 800 Korean parts makers manufacture about 300 major automotive parts, principally tires, batteries, engine parts, shock absorbers, bearing caps, rearview mirrors, brake pistons, combination lamps, cooling fans, control cables, body stampings, pumps, parking brake levers, and tube connectors. The bulk of Korean parts are manufactured by Korean automakers, or by diversified producers that produce auto parts along with other products.

Prior to 1983, Korean automakers produced mostly for the Korean market, exported little (predominantly to the Middle East), and imports were tightly controlled. Beginning in 1983, however, exports of automobiles to the United States and Canada increased dramatically. Total auto production expanded rapidly and growth in the Korean automotive parts industry expanded accordingly. 1/

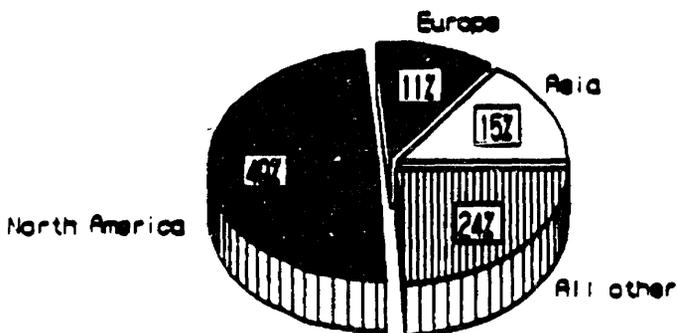
1/ USITC staff interview with Korean Government officials, Seoul, Korea, Apr. 29, 1987.

Figure 4-6
Automotive parts: Japanese exports by major markets, 1982



Source: The Japanese Ministry of Finance.

Figure 4-7
Automotive parts: Japanese exports by major markets, 1985



Source: The Japanese Ministry of Finance.

Table 4-9
Automotive parts: Japanese exports by markets, 1982-85 1/

(In thousands of dollars)

Market	Fiscal year ending Mar. 31--			
	1982	1983	1984	1985
East Asia.....	376,846	532,928	535,558	593,466
Southeast Asia.....	690,470	740,287	678,878	773,285
Middle East.....	476,765	525,881	523,482	545,884
Europe.....	629,373	739,361	786,184	1,035,248
North America.....	1,228,148	2,491,043	3,333,348	4,402,472
Central America.....	173,476	197,260	261,461	293,570
South America.....	159,812	145,452	125,482	129,588
Africa.....	455,122	482,376	419,619	370,955
Oceania.....	284,973	373,490	493,280	578,116
Communist countries.....	139,123	154,376	194,808	280,497
Total.....	4,607,111	6,384,478	7,349,105	9,003,304

1/ The Japanese fiscal year ends Mar. 31.

Source: The Japanese Ministry of Finance.

Korean parts makers are increasing their emphasis on R&D. For example, Hyundai is focusing on the development of high-end items for the Excel model such as engine screw terminals, rollback springs, steering assemblies, and air-conditioners. Daewoo reportedly is producing knuckle carburetors and aiming to export more advanced components through its affiliated companies. 1/

In addition, 32 Korean technology agreements were formed with foreign firms in 1986, up over 40 percent from 1984. The bulk of such agreements (about 75 percent) were with Japanese firms, and the rest were split between the United States and West Germany. Ten joint ventures were formed in 1986; an example, Hando, established Halls Climate Control Co. to produce oil coolers and compressors for radiators in a 50/50 joint venture with Ford Motor Co. 2/

Labor disputes at Korean parts making facilities during August 1987 interrupted supplies of parts to Korean automakers. Korean parts workers have been seeking higher wages and representation in company management. Labor uprisings could force Korean automakers to reexamine their parts procurement procedures. Problems with timely supply could force Korean auto producers to consider alternate sources of parts. 3/

1/ "Auto Parts Industry," Korea Buyers Guide, p. 68.

2/ USITC staff interviews with Korean automakers and Korean Government officials, Seoul, Korea, Apr. 29-May 1, 1987; and "Auto Parts Industries," Korea Buyers Guide, p. 69.

3/ USITC staff interview with Korean Government officials, Seoul, Korea, Apr. 29, 1987.

Domestic market.--Korean production of complete automobiles rose from 162,500 vehicles in 1982 to 601,000 units in 1986 (930,000 units are projected for 1987) (fig. 4-8). Korean exports of complete automobiles increased from 20,284 vehicles in 1982 to 306,000 units in 1986 (600,000 units are projected in 1987).

Trade.--Korean exports of automotive parts followed export sales of finished vehicles, rising from \$68 million in 1982 to an estimated \$247 million in 1986 (table 4-10). During 1986, Korean exports were shipped to 130 countries. The most prevalent items included bearings, car stereos, gears, leaf springs, and radiators. 1/ Total sales of Korean automotive parts

Table 4-10
Automotive parts: Korean sales, exports, and imports 1982-86

Item	1982	1983	1984	1985	1986	Average annual change, 1986 over 1982
	-----Million dollars-----					Percent
Sales.....	783	949	1,153	1,379	2,272	30.3
Exports.....	68	74	108	149	1/ 247	38.1
Imports.....	-	340	331	301	-	2/ -2.9

1/ Estimated.

2/ Average annual change, 1985 over 1983.

Source: Report from the U.S. Embassy, Seoul, Korea, March 1987.

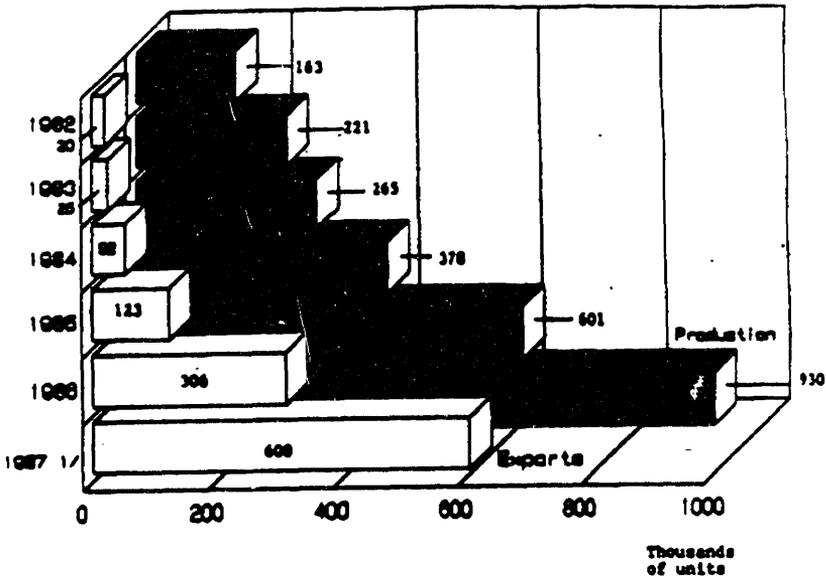
rose from \$783 million in 1982 to \$2.3 billion in 1986. Korean imports decreased from \$340 million in 1983 to \$301 million in 1985, and were primarily from Japan, reflecting the working relationship between Korean and Japanese producers. 2/

Korean imports of auto parts are dutiable at tariff rates ranging from 5 to 60 percent ad valorem and require an import license issued by a Korean foreign-exchange bank. Requests for licenses generally have been approved without delay, unless the product was restricted under Korea's Official Trade Plan covering the period July 1, 1984-June 30, 1987. Imports of regulated items were permitted under the plan only if approval was granted by the Korean Automobile Industry Cooperative Association (KAICA). Certain auto parts products were restricted under the plan as follows: internal combustion engines, pumps for liquids, and other parts and accessories, except those of tractors for agricultural use. However, the restrictions on these items were

1/ "Auto Parts Industry," *Korea Survey Guide*, p. 68.

2/ USITC staff interview with U.S. Embassy officials, Seoul, Korea, Apr. 29, 1987.

Figure 4-8
Automobiles: Korean production and exports, 1982-87



1/ Estimated

Source: Report from the U.S. Embassy, Seoul, Korea, 1987.

lifted effective July 1, 1987, under the Government of Korea's import liberalisation plan. 1/

Government program.--The Government of Korea has instituted a 3-year localization program, under which efforts are made to increase domestic production of imported products. The localization program has two key goals: (1) to restructure Korean industries; i.e., to shift from simple assembly to more complex production; and (2) to improve international competitiveness and

1/ Report from U.S. Embassy, Seoul, Korea, March 1987.

reduce the bilateral trade deficit with Japan (Korea's principal source of auto parts imports). 1/

Both large and small Korean firms are participating in the local production program. For example, Lucky is planning to produce engineering plastics such as PET, PBT, polymer, nylon, and ABS; Kolon has completed its production facilities for engineering plastics; Dongyang Nylon has developed a fire-retardant nylon resin; Hyundai Cement and Sehan Ink Paint are gaining expertise in the production of engine parts; and Pacific Development plans to manufacture reinforced plastic components for gears and gear boxes. 2/ Under the program, about 1,600 auto parts and components (estimated value at \$1.1 billion) that are currently imported will be localized during 1987-91. In 1986, 78 Korean firms manufactured 111 products (valued at \$58 million) under the plan; in 1987, 380 items are targeted to be similarly produced.

The Government of Korea has also developed a Korean Industrial Standard (KIS) that is adapted from similar foreign systems--e.g., Japan (JIS), U.S. (U.L.), and the guidance of International Standards Organization (ISO), and the International Electrotechnical Commission (IEC). At present, over 7,000 items in the KIS are classified into 15 categories. The central aim of the KIS marking mandatory system is to ensure safety control. 3/

Mexico

Industry structure--The Industria Nacional de Autopartes (INA), a Mexican trade association, categorizes approximately 105 Mexican producers of automotive parts. The INA reports annual sales of \$2.0 billion in 1986.

Following the Mexican economic crisis of 1981-82, production levels of nearly all manufactured goods in that country declined to about 50 percent of their previous levels. The automotive industry was particularly affected, since major manufacturers had been expanding capacity in anticipation of a growing domestic market. Production of automotive parts, however, fluctuated upwards during 1982-86, reflecting the slowly recovering Mexican automotive market (table 4-11).

Total employment in the Mexican motor-vehicle industry increased by 2 percent to 234,000 in 1986 (table 4-12). Although the minimum wage rose in terms of the Mexican peso during 1982-86, because of the peso depreciation it fell to about US\$1.00. Highly skilled maintenance and technical workers received approximately US\$3.00 per hour; however, the majority of workers were compensated at approximately US\$1.00 per hour. Total hourly wage and compensation for the automotive industry declined during the period by 42 percent to an estimated \$1.48 per hour in 1986 (table 4-12).

1/ USITC staff interview with Korean Government officials, Seoul, Korea, Apr. 29, 1987.

2/ "Auto Parts Industry," Korea Buyers Guide, p. 49.

3/ Report from U.S. Embassy, Seoul, Korea, March 1987.

TAIWAN

imports of strategic parts. Because most major parts manufacturers in Spain are also subsidiaries or affiliates of large, multinational corporations, very little R&D for the automotive parts industry is undertaken in that country. Development expenditures by Spanish automotive parts firms totaled about \$50,000 annually. 1/

Domestic market.--Renault, Talbot-Peugeot, Citroen, Ford, GM, and Seat-Volkswagen are the six major Spanish car manufacturers. Together, their production of passenger cars rose from 927,300 in 1982 to about 1.2 million in 1985. Spain has become Europe's most significant source of subcompact passenger cars; exports as a percentage of production rose from 53 percent in 1982 to 62 percent in 1985. Motor-vehicle production of all types is projected to increase significantly from 1988 to 1990. Apparent consumption of passenger vehicles rose about 8 percent during the period.

The aftermarket for automotive parts is more important in Spain than in other western European nations because of the age of the automotive stock (about three-fourths of all cars and trucks are over 5 years old). 2/ Spanish consumption of automotive parts is expected to grow substantially during 1988-90 to about \$8 billion, more than twice the 1983 level.

Trade.--Spanish domestic content provisions require that 60 percent of the value of the parts used to manufacture a car must be made in Spain. Except for these requirements, industry sources report no other nontariff barriers, e.g., quotas and licenses affecting imports of automotive parts. 3/ Since 1972, Spain has been a member of Europe's automobile and automotive parts production system, where each country produces certain parts and exports the parts to other European countries for local vehicle manufacture. Exports account for about 26 percent of all Spanish parts production and are shipped almost solely to EC countries. 4/ In 1984 and 1985, Spanish imports and exports of automotive parts and equipment were virtually identical, at about \$1.3 billion.

Government programs.--The Government of Spain owns minimal shares in certain Spanish parts firms though the National Institute of Industry (a state-owned holding company). Moreover, the Spanish Government has made known its desire to divest itself of these shares in recent years. The Government provides funding for projects in the automotive parts field through its Center for Industrial Technology and Development.

Taiwan

Industry structure.--The Taiwan Transportation Vehicle Manufacturers Association (TTVMA) estimates that there are over 2,000 Taiwan firms producing automotive parts. 5/ Most of these firms are small in size, with 70 percent

1/ Report from the U.S. Embassy, Madrid, Spain, February 1987.

2/ Ibid.

3/ Ibid.

4/ Report from the U.S. Embassy, Madrid, Spain, February 1987.

5/ Interview with officials of the Taiwan Transportation Vehicle Manufacturers Association, Taipei, Taiwan, Apr. 27, 1987.

capitalized at less than \$1.5 million each. Industry sources state that only seven firms produce original equipment parts. 1/

Prior to 1985, Taiwan authorities provided incentives for foreign automakers to construct assembly plants in Taiwan by creating import barriers and levying a 70-percent domestic content requirement on the auto assemblers in order to develop the Taiwan automotive parts industry. By year end 1986, eight auto assembly plants were established in Taiwan, including a joint venture with Ford, five joint ventures with Japanese automakers, and two technical cooperation agreements--one with a French firm and one with a Japanese company.

In March 1985, Taiwan began a new auto industry development plan. Taiwan authorities indicated that a new plan was instituted because the Taiwan auto parts industry had become highly fragmented, with many small parts firms supplying each of the eight auto assembly plants. These small parts makers were unable to produce original equipment products; they produced lower value-added parts for the Taiwan aftermarket. The new auto plan is targeted at encouraging competition in the industry by lowering the domestic content ratio to 50 percent and lowering import duties on auto parts from about 70 percent to 50 percent. 2/ In addition, foreign investment was encouraged (no local equity investment is required for auto parts projects, 3-year tax holidays, duty-free import of machinery, and exemptions from export performance ratios). Moreover, exporters are able to get 180 to 360-day export loans from the EXIM Bank of Taiwan.

The TIVMA has about 344 member companies, almost one-third of which produce electrical parts for cars. TIVMA industry data are presented in table 4-14.

The Ministry of Economic Affairs (MOEA) estimates that Taiwan's auto parts output grew at a compound annual rate of 17 percent during 1973-86, reaching \$769 million in 1986. Most of the growth occurred during 1975-80, when output rose 35 percent annually. Taiwan production of selected automotive parts is presented in table 4-15.

Taiwan parts makers have concentrated on lower value products; e.g., tires, jacks, light bulbs, sound and environment equipment, and other basic electrical items. 3/ The Industrial Economics Research Institute surveyed 177 of the largest Taiwan suppliers; the Institute's report shows the following product mix (table 4-16).

The power train/tires category is largely tires that accounted for approximately 69 percent, or \$100 million, of the total production in 1984 by the 177 firms. The other major product in this group was rear axle assemblies, with output valued at \$20 million in 1984. Wiring systems (\$70 million in 1984) were the largest item in the relatively low-tech electrical category; batteries and lights were the next most important items with 1984 outputs of \$16.8 million and \$10.6 million, respectively. Seats (\$23 million

1/ Interview with officials of the American Institute in Taiwan (AIT), Apr. 27, 1987.

2/ USITC staff interview with the AIT, Taipei, Taiwan, Apr. 27, 1987.

3/ Interview with the American Institute in Taiwan, Taipei, Taiwan, Apr. 27, 1987.

Table 4-14
Automotive parts: TTVMA members' capital, employees, and firms, as of
December 1985

Item	Capital	Employees	Firms
	Million dollars	Number	Number
Engine parts and fittings.....	151	10,732	54
Electrical parts for engine and body.....	250	40,785	103
Body.....	219	9,594	68
Power train, steering, and brakes.....	129	8,682	46
Body decoration.....	8	1,548	14
Rubber and plastics.....	11	1,875	15
Other parts.....	22	2,454	44

Source: Report from American Institute in Taiwan, Taipei, Taiwan, March 1987.

Table 4-15
Selected automotive parts: Taiwan production, 1976 and 1982-84

Item	1976	1982	1983	1984	1985	1986
Tires (1,000 ps).....	911	2,220	2,984	3,753	4,236	5,382
Tubes (1,000 ps).....	1,005	1,834	2,332	4,818	5,646	6,580
Bulbs (millions).....	65.7	163.1	302.4	328.7	436.0	559.3
Batteries (1,000 ps).....	794	3,023	3,919	4,102	4,336	5,534
Jacks (1,000 set).....	777	4,928	5,234	4,081	3,332	3,601

Source: Report from the American Institute in Taiwan, Taipei, Taiwan, March 1987.

Table 4-16
Automotive parts: Taiwan production, of 177 major auto parts firms, by
products, 1982-84

Item	(In millions of dollars)		
	1982	1983	1984
Engine parts.....	37	39	47
Power train/tires.....	151	137	156
Steering.....	6	8	8
Suspension.....	10	14	15
Brakes.....	12	14	17
Electrical.....	81	115	148
Body.....	72	88	96
Accessories.....	59	72	84

Source: Report from the American Institute in Taiwan, Taipei, Taiwan, March 1987.

in 1984) were the most important item under body parts, followed by safety glass (\$17 million), and instrument panel assemblies (\$13 million). Jacks (\$30 million) accounted for 36 percent of the accessory group, followed by air-conditioners (\$16 million).

Foreign investment has been an important factor in the development of Taiwan's automotive parts industry. Many Japanese suppliers located production operations in Taiwan in order to meet Taiwan's domestic content requirements. A 1985 survey by the Industrial Economic Research Institute indicated that of the 177 factories it surveyed, 67 had some kind of technical cooperation with foreign firms, covering 88 products. Of the 88 products, three were made by subsidiaries (two Japanese and one American), 28 by cooperative ventures having foreign equity investment, and 57 on a "pure" (i.e., nonequity) technical cooperation basis. Of the product total, 74 were with Japanese firms and 6 were with U.S. companies. ^{1/} However, many Japanese firms concentrated investment in relatively unsophisticated products and restricted the transfer of technology with respect to certain products. Thus, these technical cooperation arrangements were often assembly-type operations:

Industry sources indicate that the above situation is changing at present. Japanese parts makers are reported to be increasing technical cooperation arrangements and emphasizing the production of top quality Taiwan-produced products in response to the appreciation of the yen. Japanese-owned firms may ship these Taiwan-produced auto parts to Japan for OEM production of autos, or for third-country export.

Domestic market.--Taiwan production of passenger cars, a significant market for Taiwan auto parts, grew from about 130,000 units in 1982 to just under 160,000 units in 1985. However, apparent consumption of auto parts in Taiwan fell from \$981 million in 1982 to \$391 million in 1986, or by 33 percent. The fall in apparent consumption was principally due to significantly increased exports, as both domestic production and imports of auto parts rose by about 25 percent in Taiwan from 1982 to 1986.

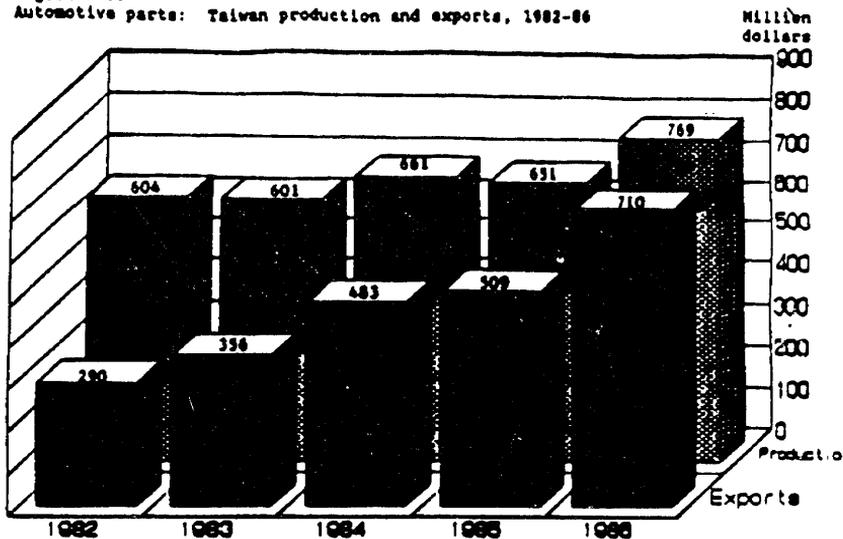
Trends.--As Taiwan's auto production stagnated between 1983-85, Taiwan parts makers began to increase exports. Total exports of automotive parts rose by 145 percent to \$710 million in 1986. Exports have increased from 48 percent of production to 92 percent during 1982-86, as shown in figure 4-9.

The bulk of the growth in the Taiwan automotive parts industry has been in the electrical, body, and accessories segments. In 1984, export ratios for most of the products in these three groups ranged between 53 and 69 percent of output. Export ratios for groups such as engine parts, power train (including tires), and steering systems were lower--averaging about 20 percent of output. These products are typically used by the eight Taiwan auto assemblers for production of autos destined for the Taiwan market.

In 1983, parts and accessories accounted for the bulk (about 70 percent) of total Taiwan exports; auto electrical parts and rubber and plastic products accounted for about 13 percent and 11 percent, respectively (table 4-17).

^{1/} Report from the AIT, Taipei, Taiwan, March 1987.

Figure 4-9.
Automotive parts: Taiwan production and exports, 1982-86



Source: Report from the American Institute in Taiwan, Taipei, Taiwan, March 1987.

Table 4-17
Automotive parts: Percentage distribution of Taiwan exports among product categories, 1982-85

Item	1982	1983	1984	1985
Rubber/plastics.....	10.1	10.8	10.3	10.9
Metal parts.....	.8	.8	.4	.5
Power train and parts.....	7.7	4.5	3.9	3.2
Electrical parts.....	22.3	17.8	19.4	15.0
Accessories.....	57.8	64.9	64.9	69.1
Instruments.....	1.2	1.2	1.1	1.1
Total.....	100.0	100.0	100.0	100.0

Source: Report from the American Institute in Taiwan, Taipei, Taiwan, March 1987.

A TINVA report indicates that Taiwan exported \$546 million of auto parts in 1984. Products with export values of over \$1 million are presented in table 4-18.

Table 4-18
Automotive parts: Taiwan exports, 1984

(In millions of dollars)	
Item	1984
Accessories for motor vehicles.....	116.5
Parts of motor vehicles.....	115.3
Jacks.....	62.2
Wiring harnesses.....	58.5
Car sound equipment.....	54.3
Tire and tire products.....	49.8
Engines and parts:	
Complete engines.....	6.7
Engine parts.....	4.0
Pistons and pins.....	4.2
Inlet, exhaust valves.....	1.6
Subtotal, engines and parts.....	16.5
Auto bulbs.....	15.3
Motor electrical lighting equipment.....	11.1
Electrical signaling equipment.....	7.4
DC electric fans.....	5.8
Wheels.....	5.8
Instruments.....	5.2
Body parts.....	3.2
Radiators.....	2.2
Brakes, parts.....	2.0
Cables.....	1.3
Air filters.....	1.2
Auto air-conditioners.....	1.0
All other.....	10.8
Total.....	546.0

Source: Report from the American Institute in Taiwan, Taipei, Taiwan, March 1987.

Taiwan exports of certain automotive parts (including shock absorbers, rods and axles, chassis frames, transmission shafts, universal joints, brake systems, gears, steering racks, auto and manual transmissions, and miscellaneous parts) are shipped predominantly to the United States. The United States received about 66 percent (by value) of Taiwan exports of automotive parts in 1986; declining slightly from 67 percent in 1985, but up markedly from 42 percent in 1982. Saudi Arabia, Japan, Australia, Canada, Nigeria, and Singapore each absorb about 2 to 3 percent of exports, whereas other exports are scattered among an additional 50 countries. 1/

About 80 percent of Taiwan imports of automotive parts are used in domestic auto assembly plants. The TIVMA estimates that Taiwan imported about \$332 million of auto parts in 1986, compared with \$267 million in 1982.

1/ USITC staff interview with TIVMA officials, Taipei, Taiwan, Apr. 27, 1987.

Principal imports included automatic and manual transmissions, brake systems, cylinder blocks, and carburetors. Japan and the United States are the largest suppliers at about 80 percent and 6 percent, respectively. 1/

In July 1987, Taiwan authorities announced that tariffs on imported components would be reduced from 35 percent to 20 percent, and the 55-percent tax on most built-up imported cars would be cut by about one-third. U.S. industry sources claim that these moves were taken to reduce Taiwan's large balance of payments surplus and to offset further protectionist moves against Taiwan. 2/

Government programs.--The Taiwan authorities have established inspection and safety standards for 33 safety-critical automotive parts that are characterized as "strategic components" (e.g., bearings, camshafts, cylinder heads, connecting rods, disc brakes, and vacuum boosters). Taiwan producers manufacturing these products are eligible to receive tax holidays and certain R&D aid. Taiwan authorities have also taken definitive steps to reduce counterfeiting and trademark infringements. 3/ The chief means of crackdown in these areas include increased inspections and the enforcement of severe criminal and monetary penalties for convicted counterfeiters.

The United Kingdom

Industry structure.--There are currently about 300 major manufacturers of automotive components in the United Kingdom, in addition to approximately 2,000 small- to medium-sized companies. During 1982-86, about 28 British parts makers ceased operations, and 18 new firms began auto parts production. 4/

The British automotive parts industry employs about 275,000 workers. The average wage per week is US\$232 after taxes, including fringe benefits. 5/ Fringe benefits for production workers include free membership to private health programs, subsidized meals, and subsidized travel to and from work.

Industry sources estimate that investment in new plant and equipment in the British auto parts industry during 1987-92 will exceed \$160 million. The British Society of Motor Manufacturers and Agents indicated that about \$16 million is spent on R&D annually. 6/

The United Kingdom's automobile industry experienced significant structural changes during 1977-87. These changes have had a major impact on the United Kingdom's parts makers. Automakers have reduced the number of vehicle models, thus, the number of different parts has been reduced.

1/ Ibid.

2/ USITC staff telephone interview with Automotive News officials, Aug. 25, 1987.

3/ USITC staff interview with TTYMA and BOED officials, Taipei, Taiwan, Apr. 27, 1987.

4/ Report from U.S. Embassy, London, England, May 1987.

5/ Ibid.

6/ Report from the U.S. Embassy, London, England, May 1987.

SOURCE: U.S. GLOBAL COMPETITIVENESS: THE U.S.
AUTOMOTIVE PARTS INDUSTRY, USITC PUB. 2037,
DECEMBER 1987

APPENDIX D

6-3

Table 6-1
Automotive parts: Montariff barriers experienced by U.S. producers in foreign
markets, by countries, 1982-86

Category	Country(ies)	Percentage of total respondents
Quantitative restrictions and similar specific limitations:		
Licensing requirements.....	Colombia	23
	Mexico	20
	Venezuela	19
	Brazil	19
Quotas.....	Venezuela	6
	Mexico	5
Embargos.....	Mexico	5
Export restraints.....	Brazil	7
Exchange and other monetary or financial controls.....	Venezuela	27
	Brazil	17
	Mexico	15
	Canada	15
Maximum/minimum price regulations.....	Venezuela	3
	Mexico	2
	Argentina	2
Local content requirements.....	Mexico	33
	Brazil	18
	Venezuela	13
	Korea	10
Restrictive business practices.....	Japan	20
	Korea	9
	Mexico	6
Discriminatory bilateral agreements.....	West Germany	3
	France	3
Discriminatory sourcing.....	Japan	16
	Korea	3
	Brazil	3
Montariff charges on imports:		
Border taxes.....	Mexico	15
	Canada	8
Port and statistical taxes.....	Canada	2
	Venezuela	2
	Brazil	2
Non discriminatory use and excise taxes and registration fees.....	West Germany	2
Discriminatory excise taxes, government controlled insurance, use taxes, and commodity taxes.....	Brazil	3
	Israel	2

Table 6-1
Automotive parts: Nontariff barriers experienced by U.S. producers in foreign markets, by countries, 1982-86--Continued

Category	Country(ies)	Percentage of total respondents
Nontariff charges on imports--Con.		
Nondiscriminatory sales tax.....	Canada	2
Discriminatory sales tax.....	Mexico	2
Other taxes and fees.....	Australia	2
	Canada	2
Government participation in trade:		
Subsidies and other aids.....	Japan	14
	Brazil	8
	Mexico	8
	Venezuela	7
State trading, government monopolies, and exclusive franchises.....	Venezuela	5
	Hungary	5
	Mexico	3
	Romania	3
Trademark, patent, and other intellectual property laws which discourage imports.....	Mexico	3
Government procurement.....	Iraq	5
	Iran	3
Standards:		
Health and safety standards.....	Australia	2
Product content requirements.....	Mexico	5
	Brazil	3
	Korea	3
Processing standards.....	Venezuela	1
	Japan	1
Industrial standards.....	Japan	2
Requirements on weights and measures..	Japan	2
Labeling and container requirements.....	Canada	3
	Mexico	2
Marketing requirements.....	Canada	2
Packaging requirements.....	Canada	1
	Japan	1
Trademark problems.....	Taiwan	3
	Brazil	2
Customs procedures and administrative practices:		
Antidumping practices.....	Spain	2
	West Germany	2
Customs valuation.....	India	3
	Brazil	3

Table 6-1
Automotive parts: Nontariff barriers experienced by U.S. producers in foreign markets, by countries, 1982-86--Continued

Category	Country(ies)	Percentage of total respondents
Consular formalities.....	United Arab Emirates	6
	Kuwait	5
	Saudi Arabia	5
Documentation requirements.....	Japan	3
	Canada	2
	Brazil	2
	Mexico	2
Administrative difficulties.....	Japan	2
	Venezuela	2
Merchandise classification problems.....	Japan	2
	Venezuela	3
Regulations on samples, returned goods, and re-exports.....	Venezuela	3
	Colombia	3
Countervailing duties.....	Brazil	1
	Japan	1
	Israel	1

Source: Compiled from data submitted in response to questionnaires of the U.S. International Trade Commission.

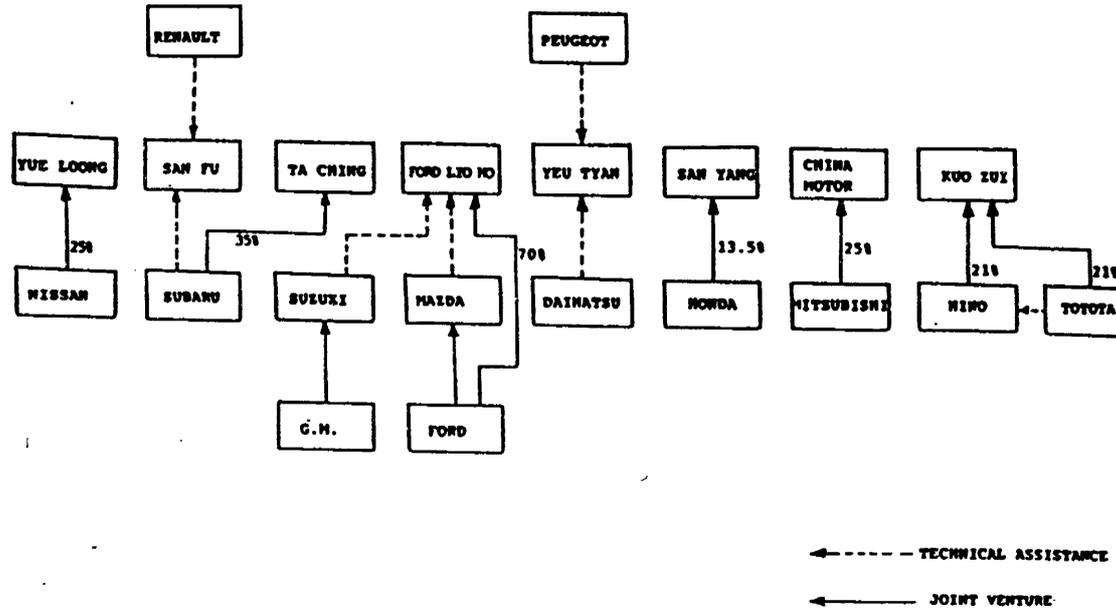
More than any other country, Japan has been accused of erecting barriers to U.S. auto parts exports. Specific actions consistently noted by U.S. companies include alleged unfair links between Japanese suppliers and Japanese automakers, unreasonable delays in negotiations for contracts, difficulty in obtaining the information necessary for bids, unreasonable engineering or design standards, and frequent product modification requests.

According to Commerce's Assistant Secretary for Trade Development, the primary barrier to U.S. auto parts sales to Japanese vehicle manufacturers are not Government barriers, but rather the traditional family-like manufacturer-supplier relationships that exist in Japan (see description of the Japanese keiretsu system, pp. 4-12 to 4-14). He claimed that these relationships apply not only in the Japanese market (estimated to be a \$50 billion market), but also at the new Japanese vehicle assembly plants in the United States. He adds that these ties "have effectively precluded many U.S. suppliers from participating in this huge, fast-growing market." 1/ The difficulties encountered in trying to penetrate the Japanese market have recently prompted political negotiations (see MOSS talks, p. 6-16) to improve the situation. However, several U.S. manufacturers argue that the Japanese vehicle producers are not serious about buying U.S.-made parts, but are showing interest only because of pressure exerted by both the Japanese and U.S. Governments. 2/

1/ Transcript of the hearing, pp. 6-8.

2/ "Counterfeit Parts: A \$3 Billion a Year Industry," *Automotive Parts International*, Dec. 30, 1986, p. 6.

TAIWAN AUTOMAKER FOREIGN ASSOCIATIONS



Source: International Strategy Consultants (ISC)

TAIWAN AUTOMAKER SUMMARY

YUE LOONG / FORD LIO HO

- THE TWO TOP AUTOMAKERS IN TAIWAN, WELL ESTABLISHED IN LOCAL MARKET AND POSITIONED FOR EXPORTS.

CHINA MOTORS / SAN YANG

- THESE TWO COMPANIES ARE WELL ESTABLISHED LOCALLY BUT HAVE LIMITED EXPANSION CAPACITY AND NO EXPORT PLANS.

SAN FU / YEU TYAN

- TWO FAMILY-OWNED COMPANIES THAT MUST HAVE A FOREIGN PARTNER TO SURVIVE IN THE LOCAL MARKET OR EXPORT. DECISIONS MADE IN 1988 WILL DETERMINE THEIR FUTURE.

KUO ZUI / TA CHING

- TWO NEW AUTOMAKERS TO BEGIN PRODUCTION WITH JAPANESE PARTNERS BY 1989. BOTH WILL EXPORT TO THE REGION.

Source: International Strategy Consultants (ISC)

TAIWAN AUTOMAKER OVERVIEW

AUTOMAKER	EST. 1988 PRODUCTION	EST. 1990 CAPACITY
YUE LOONG	94,000	160,000
FORD LIO HO	68,000	150,000
SAN YANG	35,000	35,000
CHINA MOTORS	32,000	45,000
YEU TYAN	28,000	60,000
KUO ZUI	10,000	60,000
TA CHING	—	60,000
TOTAL	300,000	615,000

Source: International Strategy Consultants (ISC)

APPENDIX GReport of the automotive industry
human resources
task forceCanadian Occupational
Projection System
(COPS)**THE FUTURE
SIZE OF CANADA'S
INDUSTRY**

Making an accurate forecast of the size of Canada's auto industry over the next five to ten years is extremely difficult. Nevertheless, it is important for purposes of our employment and occupational projections to have some sense of what range of futures is likely. We propose to develop three forecasts for the industry; together they should give a better sense of the possibilities before the industry than any single forecast could do.

In preparing the scenarios, we made certain assumptions that remain constant in all three cases. They are as follows:

- North American market growth of 1.5% a year from the 1984 level of 15,767,000 to 17,240,000 total vehicles in 1990.
- No significant change in U.S. auto trade policy from the present free trade stance.
- Canadian dollar no higher than 80% of the value of U.S. dollar.
- No significant increase in vehicle or parts exports from Canada to countries outside the United States.

These assumptions fall well within the forecasts of most industry observers. Market growth in North America is projected by almost everyone to be between 1% and 2% a year to 1990. We picked the mid-point of 1.5%. We have seen no major forecasts of the future value of the Canadian dollar to 1990 predicting it will increase to more than 80% of the value of the U.S. dollar. And no one in the industry expects Canadian exports to areas outside of North America to increase significantly.

In developing our scenarios we also ignored the cyclical nature of the industry. All the scenarios are forecasts for 1990 based on extrapolating from 1984, a peak production year. However, they should not be viewed as predicting that 1990 will be a

peak year but rather as giving a general sense of how much bigger or smaller the industry could become by that time.

We developed the three scenarios by making specific assumptions about four critical factors:

- Canadian trade policy towards offshore vehicle producers;
- the level of passenger car and commercial vehicle imports to North America³;
- the level of offshore parts imports to North America; and
- Canada's share of total North American vehicle and parts production.

The assumptions in the three scenarios are summarized in Table 2.4⁴.

We call the first scenario **Universal Auto Pact**. It represents what might happen if the federal government adopted the trade policy recommendation of the 1983 Task Force on the Canadian Motor Vehicle and Automotive Parts Industries. Under this scenario, Canadian trade policy in 1990 would require all companies selling vehicles in the Canadian market to create Canadian value-added (CVA) in vehicle or parts production equal to 60% of their cost of sales in Canada in 1990. Exceptions might be made for those selling very small volumes, but all major vehicle importers would have to invest in Canadian production facilities and/or purchase substantial quantities of Canadian-made parts.

3. Throughout the report we use North America to refer to Canada and the United States.

4. The employment implications of our scenarios are the subject of discussion in Chapter 8.

Table 2.4
Major Assumptions Underlying the Three Scenarios
for the Canadian Auto Industry in 1990

<u>Assumptions</u>	<u>1984</u> <u>Actual</u>	<u>Scenario 1:</u> <u>Universal</u> <u>Auto Pact</u>	<u>Scenario 2:</u> <u>More of</u> <u>the Same</u>	<u>Scenario 3:</u> <u>Import</u> <u>Flood</u>
Total Canada and U.S. Vehicle Sales	15,787,000	17,240,000	17,240,000	17,240,000
Canadian Trade Policy	VRA with Japan at 18% of cars	60% CVA required of all vehicle sellers	VRA with Japanese in 18-20% range	No import restrictions
Import Share of Canada/U.S. Market				
Passenger Cars	24%	31%	31%	41%
Commercial Vehicles	15%	19%	19%	21%
Total Import Share	21%	28%	28%	35%
Import Share of Canada/U.S. Parts Market	8%	12%	12%	16%
Value-added in Canada as % of Total Canadian/U.S. Automotive Value-Added	8.4%*	10.9%**	9.6%	7.7%

* Canada Consulting Group estimate based on available data.

** Of the 10.9%, 2.1% represents value-added directly created by the new trade policy in Scenario 1.

Under the Universal Auto Pact scenario, vehicle imports into North America would rise to 28%, primarily because of the unrestricted U.S. market. Within this, passenger car imports would have risen to 31% of the passenger car market from 24% in 1984 (and 25% in 1983). Commercial vehicle imports would have risen to 19% of the commercial vehicle market from 15% in 1984 (and 17% in 1983). We assume offshore parts imports would also increase to 13% from the current 8% of the market. But because of the 60% value-added requirements, these import increases would not have a significant negative impact in Canada. Instead, Canada would be assured of production

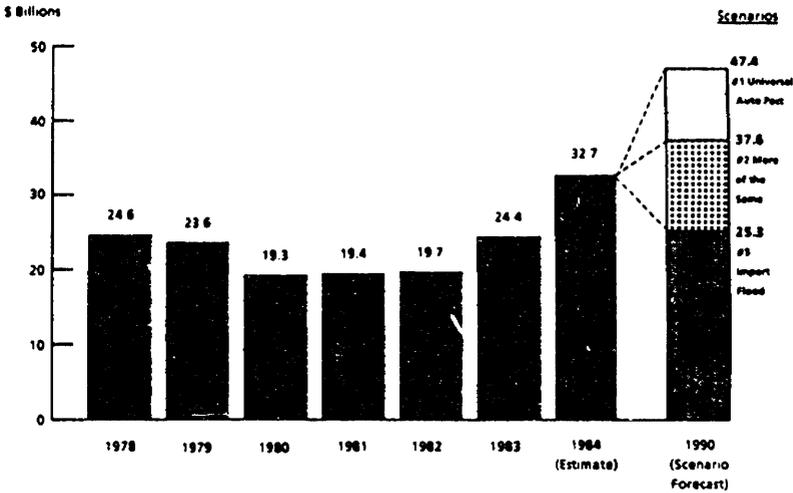
value-added equal to at least 60% of the total value of sales in the Canadian market. Because of the value-added requirements and because the additional investment by offshore producers would stimulate increased Canadian parts production that might feed U.S. plants, we estimate the automotive value-added in Canada as a percentage of total North American value-added would rise to 10.9% — well above the 1984 estimated level of 8.4%. Of this rise about 2.1 percentage points would be due directly to the 60% value-added requirement in the new trade policy.

The overall result of the assumptions in the first scenario is that the Canadian auto industry would grow from net shipments of \$32.7 billion in 1984 to net shipments of \$47.4 billion in 1990 — a gain of 45% (see Figure 2.2). In effect, this scenario has the Canadian auto industry outperforming the U.S. industry because of a vastly different trade strategy. Whether the U.S. would stand idly by as Canada obtained significant offshore investment by this means is open to question. However, the U.S. has already reaped significant offshore automotive investment and might have little reason to object to Canada applying trade leverage to gain significant investment from offshore firms.

The second scenario we call More of the Same. It represents a general continuation of current policies. Under it Canadian trade policy in 1990 might look very much like trade policy today, with some type of voluntary import restraints holding the Japanese to between 18 and 20% of the market. Because the U.S. market would remain unrestricted and the Canadian market would be totally open to offshore imports from countries other than Japan, we again estimate the overall vehicle import level in North America would rise to 28%, consisting of a 31% passenger car import penetration and a 19% commercial vehicle import penetration. We also estimate in this scenario that the trend to greater offshore sourcing of parts would raise parts import levels to 12% of the North American market.

Figure 2.2

Three Scenarios for Total Shipments in the Canadian Automotive Industry to 1990
(In billions of constant 1984 dollars)



Source: See Table 2.1 for 1978-1984. Forecasts in 1990 are from The Canada Consulting Group Automotive Industry Model

A critical and difficult assumption to make in this scenario concerns what would happen to Canada's share of the total value-added in the North American industry. Under this scenario we project that Canadian value-added would increase as a proportion of total North American value-added, from an estimated 8.4% in 1984 to 9.6%. For CVA to reach 9.6%, a number of developments would have to occur. In the first place Canada's parts industry would have to keep growing at a rate significantly above growth in the U.S. parts industry. This would continue the trend between 1979 and 1984, during which the Canadian parts industry grew by 31% in real terms; at the same time, the U.S. parts industry was smaller in 1984 in real terms than it was in 1978 before the recession. In the second place the North American vehicle companies would

need to continue to maintain a high level of investment in Canadian facilities. Given a Canadian dollar worth no more than 80% of the U.S. dollar and a corresponding labour cost advantage in Canada, it is certainly conceivable the U.S. vehicle companies would want to maintain a high level of investment in Canada. However, growth in total market size will not be sufficient to offset increased import penetration under Scenario 2, and the additional 1.66 million units of Japanese and Korean capacity anticipated between 1984 and 1990 represent yet more units of production not required in the projected marketplace (See Table 2.5). Up to a million additional units of Big Four passenger car capacity will also be coming on stream between now and 1990. Some plants will have to close or operations in general will have to be scaled back. Given the U.S.-UAW collective agreement job bank guarantees and the U.S. protectionist mood in general, it will be imperative that Canadian facilities maintain high quality and productivity levels if the Canadian share of North American value-added is to be maintained or increased.

The third development we are anticipating in the second scenario is more problematic. To attain a larger portion of total North American production, Canada will need to secure some major offshore investments. The announced Canadian Toyota, Honda assembly plants could be the beginning of that investment growth, especially if the plants are expanded to production volumes of 150,000 to 200,000 vehicles a year. They could also encourage the location of Japanese parts plants in Canada to hook up with their anticipated just-in-time supply systems. The continuation of the VRA would also be an inducement to other Japanese vehicle companies to locate production facilities in Canada. It would not be impossible for the Canadian industry to reach 9.7% of total North American value-added without additional offshore investment, but it would be very difficult. It would also be difficult if the investment which does come to Canada adds a capacity without making a contribution to value-added commensurate with any parts or assembly production which is displaced.

Table 2.5
 Structure of the North American Passenger Car Market
 1984 Actual & 1990 Scenarios
 (000s of units)

	<u>1984 Actual</u>		<u>Scenario 1&2</u>		<u>Scenario 3</u>	
Total Canada & U.S. Passenger Car Sales	11,360	100%	12,400	100%	12,400	100%
Imported Passenger Cars	2,685	24%	3,850	31%	5,090	41%
Non-Auto Pact Passenger Car Production	140	1%	1,660*	14%	1,660*	14%
Auto Pact Passenger Car Production	8,535	75%	6,890	55%	5,650	45%
Auto pact Production — reduction from 1984			(1,645)		(2,885)	

- * From Table 1.3 based on facilities announced as at December, 1985. Actual production could be higher, with up to 500,000 additional units of non-Auto Pact capacity known to be under consideration by several offshore manufacturers either independently or in partnership with Big Four manufacturers. Certain of these non-Auto Pact manufacturers have announced intentions to qualify under Auto Pact but it is unclear whether they will satisfy requirements by 1990.

The net result of assumptions in the second scenario is that overall shipments in the Canadian industry would increase by 15.1% to \$37.6 billion in 1990. Three-fourths of this increase would result from the increased Canadian share of North American value-added and one-fourth from the growth of the overall vehicle market. However, the overall level of Canadian output would be 11% higher in 1990 under this scenario were it not for the higher levels of vehicle and parts imports.

The third scenario is called Import Flood because under it vehicle imports are assumed to rise to 35% of the total North American market. Passenger car imports rise dramatically to 41% of the North American market - almost half as high again as the 28% peak import level reached in 1982 - and commercial vehicle imports also rise, to 21% of that market. We also assume that parts imports would increase to 16% of the North American parts market. Under the third scenario, Canadian trade policy would consist of no import restrictions other than normal tariffs. We also assume the Canadian share of total North American value-added would fall to 7.7%, mainly as a result of a disproportionately larger amount of offshore investment going to the U.S. in the absence of any Canadian restrictions on offshore producers. In any case 7.7% is still a higher level than that achieved by the Canadian industry in 1972-73 and 1976-80.

These assumptions result in a 22.7% real decline in Canadian industry shipments under the Import Flood scenario. Such a decline would result mainly from the higher level of vehicle imports, especially the level of passenger car imports although the high parts import level and the decline in Canada's share of North American production would play a role, too. As we show in Chapter 8, when we translate these scenarios into employment projections, the Import Flood scenario would have serious ramifications for many auto workers. The combination of higher vehicle imports with the new capacity of Asian producers in North America would create excess capacity in the industry of some 2.8 million units - equivalent to 11 traditional full-scale, two-shift assembly plants each producing 250,000 vehicles a year. To the extent that this offshore investment consists of merely assembly platforms with low North American value-added, there would be further negative effects on the parts industry. As table 2.5 shows, non-Auto Pact, North American-based passenger car production in 1990 could account for 14% or more of North American sales.

All told, under Scenario 3, tens of thousands of automotive jobs stand to be lost in Canada alone, and the impact of this job loss would be felt beyond the industry to the economy at large. Because of its serious negative implications for many individuals and communities, not to mention the economy as a whole, it is difficult to imagine Scenario 3 being allowed to happen. It is not impossible, however, particularly given how powerless Canada is to change U.S. market policies. If the U.S. were willing to tolerate

the immense dislocations and social costs of a 41% passenger car/21% commercial vehicle import level, Canada's political options would be narrowed even as events increased the urgency of moving to trade policy as contemplated by Scenario 1.

We have described three possible but very different scenarios for the industry. We believe they give a good sense of the overall range of prospects for the Canadian automotive industry in 1990. That the range varies from 45% larger to 23% smaller than the industry was in 1984 says a great deal about the uncertainties the industry faces. Even in the best scenario, with the industry growing by 45%, a higher level of imports to North America will be inevitable given U.S. government policy. It is possible, though, that despite higher imports, Canada can still expand its industry vigorously. Canadian success will depend on four main factors:

1. The government of Canada must pursue a trade policy that will result in higher investment by offshore manufacturers or significant purchases of Canadian-made parts.
2. The Canadian operations of the North American vehicle companies will need to continue their strong record in productivity and quality improvement.
3. The Canadian independent parts industry will need to continue its aggressive approach to expansion, selling especially to the new Japanese and Korean plants in the U.S. and Canada.
4. Labour and management in Canada will need to find ways to develop a human resource strategy that takes the best of the new models of work organization and tailors them to the Canadian environment.

It is clear that despite the high level of foreign ownership in the industry, its future will depend very much on decisions and actions taken by Canadians. Trade policy and competitiveness are both factors over which Canadians have significant control in this industry. Unlike resource industries, there are no natural competitive advantages in the automotive industry. Canadians created a vigorous and healthy automotive sector. It will be up to Canadians to sustain it.

CHAPTER 4. MAJOR FOREIGN COMPETITORS

Major foreign competitors of the U.S. automotive parts industry are Canada, Japan, Mexico, and West Germany. In recent years, however, competition has increased from Brazil, Korea, and Taiwan, as well as from other newly industrialized countries.

Brazil

Industry structure.--The Brazilian automotive parts industry, established in 1957, consists of some 2,000 firms. About 400 of these are located in the Sao Paulo region, close to the auto assembly facilities of Ford, General Motors, and Volkswagen. 1/ A number of Brazilian auto parts producers are subsidiaries of U.S.-owned parts makers, the majority of which established operations in Brazil to supply original-equipment parts to the major Brazilian auto assemblers. However, many of these U.S.-owned firms have since established export programs. Many did so to take advantage of the incentives of the SEFIEK program (see p. 2-16). 2/

The Brazilian automotive parts industry employs about 30,000 workers (fig. 4-1). Average wages, including fringe benefits, vary between U.S. \$3.60 and \$5.20 per hour for skilled workers and \$1.85 to \$3.16 per hour for semi-skilled and nonskilled employees. Although the typical employee works 8 hours a day, 5 days a week, many production workers work 6 days a week. 3/ In general, overtime during working days carries a 50-percent premium, and Sundays and holidays carry a 100-percent premium up to a total of 8 hours a day; above 8 hours, the premium rises to 150 percent. Principal fringe benefits provided by certain major companies include a Social Security-type pension plan administered by the Government of Brazil, government medical and dental services, accident insurance, a termination pay fund, sick pay, maternity leave, yearly vacations, and uniforms and other accessories needed for specific work categories. Additional benefits provided by certain firms include free medical, hospital, dental, and medicine services beyond that which is provided by the government; subsidized transportation; and subsidized meals. 4/

Brazilian automotive parts producers' capital expenditures for new plant and equipment increased irregularly from \$271 million in 1982 to \$400 million in 1986 as shown in the tabulation on the following page. 5/

Most Brazilian parts makers devote less than 3 percent of sales to research and development (a ratio similar to that of the U.S. industry and

1/ USITC staff interview with General Motors do Brasil officials, Sao Paulo, Brazil, May 11, 1987.

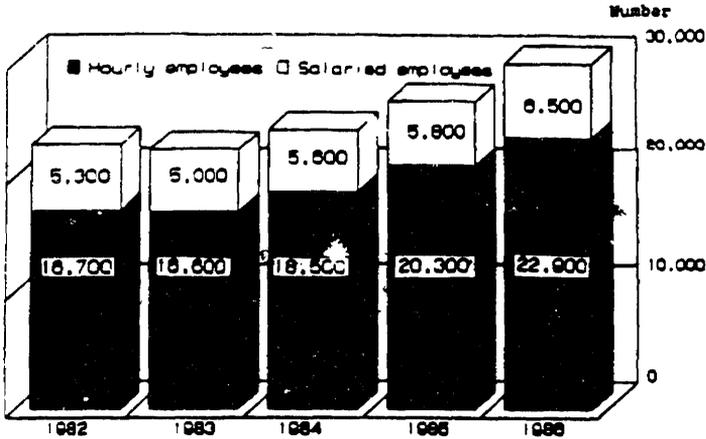
2/ Ibid.

3/ USITC staff interview with Cofap officials, Sao Paulo, Brazil, May 13, 1987.

4/ USITC staff interview with U.S. Department of State officials, Sao Paulo, Brazil, May 11, 1987.

5/ Report from the U.S. Consulate, Sao Paulo, Brazil, June 1987.

Figure 4-1
Automotive parts: Brazilian hourly and salaried employees, 1982-86



Source: Report from the U.S. Consulate, Sao Paulo, Brazil, June 1987.

Year	Value (Million dollars)
1982.....	271
1983.....	189
1984.....	232
1985.....	254
1986.....	400

many foreign industries). 1/ Industry sources state that Brazilian subsidiaries of multinational corporations benefit greatly from the transfer of technology from parent companies.

According to industry sources, the unpredictable nature of the Brazilian economy makes future capital investment projections difficult. High real interest rates during January-June 1987, for example, made financing new investments extremely expensive. Industry sources also indicate that investment incentives are inhibited by Government-enforced price controls on

1/ USITC staff interview with Sindipecas officials, Sao Paulo, Brazil, May 12, 1987; and USITC Publication 1950, report on The Effect of Developing Country Debt-Servicing Problems on U.S. Trade, March 1987.

domestic sales. 1/ In addition to the high cost of capital and the cyclical demand in the Brazilian market, exchange rate trends have had a negative impact on the international competitiveness of Brazilian auto parts producers. Despite these problems, industry sources stated that Brazilian parts producers are expected to invest in new plants and equipment at a steady rate in order to remain competitive in the global market. Most investment is carried out via commercial lending. Bond issuances or stock issuances are also commonplace. The National Development Bank (BANDESA) is the principal Government of Brazil source available for financial lending to auto parts producers.

Brazil's large foreign debt has resulted in a growing trend toward "debt for equity swaps" by U.S., European, and Japanese banks. 2/ The exchange takes place when a creditor bank offers Brazilian Central Bank paper at face value for Brazilian cruzados, then assumes an equity position (with a partner) in a local firm. With an increasing number of swaps planned for the automotive parts sector, it is likely that U.S. firms' equity interest in the Brazilian automotive parts industry will grow in the near future.

Domestic market. --The Brazilian domestic market for automobiles is about 1 million vehicles per year, amounting to about \$5.3 billion. The principal purchasers of automotive parts are Brazilian automakers. The four largest, which account for almost all domestic production, are subsidiaries of Ford, General Motors, Volkswagen, and Fiat. 3/

Brazilian production of automotive parts climbed by 27 percent during 1982-86 to \$6.5 billion in 1986 (table 4-1). About 60 percent of domestic production is for the OEM market. Capacity utilization rates increased from 71 percent in 1982 to 84 percent in 1986.

Table 4-1
Automotive parts: Brazilian production and capacity utilization, 1982-86

Item	1982	1983	1984	1985	1986	Average annual percentage change, 1986 over 1982
Production (billion dollars)....	5.1	3.8	5.9	5.6	6.5	6.3
Capacity utilization (percent).....	71	70	78	80	84	4.3

Source: Report from the U.S. Consulate, Sao Paulo, Brazil, June 1987.

1/ USITC staff interview with Sindipecas officials, Sao Paulo, Brazil, May 12, 1987; and USITC Publication 1950, report on The Effect of Developing Country Debt-Servicing Problems on U.F. Trade, March 1987.

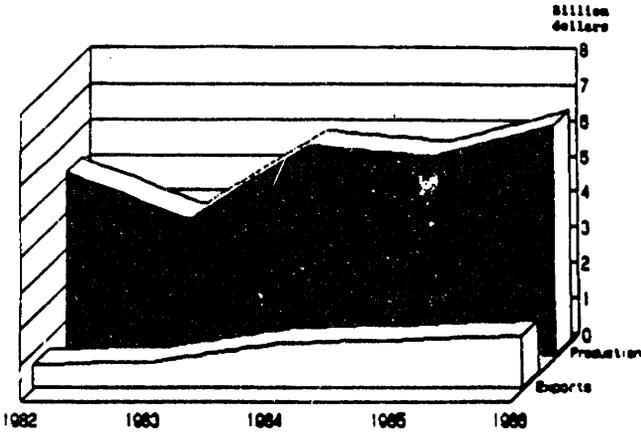
2/ USITC staff interview with U.S. Department of State officials, Sao Paulo, Brazil, May 11, 1987.

3/ USITC staff interview with Sindipecas officials, Sao Paulo, Brazil, May 12, 1987.

Trade---Approximately 200 Brazilian manufacturers export automotive parts to more than 100 countries. Brazilian exports ^{1/} of automotive parts rose by 114 percent (fig. 4-2) during the period to \$1.5 billion in 1986, as shown in the following tabulation:

<u>Year</u>	<u>Value (Million Dollars)</u>
1982.....	700
1983.....	800
1984.....	1,300
1985.....	1,400
1986.....	1,500

Figure 4-2
Automotive parts: Brazilian production and exports, 1982-86



Source: Report from the U.S. Consulate, Sao Paulo, Brazil, 1987.

Exports to the United States, the largest export market, ranged from 37 percent of total exports in 1982 to 60 percent in 1984 and 1986 (table 4-2). Exports destined for Latin American countries fell during 1982-86, largely because of declining economic conditions in that region. ^{2/}

^{1/} Report from the U.S. Consulate, Sao Paulo, Brazil, June 1987.

^{2/} Transportation costs amounted to 8.4 percent according to USITC Publication 1375, Report on Investigation No. 332-141 on Transportation Costs of U.S. Imports, April 1983.

Table 4-2
Automotive parts: Major export markets for Brazilian-produced automotive parts, 1982-86

Market	1982	1983	1984	1985	1986	Annual average change, 1986 over 1982
	1,000 dollars					Percent
United States....	243.0	418.0	763.9	808.6	870.0	37.6
Italy.....	79.7	79.9	125.2	162.0	145.0	16.1
West Germany.....	78.4	-	-	65.6	72.3	-2.0
Argentina.....	-	45.6	59.4	-	72.5	12.3

Source: Estimated from the report from the U.S. Consulate, Sao Paulo, Brazil, June 1987.

U.S. industry sources claim that the Government of Brazil has undertaken programs that restrict the importation of automotive parts while developing local industries and strategic sectors to conserve foreign exchange reserves. For example, Brazil limits imports by levying high tariffs; Brazilian tariffs for automotive parts range from 8 to 205 percent ad valorem, with the tariffs on most products ranging between 25 and 90 percent (the average U.S. tariff rate for parts is 3.1 percent). In addition, there are important surcharges (extrapolated from the tariff rate) on imports of certain products. Tariffs, along with the relatively high transportation costs between the United States and Brazil, ^{1/} render most U.S.-produced parts nonprice competitive in the Brazilian market. ^{2/}

In addition to high tariff rates, import licenses are mandatory for most automotive parts. Licenses are issued by the Foreign Trade Department of the Banco de Brasil (CACEX). An important facet of obtaining import licenses is the fact that the Brazilian "law of similars" can be used to limit imports of products that are already manufactured in the country. Although there are many exceptions to this rule, the application of any specific exemption from this rule is not automatic and is subject to negotiation between the Government of Brazil and the importer. However, it should be noted that there is a duty drawback system commonly used by Brazilian parts makers that permits the Brazilian Government to suspend or reimburse import duties and other taxes on certain imports when they are used in the manufacturing of a product for export. ^{2/}

Government programs.--The Government of Brazil has initiated several noteworthy programs to encourage domestic competition, promote alternative fuels, control automotive emissions, and stimulate exports. A 1979 Government of Brazil decree restricted new parts making projects by Brazilian auto assemblers. However, these limitations can be relaxed if a particular

^{1/} Ibid.

^{2/} Report from the U.S. Consulate, Sao Paulo, Brazil, June 1987.

automotive part is not produced by a Brazilian firm. This decree has had the effect of stimulating an increase in the number of independent producers. 1/

Brazil has a special program to promote the development of an alcohol-burning engine. The research that led to the development of this engine was the result of a joint effort by the Government of Brazil and auto manufacturers. The Brazilian Government has also announced controls to reduce auto emissions; thus, there has also been research efforts aimed at reducing alcohol engine emissions. 2/

The BEFIEX program is the most important Government of Brazil program for encouraging exports of automotive parts. BEFIEX is a contractual agreement between the Government and a specific manufacturer. Under a BEFIEX contract, a firm can receive exemptions from import duties as well as a direct rebate, based on the percentage of local value added, of the industrial products tax (IPT). In exchange for these incentives, the firm commits to a certain level of exports over a period of time (typically 10 years). The value of imports receiving tax benefits is typically a percentage of the value of exports pledged. 3/ For example, in exchange for \$300 million of imports that receive tax benefits, a firm might commit to \$800 million of exports. Auto parts manufacturing subsidiaries of multinational firms account for approximately one-third of all BEFIEX contracts. Potentially, if a firm did not comply with its contractual obligations, strict financial penalties could be enforced. However, in practice, if a firm is unable to comply, a contract is typically renegotiated with the Government.

Another less frequently used government program, Resolution 68 of the "Conselho Nacional do Comercio Exterior" (CONCEX), permits the Foreign Trade Department of the Bank of Brazil (CACEB) to draw upon the resources of the Fundo de Financiamento a Exportacao (FINEX) to provide financing for exports. Financing can be extended to exporters or foreign importers. Exporters can receive financing for up to 85 percent of the value of the merchandise. 4/

Canada

Industry structure.--There are over 2,000 firms producing automotive parts in Canada, employing some 84,000 persons. They are generally categorized as captive suppliers of major automobile assemblers (all of whom are foreign owned), independent foreign-owned companies, and independent Canadian-owned companies. In-house original equipment parts (e.g., engines and transmissions) produced by the major auto assemblers accounted for about 40 percent of total Canadian production in 1984-85. Industry sources report that General Motors (GM) manufactures approximately 70 percent of its auto parts in-house, Ford approximately 45 percent, and Chrysler about 25 percent. 5/

1/ USITC staff interview with U.S. Department of State officials, Sao Paulo, Brazil, May 11, 1987.

2/ USITC staff interview with U.S. Department of State officials, Sao Paulo, Brazil, May 11, 1987.

3/ Ibid.

4/ Report from the U.S. Consulate, Sao Paulo, Brazil, June 1987.

5/ USITC staff interview with officials of the Canadian Automotive Parts Manufacturers Association, Toronto, Canada, Apr. 30, 1987.

MEXICO

reduce the bilateral trade deficit with Japan (Korea's principal source of auto parts imports). 1/

Both large and small Korean firms are participating in the local production program. For example, Lucky is planning to produce engineering plastics such as PET, PBT, polymer, nylon, and ABS; Kolon has completed its production facilities for engineering plastics; Dongyang Nylon has developed a fire-retardant nylon resin; Hyundai Cement and Daehan Ink Paint are gaining expertise in the production of engine parts; and Pacific Development plans to manufacture reinforced plastic components for gears and gear boxes. 2/ Under the program, about 1,800 auto parts and components (estimated value at \$1.1 billion) that are currently imported will be localized during 1987-91. In 1986, 78 Korean firms manufactured 111 products (valued at \$58 million) under the plan; in 1987, 380 items are targeted to be similarly produced.

The Government of Korea has also developed a Korean Industrial Standard (KIS) that is adapted from similar foreign systems --e.g., Japan (JIS), U.S. (U.L.), and the guidance of International Standards Organization (ISO), and the International Electrotechnical Commission (IEC). At present, over 7,000 items in the KIS are classified into 15 categories. The central aim of the KIS marking mandatory system is to ensure safety control. 3/

Mexico

Industry structure.--The Industria Nacional de Autopartes (INA), a Mexican trade association, categorizes approximately 105 Mexican producers of automotive parts. The INA reports annual sales of \$2.0 billion in 1986.

Following the Mexican economic crisis of 1981-82, production levels of nearly all manufactured goods in that country declined to about 50 percent of their previous levels. The automotive industry was particularly affected, since major manufacturers had been expanding capacity in anticipation of a growing domestic market. Production of automotive parts, however, fluctuated upwards during 1982-86, reflecting the slowly recovering Mexican automotive market (table 4-11).

Total employment in the Mexican motor-vehicle industry increased by 2 percent to 234,000 in 1986 (table 4-12). Although the minimum wage rose in terms of the Mexican peso during 1982-86, because of the peso depreciation it fell to about US\$1.00. Highly skilled maintenance and technical workers received approximately US\$5.00 per hour; however, the majority of workers were compensated at approximately US\$1.00 per hour. Total hourly wage and compensation for the automotive industry declined during the period by 42 percent to an estimated \$1.48 per hour in 1986 (table 4-12).

1/ USITC staff interview with Korean Government officials, Seoul, Korea, Apr. 29, 1987.

2/ "Auto Parts Industry," Korea Buyers Guide, p. 69.

3/ Report from U.S. Embassy, Seoul, Korea, March 1987.

Table 4-11
Automotive parts: Mexican production of selected products, 1982-86

Item	1982	1983	1984	1985	1986	Average annual change, 1986 over 1982	
						Percent	Percent
	1,000 units						
Batteries.....	3,103	2,798	3,616	3,611	3,436	1/	2/ 2.0
Bearings.....	5,700	5,250	5,050	7,750		2/	7.9
Autosound components:							
AM radio receivers without tape players....	274	128	116	148		1/	2/ -14.3
AM/FM stereos without tape players.....	30	12	17	10		1/	2/ -23.9
AM/FM stereos with tape players.....	6	5	7	12		1/	2/ 19.5
Shock absorbers.....	1/	3,300	1/	4,214	3,600	3/	3.6
Tires.....	1/	1/	9,861	10,381	9,173	4/	-1.8

1/ Not available.

2/ Average annual change, 1985 over 1982.

3/ Average annual change, 1986 over 1983.

4/ Average annual change, 1986 over 1984.

Source: Report from U.S. Embassy, Mexico City, Mexico, March 1987.

Table 4-12
Automobiles and automotive parts: Mexican employment and hourly wages, 1982-86

Item	1982	1983	1984	1985	1986	Average annual change, 1986 over 1982	
						Percent	Percent
Total employment (1,000).....	228.3	204.4	204.3	209.0	234.0		0.6
Hourly wages.....	\$2.55	\$1.97	\$2.56	\$2.39	\$1.48		-12.7

Source: Report from U.S. Embassy, Mexico City, Mexico, March 1987.

During July-August 1987, the Mexican automotive industry was affected by labor disputes. On July 1, 1987, 10,500 workers at Volkswagen de Mexico initiated an 8-week strike, which ended with the company granting a 78-percent wage increase. 1/ (The inflation rate in Mexico for 1986 and 1987 was

1/ USITC staff telephone interview with staff of Automotive News, Sept. 24, 1987.

estimated at about 140 percent annually.) Production of 1988 models was delayed because of powertrain and sheet metal component shortages caused by the strike. 1/

Ford Motor Co. of Mexico has noted significant improvement in the quality of parts provided by Mexican suppliers. According to Ford's Director of Supply and Planning Policies, the average quality rating of Ford Mexico's suppliers has improved by approximately 50 percent in the past 18 months. Additionally, some 45 Mexican suppliers sold approximately \$344 million worth of materials to Ford of North America in 1986. 2/

Despite the downturn in the Mexican market for auto parts during 1982-86, one sector of the industry, the maquiladora program, has prospered in recent years. Established in 1965, this program allows for in-bond production, and relaxes Mexican foreign investment restrictions, allowing for 100 percent control of maquiladora operations by foreign companies. The principal proviso is that virtually all production must be exported. The two most significant reasons for companies locating assembly operations in maquiladoras are low wage rates and close proximity to the United States. The labor rate in maquiladoras is typically less than US\$1.00 per hour. Currently, over 90 percent of the maquiladoras are located along the border. By the end of 1985, there were about 735 maquiladoras, employing over 200,000 persons.

Although the industries that are represented in maquiladoras vary widely, typical articles produced include products which are highly competitive in the U.S. market, have an easily segmented production process, and are comparatively labor intensive. Automotive wiring harnesses, for example, are assembled extensively in maquiladoras, with General Motors, Ford, and Chrysler all having maquiladoras producing these parts (e.g., General Motors has about six such firms). In addition to the Big Three, almost all of the U.S.-based independent producers of wiring harnesses operate in maquiladoras. Other automotive products produced in maquiladoras include autosound components, seat belts, automotive electrical articles, engine parts, radiators, steering wheel covers, brake pads, and seat belts.

Domestic market.--Sales of new motor vehicles in Mexico fell sharply, from about 470,000 units in 1982 to less than 275,000 in 1983, and then climbed slowly to about 400,000 in 1986. 3/ The heavy drop in sales and production of new cars had a strong impact on Mexican auto parts production, which fell from \$1.2 billion in 1981 to less than \$1 billion in 1983. 4/ Offsetting the decline in demand from motor-vehicle producers was the steadily rising demand for auto parts in the replacement market. Additionally, Government measures designed to restrain imports protected Mexican auto parts

1/ "Mexican Police Turn Back Striking VW Workers," Automotive News, Aug. 24, 1987, p. 52.

2/ Stephen Downer, "Mexico to Cut Auto Parts Tariff to 30% from 40%," Automotive News, July 13, 1987.

3/ World Motor Vehicle Data Book, Motor Vehicle Manufacturers Association, Detroit, MI, eds. 1982-87.

4/ Report prepared for the U.S. Department of Commerce by Batres, Valdes, Wygard y Asociados, S.C., Mexico City, Mexico, November 1983.

producers and the import penetration ratio fell from almost 30 percent in 1982 to less than 10 percent in 1983. ^{1/} According to industry officials, greater emphasis has been placed on production for export because of Government pressure and the depressed state of the local economy. Industry sources estimate that of the 500,000 cars and trucks that will be sold in Mexico in 1988, one-half are destined for export.

Trade.--Complete data for Mexico's imports and exports are not available. However, since the United States is by far Mexico's largest trading partner, official U.S. trade statistics can be used as an approximation. U.S. imports from Mexico increased from \$648 million in 1982 to \$2.3 billion in 1986, or by almost 255 percent. Much of this increase can be attributed to an increase in the use of maquiladora facilities by U.S. based producers. U.S. exports to Mexico increased from \$1.1 billion in 1982 to \$1.7 billion in 1986, or by 55 percent. This increase is also due to an increase in maquiladora activity. According to the Director of Industrial Relations for General Motors de Mexico, because of the falling value of the Mexican peso, Mexico "could replace Korea as a components supplier. It has the raw materials, cheap labor, (and) market adjacency to the United States." ^{2/}

Car and truck assemblers are required to earn at least 50 percent of the net foreign exchange needed to cover their foreign-exchange budget by exporting automotive parts manufactured domestically (parts used in finished autos and trucks can be included in this 50 percent). A maximum of 20 percent can be earned by the export of automotive parts from maquiladora operations. ^{3/} Imports by Mexican parts firms or Mexican auto assemblers are controlled by import licenses issued only to approved companies. The Mexican Government currently levies a 40-percent import duty on all parts imported by automakers, which is scheduled to be reduced to 30 percent by October 1988. ^{4/}

Government programs.--The most significant Government of Mexico policy affecting automotive parts operations is the Automotive Decree of 1983. The two major components of the decree affecting the automotive parts industry are local content and balance of trade requirements. The minimum local content requirement in 1987 for Mexican-produced automobiles is 60 percent, and ranges from 60 to 90 percent for trucks and buses. Moreover, Mexican parts makers are required to adhere to a similar 60 percent local content minimum; further, they are mandated to average 80 percent local content across their entire range of their product lines, including those for direct exports. ^{5/} Mexican auto parts firms (normmaquiladoras) are restricted to 40 percent foreign ownership by the Government.

^{1/} Ibid.

^{2/} Stephen Downer, "Mexico to Cut Auto Parts Tariff to 30% from 40%," *Automotive News*, July 13, 1987.

^{3/} Stephen Downer, "Mexico to Cut Auto Parts Tariff to 30% from 40%," *Automotive News*, July 13, 1987.

^{4/} Report from U.S. Embassy, Mexico City, Mexico, March 1987.

^{5/} Stephen Downer, op. cit.

JAPAN AUTOMOBILE MANUFACTURERS ASSOCIATION, INC.,
Washington, DC, May 2, 1989.

AMBASSADOR CARLA HILLS,
U.S. Trade Representative,
Washington, DC

Dear Ambassador Hills:

The Japan Automobile Manufacturers Association, Inc. (JAMA) is a Tokyo-based trade association representing the 13 vehicle manufacturers in Japan. For many years we have been sensitive to charges by U.S. industry that there are obstacles in Japan to the import and marketing of U.S. automotive and automobile parts products. Accordingly, JAMA has worked closely with U.S. industry and government to positively address these concerns.

In this regard, we have supported the following: reductions in Japan's import tariff on automotive products to the current level of zero, grace periods for imports in meeting implementation dates of emissions and fuel economy standards, waivers of Japanese certification procedures for small volume imports, changes in the commodity tax structure, harmonization of international standards, and most recently, significant efforts to increase procurement of U.S. auto parts.

These changes, combined with a strengthening yen, attention to quality, and aggressive marketing, have led to a steady improvement in the position of foreign auto and auto parts companies in the extremely competitive Japanese market. According to the President of Austin Rover, Japan: "As we got into the early '80's . . . the barriers started coming down, and the market for imports here (in Japan) was clearly entering an expansionary phase." Current forecasts indicate that this trend will continue.

It is therefore disturbing to read in the "Super 301" docket that some—but, interestingly, not all—U.S. manufacturers say they face "unreasonable" and/or "unjustifiable" practices associated with the importing, certification, distribution and sale of automobile and automobile parts in Japan. Of these charges, many are simply wrong; others have been resolved, and still others lack specificity.

Attached is a "white paper" which presents certain facts relating to these charges. We will do our best to provide you or your staff with any additional information you may require.

JAMA will continue to play a positive role in promoting open markets and addressing the concerns of American government and industry wherever reasonable and appropriate.

Sincerely yours,

AKIHIKO MIYOSHI, *General Director, Washington Office.*

Enclosure.

III. THE AUTOMOTIVE DISTRIBUTION SYSTEM IN JAPAN

A. FOREIGN AUTO COMPANIES ACCESSING DISTRIBUTION NETWORKS IN JAPAN

Allegation: The distribution system of Japan's automobile industry is closed. Japanese auto manufacturers forbid dealers to sell other makes. While there may be nothing in dealer contracts forbidding the handling of other makes, Japanese auto manufacturers maintain strong control so that, in fact, their dealer networks will not handle imported products.

Facts:

- 1) There are no restrictions, legal or otherwise, which are designed to discriminate against the distribution of imported vehicles in Japan. There are currently nine domestic passenger car companies and about 25 foreign companies competing in Japan's market of 6.5 million cars and trucks. This competition takes place in strict accordance with Japan's Anti-Monopoly Law.
- 2) With the development of the passenger car market in Japan in the 1960s, Japan's automobile distribution system was patterned after that of the United States.
- 3) During the developmental stages of the Japanese automobile market, demand for luxury imports was low. Thus, from a profit-making perspective, selling imports had virtually no appeal to Japanese car dealers.
- 4) As the Japanese automobile market matured, demand has turned more strongly toward the luxury car market segments. This has, in turn, increased opportunities for import car sales.
- 5) Many foreign car companies are aggressively expanding their dealer networks in Japan. In addition, they are signing agreements with Japanese producers that facilitate use of domestic dealers' networks.
- 6) However, it is a fact that Japanese dealers have generally found single-make franchises most preferable from the perspective of improving management efficiency, financial stability and development potential. In any event, Japanese car dealers take on import franchises on the basis of whether or not the decisions make sound business sense.
- 7) Examples of foreign producers setting up sales companies in Japan and developing their own unique

dealer networks are as follows:

a) BMW established BMW Japan in 1981 and currently has 107 outlets. According to the president of BMW Japan, "There has been much written about the complexity of distribution in Japan. In fact, when we set up the company by buying out our importer in 1981, we inherited 36 unprofitable dealerships. Today we have 70 dealers with 107 outlets, nearly all of which sell only BMW cars. Profitability has been greatly improved, to say the least."

b) Austin Rover established Austin Rover Japan in 1983 and currently has 85 outlets. According to Peter J. Woods, the president of Austin Rover Japan, "Another very important factor in our growth was an increase in exclusive dealerships. . . . We had virtually zero exclusivity in 1985; now we've got 50 percent, and it's still growing; every month we're signing on new exclusive dealers."

c) Mercedes Benz established Benz Japan in 1986 and has 172 outlets.

d) Volvo established Volvo Japan in 1986 and has 97 outlets.

8) Import dealers are being drawn from the ranks of domestic dealers looking to diversify.

a) In a December 5, 1988 article, Nikkei Business quoted Mr. Izumi, chairman of the Japan Automobile Dealers Association (JADA), as follows: "Competition gets fiercer by the day, and the market is getting very mature. This means that dealers are going to have to diversify their businesses. Imports will definitely increase so many dealers will start handling imports in addition to their domestic lines. It's a trend of the times."

b) Mr. Izumi of JADA is also President of Tokyo Nissan. In February 1988, Tokyo Nissan began selling Mercedes Benz and Volkswagen imports through a company called "Capital."

c) Nikkei Business also reported the following: Of Austin-Rover's 85 dealers, it is said that ten were enticed from domestic dealer networks, as were about one-tenth of BMW's 107 outlets. Azuma Mitsubishi Motor Sales of Sumida-ku in Tokyo is a case in point. In 1984, they set up a separate company called Kanaya, specifically to sell BMW cars imported from West Germany. Today, according

to CEO Hiroshi Kanaya, the company is one of the top five among BMW's dealers in terms of unit sales. It certainly has grown into a powerful dealership. The excellent profitability of the BMW line prompted Azuma to shift toward imports increasing to four BMW outlets."

d) Hirata Tatsuo, a director at Nissho Iwai, which has formed a joint venture with Suzuki Motors to sell General Motors and Peugeot cars, was quoted in Nikkei Business as saying, "We'll target domestic dealers and mass merchandisers to flesh out our sales network. Recently it has gotten so we don't even have to approach them, they come to us, asking to be allowed to sell our imports. Sometimes it's more difficult to turn them down than to find them."

9) Examples of foreign makers that have arranged agreements with Japanese manufacturers for the use of their dealer networks are noted below:

a) Mazda has established a distribution channel called EUNOS through which the company will begin to market Citroen and other luxury imports in September 1989. Another Mazda channel, which is named AUTOZAM, is scheduled to begin operations in June 1989 and has reached an agreement with FIAT to market Lancia cars through that channel beginning in January 1990. In 1982, eight Mazda dealer companies created a joint venture called AUTORAMA Inc., through which both imported and domestically produced Ford cars are marketed. Recently, with the objective of enlarging the AUTORAMA channel, Ford and Mazda have both invested capital in the operation. AUTORAMA currently has more than 240 outlets.

b) Other dealers of Japanese makes who also sell imports include the following:

-- GM compacts and Peugeots have been marketed through 47 Suzuki outlets since April 1988.

-- Opel cars have been sold through Isuzu outlets since May 1988. Of the 58 outlets, six handle Opel exclusively.

-- Volvo cars have been sold through nine Subaru outlets since October 1988. The number of outlets will increase to 20 by the end of 1989.

-- Mercedes Benz vehicles will be sold through Mitsubishi outlets beginning in 1989. Initially,

four outlets will be involved. Small truck outlets are also planned.

10) Within the Japanese automobile industry distribution system are many sub-dealers, most of whom not only sell new cars, but also sell used cars and provide automotive repair services. They usually exist in areas where a full dealership would not be commercially viable. The sub-dealers utilize their long-standing position in their communities in order to take maximum advantage of personal contacts and relationships to sell cars.

The sub-dealers play a significant role in the distribution system. It is estimated that between 60,000 and 80,000 sub-dealer outlets exist. Most sell cars from dealer inventory and take a commission on the sale. However, there are approximately 9,300, which actually carry their own inventory.

The sub-dealer outlets have no contract with vehicle producers and are free of any obligations to them. Most have always dealt with more than one make and have provided a wide range of services and products. Some of the leaders of this group of outlets have already started handling imports, and trends point to more and more of them doing so in the future. This was explained in a recent Nikkei Business article as follows:

"Nakane Motors owns a large display area called 'Dachi-land.' The 30-employee company is a typical small-town motor sales firm having provided sales and service for used cars for many years. In February 1988, Nakane Motors succeeded in getting a contract from Volvo Japan, a subsidiary of the Swedish auto maker, as the dealership for the Eastern part of Gifu prefecture. Nakane Motors has been a Daihatsu sub-dealer since the start, and sold more than 200 new Daihatsu cars last year. Obviously, Nakane is an important part of the Daihatsu distribution system. Nakane decided to start selling imports because 'We have a lot bigger territory with an import dealer. With Daihatsu, we covered some 30,000 people, for Volvo, our territory has a population of more like 300,000. Handling imports will give our company a real chance to grow'."

NORTH CAROLINA DEPARTMENT OF COMMERCE TRADE BARRIERS SURVEY

1. a. Cooper Tools
 - b. Hand Tools
 - c. Countries and Trade Barriers
 1. *Korea*—They (Koreans) supposedly promise free imports (see Shin letter) but this appears not to be the case.
The problem lies with electrical cord thickness and type of cord material.
“We have complied with every government request for drawings, specs, samples, and components and each time we satisfy one demand another barrier crops up.” (Robert McLeod to William James).
 2. *United Kingdom*—excessive duty on knives and scissors (8% to 17% rather than the standard 4% to 6%) This is probably the result of a Sheffield manufacturer's lobby.
 3. *Venezuela*—“Specifically, the new tariffs and quotas affect solid and slip joint pliers, wire cutters, . . . and the infamous general catch-all description of ‘similarities’. The import tax on these items is scheduled to increase from 25% to 80%.” “Equally significant we conservatively estimate lost sales of over \$1 million during the past two years due to restrictive quotas.” (Willie James to Gene Shaw, U.S. Dept. of Commerce).
These import restrictions are the result of the Spanish lobby. (Similarities regulations favor local production and impede imports).
 4. *Japan*—“Turner importers have both verbally stated that propane cannot be imported. It is interesting to note that our high temperature fuels which are not produced in Japan can be imported.” (Robert McLeod to William James).
 5. *India*—“Presently the customs duty plus other charges add 130%. This effectively has discouraged imports.”
 6. *Arab World*—import barriers as a result of the Israeli boycott.
 7. *Canada*—import barriers as a result of bilingual packaging requirements.
 8. *Latin America*—(Argentina, Chile, Guatemala, Honduras, Haiti, Trinidad, Dominican Republic, El Salvador) import barriers as a result of required import licenses.
2. a. Hatteras International
 - b. Yachts
 - c. Countries and Trade Barriers
 1. *Japan*—no trade barriers.
 - d. Comments and/or Quotation “Favorable trade and tax policy promoting imports have been largely to credit for this steady growth.” (Janet Graly).
3. a. Gessner Co.
 - b. Textile Machinery
 - c. Countries and Trade Barriers
 1. *Japan*
 2. *Korea*
 3. *Taiwan*
 - d. Comments and/or Quotation
In light of commanding a 90% market share in North America he states that it is not easy to sell in these countries and “U.S. manufacturers of textile machinery do not get a fair shake in these three countries.” (George Johnson).
4. a. Electrical South, Inc.
 - b. Electronic Motor Controls
 - c. Countries and Trade Barriers
 1. *Japan*—attitude problem regarding imported products by consumer.
 2. *India*—300% duty.
 3. *Brazil*—law of similarities.
 4. *Columbia*—bureaucratic red tape.
 5. *Venezuela*—preferential exchange rate.
 - d. Comments and/or Quotation
The countries are excluding imports (NC exports) as a means of encouraging local investment and to protect local manufacturers.
“They (Japanese) told us they had determined that American electronics could never successfully sell in Japan.” (C. Gregory Smith).
5. a. Gaston County Dyeing Machine Co.
 - b. Textile Machinery

- c. Countries and Trade Barriers
 - 1. *Brazil*—severe tariffs, loose patent laws.
- d. Comments and/or Quotation
 - Brazilians copy American technology and then try to sell these machines in U.S. market. (Brazil).
- 2. *India*—high tariffs:
 - d. Comments and/or Quotation
 - “Reductions in the trade barriers would benefit both countries.” (Ted J. Hiley) (India)
- 3. *Europe*—pressure vessel codes unlike U.S. ASME code.
 - d. Comments and/or Quotation
 - “Many of these pressure vessel codes appear designed to discourage outside competition rather than to protect the safety of machinery users.” (Ted Hiley) (Europe)
- 6. a. Aeroglide Corporation
 - b. Grain Storage Systems
 - c. Countries and Trade Barriers
 - 1. *Brazil*
 - 2. *Spain*
 - 3. *Venezuela*
 - 4. *Yugoslavia*
 - 5. *Thailand*—all countries 1-5 copying their U.S. products.
 - d. Comments and/or Quotation
 - “Possibly strengthening of international recognition of property rights . . . might help in this regard (copying of products)”. (James Kelly).
- 7. a. R.J. Reynolds
 - b. Cigarettes
 - c. Countries and Trade Barriers
 - 1. *Thailand*—“In many countries in order to be able to compete with local manufacturers, who often times is the host government in the guise of a monopoly, we have had to establish foreign manufacturing facilities to serve the market.”
 - d. Comments and/or Quotation
 - “In order to be able to compete with local manufacturers . . . we have had to establish foreign manufacturing facilities to serve the market.” (Ralph Angiuoli).
- 8. a. Tobacco Associates Inc.
 - b. Cigarettes and Leaf
 - c. Countries and Trade Barriers
 - 1. *EEC*—import preferential tariff structure, internal cigarette tax (cigarettes).
 - d. Comments and/or Quotation
 - Export subsidies, price supports on raw tobacco leaf.
 - 2. *Australia*
 - 3. *New Zealand*—tariffs, regulations on raw tobacco.
- 9. a. Troxler Electronic Laboratories
 - b. Radioactive Materials
 - d. Comments and/or Quotation—conducts business in 135 foreign markets
 - “Even in Japan, Japanese manufacturers must comply with the same Japanese Nuclear Regulatory Authority requirements that we comply with.” (David Padiloff)
- 10. a. Homelite Textron, Inc.
 - b. Chain saws
 - c. Countries and Trade Barriers
 - 1. *Brazil*—100% duties, 360 day prior deposit for the CIF value.
 - d. Comments and/or Quotation
 - “Implementation of these procedures made the importation of chain saw products financially unfeasible.” (Alan Levanson).
- 11. a. Thomas Built Buses
 - b. Built up Buses, CKD Bus Bodies
 - c. Countries and Trade Barriers
 - 1. *Brazil*
 - 2. *Columbia*
 - 3. *Argentina*
 - 4. *Costa Rica*—Ban on our products due to local production.
- 12. a. Hardee's International

- b. Beef, food products
- c. Countries and Trade Barriers
 - 1. *Japan*
 - 2. *Thailand*—high tariffs.
- d. Comments and/or Quotation

Services and franchise royalties in Asia have restrictions, 20% to 30% tax, tariffs.
- 13. a. Bosch
- b. Power Tools
- c. Countries and Trade Barriers
 - 1. *EEC*—No discriminatory barriers at this time.
- d. Comments and/or Quotation

In regard to *EEC* 1992 and elimination of tariffs, "This agreement could have an impact on non *EEC* members in the form of higher tariffs." (S.C. Hardee).
- 14. a. Cape Industries
- b. DMT (Dimethyl Terephthalate)
- c. Countries and Trade Barriers
 - 1. *Columbia*—Import tariffs which increased from 1% to 10% for U.S. products and are discriminatory.
- d. Comments and/or Quotation

"We understand that neither of these countries (Mexico and Brazil) manufacturers are subject to any import tariffs on DMT shipped into Columbia."
 "Thus (by the removal of these tariffs) North Carolina export value could increase by as much as \$15,000,000 to \$20,000,000 by this tariff relief action." (Robert Mack)
- 15. a. Aerotron
- b. Mobile Two-way Radios
- c. Countries and Trade Barriers
 - 1. *Turkey*
 - 2. *India*
 - 3. *Brazil*—high import tariffs, in the 3 countries listed.
 - 4. *Europe*—local government approval agencies causing procrastination of import and payment approval documentation.
 - 5. *Canada*—price preferencing up to 30% for government contracts.
- d. Comments and/or Quotation

"The largest single barrier to foreign trade is the lack of comprehensive U.S. export financing." (D. Jeffrey Good).
- 16. a. Memorex Telex Corporation
- b. Korea
- c. Countries and Trade Barriers
 - 1. *Korea's*—present high tariff rates are scheduled to decrease from 16.9% in 1988 to 6.29% in 1993.
 A complex tax structure inhibits imports. Lack of ability of foreign firms to wholesale and distribute goods directly. The authority of private trade organizations which regulate trade.
- 17. a. Carolina Biological Supply
- b. Medical and laboratory Products
- c. No Trade Barriers
- d. Comments and/or Quotation

"As far as we have come across no trade barriers that you can put your finger on, all countries seem to favor their home market and that is understandable. There probably are many trade barriers against our products, but they are not visible to us." (J. Claude Harmon, Jr.).
- 18. a. Rauch Industries
- b. Christmas Tree Ornaments
- c. No Barriers Mentioned
- d. Comments and/or Quotation

"We have never really attempted to get into exporting our merchandise and therefore cannot give you a substantive answer.
 We appreciate your interest and do want you to know we are planning an export program, especially into Canada." (Marshall A. Rauch).
- 19. a. Overton's
- b. Ski and Marine Equipment
- c. No discriminatory barriers
- d. Comments and/or Quotation

"In regard to exports, Overton's has not been hindered by foreign trade barriers." (V. Parker Overton).

20. a. Flander's Filters
 b. HEPA Filters and Equipment (Elements)
 c. Countries and Trade Barriers
 1. *Brazil*—requirement of sale of license as a market hindrance, no remittance of royalties from Brazil.
 d. Comments and/or Quotation
 "I made the decision to become a minority owner in the Brazilian business." (Flanders).
21. a. Pelton and Crane
 b. Dental Equipment
 c. Countries and Trade Barriers
 1. *Brazil*
 d. Comments and/or Quotation
 "There are a number of barriers in a number of countries; however, I am traveling overseas and regret that I cannot document this prior to my return." (Mr. Hans Heinrich Nahme)
22. a. Strandberg Engineering Labs
 b. Electronic Instruments and Controls
 d. Comments and/or Quotation
 There are no real identifiable barriers overseas that we have faced:
 (This is a summary of short conversation)

TRADE BARRIERS NOTED BY
NORTH CAROLINA DEPARTMENT OF
COMMERCE SURVEY

6
Responses Promised
(not yet received)

Square D
 Trion, Inc.
 Arcon Manufacturing Inc.
 Exide Electronics
 N.C. Dept. of Agriculture
 Ingesoll-Rand Co.

22
Responses
(written or verbal)

The Cooper Group
 Gessner Company
 Aeroglide Corporation
 Tröxler Electronics
 Thomas Built Buses Inc.
 Hatteras International
 Electrical South, Inc.
 Cape Industries
 Tobacco Associates
 Homelite - Textron, Inc.
 Carolina Biological Supply
 Flanders Filters (verbal)
 Bosch Power Tools
 Aerotron Inc.
 R. J. Reynolds Tobacco Co.
 Pelton and Crane (verbal)
 Gaston County Dyeing Machine Co.
 Hardee's Food Systems, Inc.
 Overton's, Inc.
 Rauch Industries
 Memorex Telex Corporation
 Strandberg Engineering Labs, Inc. (verbal)

3
No Responses

Plastic Vac Inc.
 Northern Telecom, Inc
 H. Beveridge and Co.

STATEMENT OF THE U.S. COUNCIL FOR AN OPEN WORLD ECONOMY

SUBMITTED BY DAVID J. STEINBERG, PRESIDENT

(The U.S. Council for an Open World Economy is a private, nonprofit organization engaged in research and public education on the merits and problems of developing an open international economic system in the overall national interest. The Council does not act on behalf of any "special interest".)

"Super 301" is a shortsighted, misguided stratagem for the vigorous efforts the United States needs to exert against barriers that substantially obstruct U.S. access to foreign markets. Instead of this extraordinary device for targeting offending countries, and its attending ultimatums threatening retaliation if they do not respond satisfactorily, the United States should persistently use the current round of multilateral negotiations under the General Agreement on Tariffs and Trade as the vehicle for seeking removal of the barriers highlighted in the Super 301 maneuver. Violations of existing agreements should be remedied through accepted dispute-settlement procedures or, as a last resort, addressed with appropriate retaliatory measures. Barriers not yet covered by trade agreements should be addressed through negotiations in which the United States and the countries concerned secure equitable reciprocity.

If the United States confronts intractable protectionism in these negotiations from major trading partners regarding barriers whose elimination it considers urgent, it should withdraw from the negotiations and proceed immediately with a new strategy. Whether or not such an impasse occurs, we should be prepared to launch a dramatic, unprecedented, free-trade initiative—all the more necessary if our drive against especially injurious barriers is stalemated by protectionist inertia.

This initiative, multilateral in its thrust, should aim at programming the removal of all artificial trade barriers (in accordance with a realistic timetable) in concert with as many countries as care to participate. (See the attached article in the Christian Science Monitor in which I advocate such a strategy.) If reciprocity is our earnest desire, optimum reciprocity—indeed the ultimate reciprocity—should be our goal, achievable through programming totally free trade (and, inseparably, totally fair trade) with participating countries. This leveling of barriers would ideally project the "level playing field" on which much rhetoric has been expended.

Super 301 not only diverts the government's resources and the nation's attention from such a strategy; through the retaliation it envisages if the targeted barriers are not removed, and the counter-retaliation this could engender, the supercharged firepower of Super 301 could result in our "shooting ourselves in the foot."

If the United States wants to get tough (and it should) in its quest for reciprocity, for a level playing field, and overall for a much more open world economy, it should get smart in its choice of options.

GUEST COLUMN

How To Move Toward Genuine Free Trade

By David J. Steinberg

Special to The Christian Science Monitor

ALEXANDRIA, VA.

TRADE-POLICY issues are heating up again. Although a new round of multilateral negotiations is under way through the 40-year-old General Agreement on Tariffs and Trade, the United States has launched an extraordinary offensive in a different channel of trade diplomacy. It has not only officially designated specific countries as exceptionally unfair in impeding US access to their markets; it is also threatening retaliation if these obstructions are not removed in a specified time.

Meritorious motivations underlie these new tactics, which were mandated by Congress in Section 301 of the 1988 trade law. Fairness, reciprocity, and a level playing field (foreign barriers far exceed our own) are stressed. We seek a world trading system in which American business, if given a fair chance, has a good chance to succeed. This would help to reduce our massive trade deficit and our monumental foreign debt.

The degree to which lost US business opportunities abroad are attributable to foreign barriers is debatable. Even more in dispute are the merits of the newfangled offensive. If there were no alternative to unilateral definitions of fairness and to militant reactions against barriers we deem unfair, then tilting with Super 301 (as the

statutory mandate is called) might be justified as an unpleasant necessity in the face of foreign inertia.

But US recourse to such power tactics when multilateral machinery is in place, in fact while a multilateral negotiation is under way, suggests that a supercharged offensive like Super 301 isn't "super" at all as tact and tactics.

The US should press relentlessly for trade equity through the multilateral machinery at its disposal, even risking collapse of the current GATT round if what urgently needs to be accomplished is thwarted by recalcitrant protectionism.

Whatever the outcome of these negotiations, much will remain to be done to build a more open world economy. The US should get ready for other initiatives, always consistent with international rules. Deserving priority attention is a definitive, explicitly free-trade strategy, ironically something that the US's avowedly "free trade" policy has never had. This alone can encompass the complete range of barriers and practices impairing fair international competition: Being so comprehensive, this alone can generate a balance of concessions that each contracting party could consider equitable.

The goal would be not only totally free trade in accordance with a realistic timetable, but, inseparably, totally fair trade as well. Also vital to its viability are domestic adjustment/redevelopment strategies (consistent with a code of negotiated standards) to help ensure that free trade amply serves the national interests of the member countries, including, for the United States, the interests

of every state in the Union.

Provision would have to be made for the world's less-developed countries, which need equitable access to this free-trade area but cannot afford comparable commitments. But these countries should not get a free ride devoid of broad policy obligations (on trade, labor standards, etc.) in accord with their evolving capabilities.

The invitation to participate in forming the free-trade area should go multilaterally to all economically advanced countries, not bilaterally to one country, then another. All these countries would ultimately join: None could long afford to stay out.

A succession of bilateral free-trade pacts (beyond the existing agreements with Israel and Canada) would disrupt the highly productive multilateral trading system the US inspired after World War II.

In addition, the domestic adjustment strategy to backstop free trade with a gradual succession of countries bilaterally is not likely to be impelled by so fragmented a free-trade policy.

The US government does not appear prepared (or to be preparing) for a multilateral free-and-fair-trade strategy. Nor, with barely an exception, is there any advocacy of such an initiative anywhere else - even among the legions of self-styled "free traders" in academia, companies engaged in international business, or the vast array of think tanks.

■ David J. Steinberg is president of the US Council for an Open World Economy