GENERAL TRADE POLICY

HEARINGS

BEFORE THE

SUBCOMMITTEE ON
COMMERCE, TRANSPORTATION, AND TOURISM

OF THE

COMMITTEE ON ENERGY AND COMMERCE
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

H.R. 794

A BILL TO ESTABLISH A SERVICE INDUSTRIES DEVELOPMENT PROGRAM, AND FOR OTHER PURPOSES

H.R. 1571

A BILL TO INSURE THE CONTINUED EXPANSION OF RECIPROCAL MARKET OPPORTUNITIES IN TRADE, TRADE IN SERVICES, AND INVESTMENT FOR THE UNITED STATES, AND FOR OTHER PURPOSES

H.R. 2203

A BILL TO IMPROVE THE COMPETITIVENESS OF THE UNITED STATES IN DOMESTIC AND FOREIGN MARKETS, AND FOR OTHER PURPOSES

MARCH 15, APRIL 5, MAY 25, AND JUNE 22, 1983

Serial No. 98-55

Printed for the use of the Committee on Energy and Commerce

U.S. GOVERNMENT PRINTING OFFICE

25-904 O WASHINGTON : 1983

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GENERAL TRADE POLICY

Trade in Services

TUESDAY, MARCH 15, 1983

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE,
TRANSPORTATION, AND TOURISM,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:34 a.m., in room 2123, Rayburn House Office Building, the Hon. James J. Florio (chairman) presiding.

Mr. FLORIO. The subcommittee will come to order.

I would like to welcome all in attendance to today's hearings on H.R. 794, a bill designed to promote the U.S. service industry, particularly with regard to exports.

World trade in services such as tourism, transportation, insurance, communications, data processing, and financial services has grown at an annual rate of some 17 percent over the last decade, more than three times as fast as trade in goods.

Throughout this period, the United States has been the world's largest service exporter. Today, the majority of all new jobs created in this country are in the services sector. Seventy percent of the American work force and 60 percent of our gross national product are attributable to the service sector, and the surplus in services trade has grown so large that the U.S. balance of payments has been an overall surplus for the last 3 years.

All the news on the services front, however, is not good. Although the United States continues to dominate world trade in services, its position is being gradually eroded, largely as a result of activities of other nations.

In 1972, the United States accounted for 20 percent of all world trade in services, yet by 1980, the United States share fell to only 15 percent. There are at least two important reasons why this decline has occurred. First, the governments of our major foreign competitors generally have been regarded as having done a better job in providing businesses with information on world market opportunities and conditions. Second, the proliferation of foreign trade barriers has seriously hurt U.S. trade in services. These barriers erected by other nations whose service firms cannot compete with American service industries in the open market.

The United States is attempting to engage our GATT partners in serious efforts to address service industry problems on a multilateral basis. I think a conclusion has been arrived at, but it is going to

take years for such efforts to produce an agreement that will effectively eliminate barriers to trade in services.

In the short term, the United States must take direct action which will dissuade our trading partners from discriminating against our service firms. Our Government must commit itself to a policy of aggressively seeking out and eliminating foreign barriers to trade in services.

The legislation which we are considering today is designed to accomplish this goal in two important ways. It would establish a service industries development program within the Department of Commerce. This program would be responsible for improving the Government's data gathering and analysis functions with respect to services so that foreign market opportunities can be identified and an effective trade policy can be constructed.

This bill would also give the President authority similar to that which he already has in the area of trade in goods to equalize the trade opportunities which U.S. firms have abroad and which foreign firms have here in the United States.

Under this bill, the President could deny or limit access to the U.S. market so that foreign service companies would not have greater access to U.S. markets than American service companies have to markets abroad. Such authority should be useful both in giving our trading partners an incentive to negotiate with us in a meaningful manner and in protecting U.S. service firms against unfair competition.

The recent GATT meeting makes it very clear that the United States must be prepared to exercise this type of authority in addition to its pursuit of international agreements. Failure to take this step will only further undermine American leadership in services trade and weaken those sectors of our economy which have shown that we have the greatest strength and vitality.

The list of witnesses we have today is an extremely impressive list. We are looking forward to not only hearing from these witnesses, but going forward in a very aggressive, expeditious way. This bill has been referred exclusively to this committee. It is my hope, and I think my feeling is shared by the other members of the subcommittee, that this is a bill that can be put on the fast track, and that this committee and the full committee can act on this matter and get this legislative initiative moving so that we can have action in the very near future under the authorization that we are putting forward.

[The bills referred to by Mr. Florio follow:]

98TH CONGRESS
1ST SESSION

H. R. 794

To establish a service industries development program, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 25, 1983

Mr. FLORIO (for himself and Mr. DINGELL) introduced the following bill; which was referred to the Committee on Energy and Commerce

---

A BILL

To establish a service industries development program, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Service Industries Com-
4 merce Development Act of 1983".

5 DEFINITIONS

6 SEC. 2. As used in this Act—
7 (1) The term "barriers to, or other distortions of,
8 international trade in service" includes—
9 (A) barriers to the right of establishment in
10 foreign markets; and

1 (B) restrictions on the operation of enter-
2 prises in foreign markets, including direct or indi-
3 rect restrictions on the transfer of the information
4 into, or out of, the country or instrumentality con-
5 cerned and restrictions on the use of data process-
6 ing facilities within or outside of such country or
7 instrumentality.

8 (2) The term "foreign supplier" means a supplier
9 whose corporate headquarters is located in a foreign
10 country.

11 (3) The term "Secretary" means the Secretary of
12 Commerce.

13 (4) The term "services" means economic outputs
14 which are not tangible goods or structures, including,
15 but not limited to, transportation, communications,
16 retail and wholesale trade, advertising, construction,
17 design and engineering, utilities, insurance, real estate,
18 professional services, entertainment, and tourism, and
19 overseas investments which are necessary for the
20 export and sale of such services.

21 (5) The term "supplier" means any person who is
22 engaged in the business of providing services for ulti-
23 mate sale in the United States and includes as one
24 entity all persons who control, are controlled by, or are
25 in common control with, such person. Such term also

1 includes any predecessor or successor of such a
2 supplier.

3 SERVICE INDUSTRIES DEVELOPMENT PROGRAM AND
4 REPORTS

5 SEC. 3. (a)(1) The Secretary shall establish in the De-
6 partment of Commerce a service industries development pro-
7 gram designed to—

8 (A) on an annual basis, collect and analyze infor-
9 mation regarding United States purchases of foreign
10 services;

11 (B) develop a data base for assessing the adequa-
12 cy of current, as well as for developing future, United
13 States policies and actions pertaining to services, in-
14 cluding, but not limited to, the collection and analysis
15 of data on an annual basis concerning data on transac-
16 tions of United States service industries in foreign
17 countries;

18 (C) conduct a program of research and analysis of
19 service-related trade issues and problems, including
20 forecasts and industrial strategies;

21 (D) provide statistical, analytical, and policy infor-
22 mation to State and local governments and service in-
23 dustries;

24 (E) collect and analyze information pertaining to
25 the international operations and competitiveness of

1 United States service industries, including information
2 with respect to—
3 (i) United States regulation of service indus-
4 tries, and
5 (ii) the adequacy of current United States
6 policies and activities in the service sector;
7 (F) conduct studies of individual domestic service
8 industries;
9 (G) collect comparative international information
10 on service industries and policies of foreign govern-
11 ments toward services;
12 (H) develop policies to strengthen the export com-
13 petitiveness of United States service industries; and
14 (I) on a biennial basis, analyze information which
15 agencies of the United States Government collect con-
16 cerning portfolio investments of United States institu-
17 tional investors in foreign countries.
18 (2)(A) The Secretary may request persons to submit to
19 the Secretary such information as the Secretary may require
20 as being necessary or appropriate to assist him in carrying
21 out paragraph (1).
22 (B) All information submitted to the Secretary by a
23 person under paragraph (1) shall be confidential and shall not
24 be disclosed except when required under court order. The
25 Secretary shall, by regulation, prescribe such procedures as

1 may be necessary to preserve such confidentiality, except
2 that—
3 (i) the Secretary shall release upon request any
4 such information to the Congress or any committee
5 thereof; and
6 (ii) the Secretary may release or make public any
7 such information, excluding investment and income
8 data, in any aggregate or summary statistical form
9 which does not directly or indirectly disclose the identi-
10 ty or business operations of the person who submitted
11 the information.
12 (3)(A) The Secretary may issue subpenas requiring the
13 production of any information requested by him under para-
14 graph (1). Such production of information may be required
15 from any place within the United States.
16 (B) If a person issued a subpena under subparagraph (A)
17 refuses to obey such subpena or is guilty of contumacy, any
18 court of the United States within the judicial district within
19 which such person is found or resides or transacts business
20 may (upon application by the Secretary) order such person to
21 appear before the Secretary to produce the information. Any
22 failure to obey such order of the court may be punished by
23 such court as a contempt thereof.
24 (C) The subpenas of the Secretary shall be served in the
25 manner provided for subpenas issued by a United States dis-

1 trict court under the Federal Rules of Civil Procedure for the
2 United States district courts.
3 (D) All process of any court to which application may be
4 made under this paragraph may be served in the judicial dis-
5 trict wherein the person required to be served resides or may
6 be found.
7 (4)(A) Any person who is found by the Secretary, after
8 notice and an opportunity for a hearing in accordance with
9 section 554 of title 5, United States Code, to have willfully
10 refused to obey a request by the Secretary for information
11 issued under paragraph (3)(A) shall be liable to the United
12 States for a civil penalty. The amount of the civil penalty
13 shall not exceed $10,000. The amount of such civil penalty
14 shall be assessed by the Secretary, or his designee, by writ-
15 ten notice.
16 (B) Any person against whom a civil penalty is assessed
17 under subparagraph (A) may obtain review thereof in the ap-
18 propriate court of the United States by filing a notice of
19 appeal in such court within thirty days from the date of such
20 order and by simultaneously sending a copy of such notice by
21 certified mail to the Secretary. The Secretary shall promptly
22 file in such court a certified copy of the record upon which
23 such violation was found or such penalty imposed, as pro-
24 vided in section 2112 of title 28, United States Code. The
25 findings and order of the Secretary shall be set aside by such

1 court if they are not found to be supported by substantial
2 evidence, as provided in section 706(2) of title 5, United
3 States Code.

4 (C) If any person fails to pay an assessment of a civil
5 penalty after it has become a final and unappealable order, or
6 after the appropriate court has entered final judgment in
7 favor of the Secretary, the Secretary shall refer the matter to
8 the Attorney General of the United States, who shall recover
9 the amount assessed in any appropriate district court of the
10 United States. In such action, the validity and appropriate-
11 ness of the final order imposing the civil penalty shall not be
12 subject to review.

13 (D) The Secretary may compromise, modify, or remit,
14 with or without conditions, any civil penalty which is subject
15 to imposition or which has been imposed under this
16 paragraph.

17 (b) The Secretary shall provide to State and local gov-
18 ernments, upon their request, advice, assistance, and (except
19 as may be otherwise prohibited by law) information concern-
20 ing United States policies on foreign commerce in services.

21 (c) On not less than a biennial basis commencing with
22 1983, the Secretary shall prepare a report (which shall be
23 submitted to the Congress not later than January 15 of the
24 year after the year for which the report is made) contain-
25 ing—

1 (1) an analysis of the activities during the year
2 covered by the report of foreign suppliers within the
3 various service industries in the United States market;
4 (2) an analysis of Federal, State, and local regula-
5 tion during such year of such foreign suppliers and the
6 potential effect of such regulation on trade relationships
7 and negotiations;
8 (3) an analysis of the activities during such year
9 of United States suppliers of services in foreign coun-
10 tries, including the types of services provided, the
11 value of investment made in such services, and the
12 income resulting from their provision; and
13 (4) a study and an analysis of the impact during
14 such year of any act, policy, or practice of each desig-
15 nated major trading country that limits the access of
16 United States suppliers of services to markets in that
17 country in a manner that is unjustifiable, unreasonable,
18 or discriminatory and burdens or restricts United
19 States commerce.
20 For purposes of paragraph (4)—
21 (A) The term "designated major trading country"
22 means any major trading country which the Secretary,
23 after consultation with the Committee on Finance and
24 the Committee on Commerce, Science, and Transpor-
25 tation of the Senate and the Committee on Ways and

1 Means, the Committee on Energy and Commerce of
2 the House of Representatives, designates as a country
3 with respect to which the study and analysis under
4 such paragraph is necessary and appropriate.
5 (B) The term "major trading country" means
6 Canada, the European Economic Community, the indi-
7 vidual member countries of such community, Japan,
8 and any other foreign country or instrumentality desig-
9 nated by the Secretary for consideration for designation
10 under subparagraph (A).

11 PRESIDENTIAL AUTHORITY

12 SEC. 4. (a) Notwithstanding any other provision of law,
13 the President may impose, in accordance with subsections (b)
14 and (c) of this section, such terms, conditions, or limitations,
15 as he deems appropriate, under which foreign suppliers shall
16 be eligible to engage in interstate commerce in the United
17 States.
18 (b) Within one hundred and twenty days after receiving
19 a report under section 3(c), the President shall—
20 (1) review all acts, policies, and practices dis-
21 cussed in the report as required under paragraph (4) of
22 such section;
23 (2) determine whether limitations should be im-
24 posed under subsection (a); and
25 (3) publish notice in the Federal Register—

1 (A) of each determination made under para-
2 graph (2) together with a description of the limita-
3 tions which the President proposes to implement
4 under subsection (a) as a result of that determina-
5 tion, and
6 (B) that written comment of interested per-
7 sons regarding such determination and the pro-
8 posed limitations may be submitted to the Secre-
9 tary during the one-hundred-and-fifty-day period
10 beginning on the date of publication of the notice.
11 (c) The President may not impose any limitation under
12 subsection (a) until he has taken into account all comments
13 that are timely submitted in accordance with subsection
14 (b)(3)(B) with respect to the determination and proposed limi-
15 tations concerned.

98TH CONGRESS
1ST SESSION

H. R. 1571

To insure the continued expansion of reciprocal market opportunities in trade, trade in services, and investment for the United States, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 22, 1983

Mr. JONES of Oklahoma (for himself, Mr. GIBBONS, Mr. SHANNON, Mr. DOWNEY of New York, Mr. FRENZEL, Mr. CONABLE, Mr. VANDER JAGT, and Mr. SCHULZE) introduced the following bill; which was referred jointly to the Committees on Ways and Means, Foreign Affairs, and Energy and Commerce

---

A BILL

To insure the continued expansion of reciprocal market opportunities in trade, trade in services, and investment for the United States, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; AMENDMENT OF TRADE ACT OF 1974.

(a) SHORT TITLE.—This Act may be cited as the "Reciprocal Trade and Investment Act of 1983".

(b) AMENDMENT OF TRADE ACT OF 1974.—Except as otherwise expressly provided, whenever in this Act an

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1 amendment or repeal is expressed in terms of an amendment
2 to, or repeal of, a section or other provision, the reference
3 shall be considered to be made to a section or other provision
4 of the Trade Act of 1974.

5 **SEC. 2. STATEMENT OF PURPOSES.**

6 The purposes of this Act are—

7 (1) to foster the economic growth of, and full em-
8 ployment in, the United States by achieving open, fair,
9 and equitable access to foreign markets for United
10 States exports;

11 (2) to improve the ability of the President—

12 (A) to identify and to analyze barriers to (and
13 restrictions on) United States trade and invest-
14 ment, and

15 (B) to achieve the elimination of such bar-
16 riers and restrictions; and

17 (3) to encourage further expansion of international
18 trade, including trade in services, and to enhance the
19 free flow of foreign direct investment with implications
20 for trade in goods and services, through the negotiation
21 of agreements (both bilateral and multilateral) which
22 reduce or eliminate barriers and other trade-distorting
23 measures.

1 SEC. 3. ANALYSES OF FOREIGN TRADE BARRIERS AND
2 UNITED STATES COMPETITIVENESS.
3 (a) REPORT ON TRADE BARRIERS.—Chapter 6 of title
4 I (19 U.S.C. 2111 et seq.) is amended by adding at the end
5 thereof the following new section:
6 "SEC. 164. REPORT CONCERNING BARRIERS TO UNITED
7 STATES EXPORTS.
8 "(a) Before the close of the 12-month period beginning
9 on the date of enactment of this section, the United States
10 Trade Representative (hereinafter in this section referred to
11 as the 'Trade Representative') shall submit a report to the
12 Committee on Ways and Means of the House of Representa-
13 tives and the Committee on Finance of the Senate on trade
14 barriers to United States exports. The report, which the
15 Trade Representative shall annually revise and update after
16 it is submitted in accordance with the preceding sentence,
17 shall contain—
18 "(1) a comprehensive inventory of acts, policies,
19 or practices, which constitute barriers to, or distortions
20 of, United States exports of goods or services, or of
21 foreign direct investment by United States persons
22 with implications for trade in goods or services, and
23 such inventory shall include, but not be limited to—
24 "(A) a description of each act, policy, or
25 practice and of its operation in the particular
26 country,

1 "(B) an identification of the goods, services,
2 or investment affected, and
3 "(C) the legal basis for such act, policy, or
4 practice in the particular country; and
5 "(2) a quantitative or qualitative assessment,
6 whichever is appropriate, of the principal acts, policies,
7 or practices identified in paragraph (1) that restrict
8 market access for competitive United States exports of
9 goods or services, or foreign direct investment with im-
10 plications for trade in goods or services, and such as-
11 sessment shall include, but not be limited to—
12 "(A) the extent to which each such act,
13 policy, or practice is subject to international
14 agreements to which the United States is a party,
15 "(B) information with respect to any action
16 taken to eliminate or to reduce each such act,
17 policy, or practice, including, but not limited to—
18 "(i) any action under section 301, or
19 "(ii) negotiations or consultations with
20 foreign governments, and
21 "(C) any applicable advice given through ap-
22 propriate committees established pursuant to sec-
23 tion 135.
24 "(b) The report and the revisions and updatings thereto
25 required under subsection (a) shall be developed and coordi-

1 nated by the Trade Representative through the interagency
2 trade organization established by section 242(a) of the Trade
3 Expansion Act of 1962.

4 "(c) The head of each department or agency of the ex-
5 ecutive branch of the Government, including any independent
6 agency—

7 "(1) shall furnish to the Trade Representative or
8 to the appropriate agency, upon request, such data, re-
9 ports, and other information as is necessary for the
10 Trade Representative to carry out his functions under
11 this section; and

12 "(2) may detail such personnel and may furnish
13 such services, with or without reimbursement, as the
14 Trade Representative may request to assist in carrying
15 out such functions.

16 "(d) Nothing in this section shall authorize the release of
17 information to, or the use of information by, the Trade Rep-
18 resentative in a manner inconsistent with law or any proce-
19 dure established pursuant thereto.".

20 (b) REPORT ON COMPETITIVENESS.—Before the close
21 of the twelve-month period beginning on the date of enact-
22 ment of this Act, the United States Trade Representative
23 shall submit a report to Congress analyzing the factors not
24 addressed elsewhere in this Act, or the amendments made by
25 it, which significantly affect the competitiveness of United

1 States high technology industries that have a potential for
2 high sales growth in world markets, including—
3 (1) United States and foreign economic policies, in
4 particular, macroeconomic, regulatory, and sector or
5 factor specific policies, and
6 (2) the structure of markets which supply produc-
7 tion factors to, and distribute the product of, such in-
8 dustries.
9 (c) CONFORMING AMENDMENTS.—
10 (1) The section heading for section 163 is amend-
11 ed to read as follows:
12 "SEC. 163. REPORTS ON TRADE AGREEMENTS AND ADJUST-
13 MENT ASSISTANCE.".
14 (2) The table of contents for chapter 6 of title I is
15 amended by striking out

"Sec. 163. Reports.";

16 and inserting in lieu thereof the following:

"Sec. 163. Reports on trade agreements and adjustment assistance.
"Sec. 164. Report concerning barriers to United States exports.".

17 SEC. 4. AMENDMENTS TO TITLE III OF THE TRADE ACT OF
18 1974.
19 (a) PRESIDENTIAL DETERMINATIONS AND ACTION.—
20 Section 301 (19 U.S.C. 2411(a)) is amended—
21 (1) by striking out the last sentence of subsection
22 (a);

1 (2) by amending subsection (b)(2) by striking out
2 "products" and inserting in lieu thereof "goods";
3 (3) by redesignating subsections (c) and (d) as sub-
4 sections (e) and (f), respectively, and by adding immedi-
5 ately after subsection (b) the following new subsections:
6 "(c) CONDITIONS AND LIMITATIONS.—In implement-
7 ing this section, the President—
8 (1) may take action on a nondiscriminatory basis
9 or solely against the foreign country or instrumentality
10 involved;
11 (2) may take action without regard to whether or
12 not the action is related to the subject matter involved
13 in the act, policy, or practice identified under subsec-
14 tion (a);
15 "(3) shall take into account the obligations of the
16 United States under any applicable trade agreement;
17 "(4) shall take into account the impact of the
18 action taken on the national economy, including, but
19 not limited to, employment, inflation, industry rationali-
20 zation, and consumer costs;
21 "(5) shall conduct a review (on not less than a bi-
22 ennial basis) of each action taken by him under this
23 section in order to determine its effectiveness and
24 whether continuation of the action is in the national in-
25 terest; and

1 "(6) shall rescind an action taken under this sec-
2 tion within thrity days after the day on which—
3 "(A) the offending act, policy, or practice is
4 eliminated by the foreign country or instrumentali-
5 ty, or
6 "(B) a determination is made under para-
7 graph (5) that continuation of the action is not in
8 the national interest.
9 "(d) ACTIONS ON SERVICES.—
10 "(1) IN GENERAL.—With respect to actions on
11 the services of a foreign country under subsection (b),
12 the President may restrict, in the manner and to the
13 extent he deems appropriate, the terms and conditions,
14 or deny the issuance, of any license, permit, order or
15 other authorization, issued under the authority of Fed-
16 eral law, that allows a foreign supplier of services
17 access to the United States market in the service
18 sector concerned.
19 "(2) AFFECTED AUTHORIZATIONS.—Actions
20 under paragraph (1) shall apply only with respect to li-
21 censes, permits, orders, or other authorizations grant-
22 ed, or applications therefor pending, on or after the
23 date a petition is filed under section 302(a) or a deter-
24 mination to initiate is made by the Unted States Trade

1 Representative (hereinafter in this chapter referred to
2 as the 'Trade Representative') under section 302(c).
3 "(3) CONSULTATION.—Before the President takes
4 action under subsection (b) involving the imposition of
5 fees or other restrictions on the services of a foreign
6 country, the Trade Representative shall, if the services
7 involved are subject to regulation by any agency of the
8 Federal Government or of any State, consult with the
9 head of the agency concerned."; and
10 (4) by amending paragraph (1) of subsection (f) (as
11 redesignated by subsection (c)) to read as follows:
12 "(1) DEFINITIONS.—For purposes of this sec-
13 tion—
14 "(A) The term 'commerce' includes, but is
15 not limited to—
16 "(i) goods and services; and
17 "(ii) foreign direct investment by United
18 States persons with implications for trade in
19 goods or services.
20 "(B) The term 'services' includes services as-
21 sociated with international trade, whether or not
22 such services are related to trade in goods.
23 "(C) The term 'discriminatory' includes, if
24 appropriate, any act, policy, or practice which

1 denies national or most-favored-nation treatment
2 to United States goods, services, or investment.
3 "(D) The term 'unjustifiable' means any act,
4 policy, or practice which is in violation of, or in-
5 consistent with, the international legal rights of
6 the United States.".
7 (b) REVIEW OF PETITIONS; INITIATION OF INVESTI-
8 GATIONS BY TRADE REPRESENTATIVES.—Section 302 is
9 amended—
10 (1) by striking out the last sentence of subsection
11 (a);
12 (2) by redesignating subsection (b) as subsection
13 (c), and by amending paragraph (2) thereof—
14 (A) by striking out "the text" and inserting
15 in lieu thereof "a summary", and
16 (B) by striking out "public hearing—" and
17 inserting in lieu thereof "public hearing (unless a
18 public hearing was held on the petition under sub-
19 section (b)(2)(B))—";
20 (3) by inserting after subsection (a) the following
21 new subsection:
22 "(b) REVIEW OF PETITIONS.—
23 "(1) PETITIONS NOT INVOLVING TRADE AGREE-
24 MENTS.—Not later than forty-five days after the date
25 on which he receives a petition under subsection (a)

1 that does not involve a trade agreement, the Trade
2 Representative shall determine whether to initiate an
3 investigation.

4 "(2) PETITIONS INVOLVING TRADE AGREE-
5 MENTS.—With respect to a petition received under
6 subsection (a) that involves a trade agreement, the
7 Trade Representative shall—

8 "(A) not later than fifteen days after the date
9 on which he receives the petition, review the peti-
10 tion for legal sufficiency; and

11 "(B) not later than seventy-five days after
12 such date of receipt (unless the petitioner agrees
13 to an extension of such seventy-five-day period),
14 and based on such factfinding, policy review, and
15 public hearings as he deems necessary, determine
16 whether to initiate an investigation."; and

17 (4) by adding at the end thereof the following new
18 subsection:

19 "(d) DETERMINATION TO INITIATE BY MOTION OF
20 TRADE REPRESENTATIVE.—If the Trade Representative
21 determines with respect to any matter than an investigation
22 should be initiated in order to advise the President concern-
23 ing the exercise of the President's authority under section
24 301, the Trade Representative shall publish such determina-
25 tion in the Federal Register and such determination shall be

1 treated as an affirmative determination under subsection
2 (c)(2). The Trade Representative shall, before making any
3 determination under this subsection, consult with appropriate
4 committees established pursuant to section 135.".

5 (c) RECOMMENDATIONS BY THE TRADE REPRESENTA-
6 TIVE.—Section 304(a) (19 U.S.C. 2414(a)) is amended—

7 (1) by amending paragraph (1) to read as follows:

8 "(1) IN GENERAL.—On the basis of the investiga-
9 tion under section 302, and the consultations (and the
10 proceedings, if applicable) under section 303, and sub-
11 ject to subsection (b), the Trade Representative shall
12 recommend to the President what action, if any, he
13 should take under section 301 with respect to the mat-
14 ters subject to investigation. The Trade Representative
15 shall make that recommendation not later than—

16 "(A) nine months after the date of the initi-
17 ation of the investigation under section 302(c)(2),
18 if the petition does not involve a trade agreement;
19 or

20 "(B) eight months after the date of the initi-
21 ation of the investigation under section 302(c)(2)
22 (unless the petitioner agrees to an extension of
23 such eight-month period), if the petition involves a
24 trade agreement."; and

1 (2) by inserting immediately after the side heading
2 for paragraph (2) the following new sentence: "Any
3 reference in this paragraph to another paragraph or
4 subparagraph shall be considered to be in reference to
5 a paragraph or subparagraph of this section as it was
6 in effect on the day before the date of the enactment of
7 the Reciprocal Trade and Investment Act of 1983.";
8 and
9 (3) by striking out "paragraph (1)(C)" in para-
10 graph (3) and inserting in lieu thereof "paragraph
11 (1)(B)".
12 (d) TREATMENT OF REQUESTED INFORMATION.—Sec-
13 tion 305 (19 U.S.C. 2415) is amended by adding at the end
14 thereof the following new subsection:
15 "(c) CERTAIN BUSINESS INFORMATION NOT MADE
16 AVAILABLE.—
17 "(1) IN GENERAL.—Except as provided in para-
18 graph (2), and notwithstanding any other provision of
19 law (including section 552 of title 5, United States
20 Code), no information requested and received by the
21 Trade Representative in aid of any investigation under
22 this chapter shall be made available to any person if—
23 "(A) the person providing such information
24 certifies that—

1 "(i) such information is business confi-
2 dential,
3 "(ii) the disclosure of such information
4 would endanger trade secrets or profitability,
5 and
6 "(iii) such information is not generally
7 available;
8 "(B) the Trade Representative determines
9 that such certification is well-founded; and
10 "(C) to the extent required in regulations
11 prescribed by the Trade Representative, the
12 person providing such information provides an
13 adequate nonconfidential summary of such infor-
14 mation.
15 "(2) USE OF INFORMATION.—The Trade Repre-
16 sentative may—
17 "(A) use information subject to paragraph
18 (1), or make such information available (in his
19 own discretion) to any employee of the Federal
20 Government for use, in any investigation under
21 this chapter; or
22 "(B) may make such information available to
23 any other person in a form which cannot be asso-
24 ciated with, or otherwise identify, the person pro-
25 viding the information.".

1 (e) NOTICE AND REPORT OF EXTENSIONS.—Section
2 306 (16 U.S.C. 2416) is amended—
3 (1) by redesignating paragraphs (2) and (3) as
4 paragraphs (3) and (4), respectively;
5 (2) by inserting after paragraph (1) the following
6 new paragraph:
7 "(2) publish notice in the Federal Register of each
8 extension agreed to by a petitioner under section
9 302(b)(2)(B) or 304(a)(1)(B);"; and
10 (3) by inserting before ", and the actions taken"
11 in paragraph (4) (as so redesignated) the following: ",
12 each extension, and the reasons therefor, for which
13 notice is required to be published under paragraph
14 (2),".
15 (f) CONFORMING AMENDMENTS.—
16 (1) Section 141(d) is amended—
17 (A) by striking out "and" at the end of para-
18 graph (6),
19 (B) by striking out the period at the end of
20 paragraph (7) and inserting in lieu thereof a semi-
21 colon and "and", and
22 (C) by adding at the end thereof the follow-
23 ing new paragraph:
24 "(8) provide, where authorized by law, copies of
25 documents to persons at cost, except that any funds so

received shall be credited to, and be available for use from, the account from which expenditures relating thereto were made.".

(2) Section 301(e) (as redesignated by subsection (c)) is amended—

(A) by striking out the side heading and inserting in lieu thereof "OTHER ACTIONS.—"; and

(B) by striking out "with respect to a petition".

(3) Section 303 (19 U.S.C. 2413) is amended—

(A) by striking out "302(b)" and inserting in lieu thereof "302(c)";

(B) by striking out "with respect to a petition";

(C) by inserting "or the determination of the Trade Representative under section 302(d)" after "in the petition"; and

(D) by inserting "(if any)" after "petitioner".

(4) Section 304(b) (19 U.S.C. 2414(b)) is amended by striking out "302" and inserting "302(a) or a determination to initiate under section 302(d)".

SEC. 5. NEGOTIATING OBJECTIVES.

(a) CONGRESSIONAL MANDATE.—It is the sense of the Congress that the United States should seek—

1 (1) negotiations or consultation with foreign gov-
2 ernments to reduce or to eliminate acts, policies, or
3 practices which deny fair and equitable access to for-
4 eign markets for United States goods or services or
5 which otherwise burden or restrict United States com-
6 merce; and
7 (2) agreement of the contracting parties to the
8 General Agreement on Tariffs and Trade (GATT)—
9 (A) to review the adequacy of the agree-
10 ments, including dispute settlement provisions,
11 concluded in the Tokyo round of multilateral trade
12 negotiations, with a view to expanding and
13 strengthening their disciplines and coverage and
14 ensuring their full implementation,
15 (B) to complete the negotiation of agree-
16 ments not concluded in the multilateral trade ne-
17 gotiations, and
18 (C) to conduct a meaningful work program of
19 identification and analysis of conditions of trade,
20 including but not limited to, restrictions on trade
21 in services, restrictions on foreign direct invest-
22 ment with implications for trade in goods or serv-
23 ices, and barriers to trade in high technology
24 products, not presently or adequately covered by

1 GATT articles, with a view to developing agree-
2 ments to revise, extend, or supplement such rules.
3 (b) CONGRESSIONAL CONSULTATION.—The United
4 States Trade Representative shall keep the Committee on
5 Ways and Means of the House of Representatives and the
6 Committee on Finance of the Senate currently informed with
7 respect to trade policy priorities for the purposes of expand-
8 ing market opportunities and other matters referred to in sub-
9 section (a).
10 (c) NEGOTIATING OBJECTIVES.—
11 (1) IN GENERAL.—Chapter 1 of title I is amended
12 by inserting immediately after section 104 of the fol-
13 lowing new section:
14 **"SEC. 104A. NEGOTIATING OBJECTIVES WITH RESPECT TO**
15 **TRADE IN SERVICES, FOREIGN DIRECT INVEST-**
16 **MENT, AND HIGH TECHNOLOGY PRODUCTS.**
17 "(a) TRADE IN SERVICES.—Principal United States ne-
18 gotiating objectives under section 102 with respect to trade
19 in services shall be—
20 "(1) to reduce or to eliminate barriers to, or other
21 distortions of, international trade in services including,
22 but not limited to—
23 "(A) barriers that deny national treatment,
24 and

1 "(B) restrictions on the operation of enter-
2 prises in foreign markets, including—
3 "(i) direct or indirect restrictions on the
4 transfer of information into, or out of, the
5 country or instrumentality concerned, and
6 "(ii) restrictions on the use of data proc-
7 essing facilities within or outside of such
8 country or instrumentality; and
9 "(2) to develop internationally agreed rules, in-
10 cluding dispute settlement procedures, which will
11 reduce or eliminate such barriers or distortions and
12 help insure open international trade in services.
13 "(b) FOREIGN DIRECT INVESTMENT.—Principal
14 United States negotiating objectives under section 102 with
15 respect to foreign direct investment with implications for
16 trade in goods or services shall be—
17 "(1) to reduce or to eliminate barriers to such for-
18 eign direct investment, to expand the principal of na-
19 tional treatment, and to reduce or to eliminate trade-
20 related barriers to establishment in foreign markets, in-
21 cluding establishment of services; and
22 "(2) to develop internationally agreed rules, in-
23 cluding dispute settlement procedures, which
24 "(A) will help insure a free flow of such for-
25 eign direct investment, and

1 "(B) will reduce or eliminate the trade dis-
2 tortive effects of certain investment related meas-
3 ures.
4 "(c) HIGH TECHNOLOGY PRODUCTS.—Principal United
5 States negotiating objectives under section 102 with respect
6 to high technology products shall be—
7 "(1) to obtain and preserve the maximum open-
8 ness with respect to international trade and investment
9 in high technology products and related services;
10 "(2) to reduce or to eliminate all barriers to, and
11 the trade-distorting effects of, foreign government acts,
12 policies, or practices on, United States exports of high
13 technology products and related services, or if such re-
14 duction or elimination is not achievable, to obtain com-
15 pensation for such effects, with particular consideration
16 given to the nature and extent of foreign government
17 intervention affecting United States exports of high
18 technology products or investments in high technology
19 industries including—
20 "(A) foreign industrial policies which distort
21 international trade or investment;
22 "(B) measures which deny national treatment
23 or otherwise discriminate in favor of domestic
24 high technology industries; and

1 "(C) measures which facilitate or encourage
2 anticompetitive market practices or structures;
3 "(3) to obtain commitments that foreign countries
4 or instrumentalities will not discourage government or
5 private procurement of foreign high technology prod-
6 ucts and related services;
7 "(4) to obtain commitments to—
8 "(A) foster the pursuit of joint scientific co-
9 operation between companies, institutions or gov-
10 ernmental entities of the United States and those
11 of the trading partners of the United States in
12 areas of mutual interest through such measures as
13 financial participation and technical and personnel
14 exchanges, and
15 "(B) insure that access by all participants to
16 the results of any such cooperative efforts should
17 not be impaired; and
18 "(5) to provide effective safeguards for the acqui-
19 sition and enforcement of intellectual property rights
20 and the property value of proprietary data.".
21 (2) CONFORMING AMENDMANTS.—
22 (A) The table of contents for chapter 1 of
23 title I is amended by inserting after the item re-
24 lating to section 104 the following new item:

"Sec. 104A. Negotiating objectives with respect to trade in services, foreign direct investment, and high technology products.".

1 (B) Paragraph (3) of section 102(g) (19
2 U.S.C. 2112(g)(3)) is amended to read as follows:
3 "(3) The term 'international trade' includes—
4 "(A) trade in both goods and services, and
5 "(B) foreign direct investment by United
6 States persons with implications for trade in goods
7 or services.".

8 **SEC. 6. PROVISIONS RELATING TO INTERNATIONAL TRADE IN**
9 **SERVICES.**

10 (a) COORDINATION OF UNITED STATES POLICIES.—
11 (1) IN GENERAL.—The United States Trade Rep-
12 resentative, through the interagency trade organization
13 established pursuant to section 242(a) of the Trade Ex-
14 pansion Act of 1962 or any subcommittee thereof,
15 shall, in conformance with other provisions of law, de-
16 velop (and coordinate the implementation of) United
17 States policies concerning trade in services.
18 (2) FEDERAL AGENCIES.—In order to encourage
19 effective development, coordination, and implementa-
20 tion of United States policies on trade in services—
21 (A) each department or agency of the United
22 States responsible for the regulation of any serv-
23 ice sector industry shall, as appropriate, advise
24 and work with the United States Trade Repre-
25 sentative concerning matters that have come to

1 the department's or agency's attention with re-
2 spect to—
3 (i) the treatment afforded United States
4 service sector interest in foreign markets, or
5 (ii) allegations of unfair practices by for-
6 eign governments or companies in a service
7 sector; and
8 (iii) the Department of Commerce, to-
9 gether with other appropriate agencies shall
10 provide staff support for negotiations on
11 service-related issues by the United States
12 Trade Representatives and the domestic im-
13 plementation of service-related agreements.
14 (3) NO EFFECT ON EXISTING AUTHORITIES.—
15 Nothing in this section shall be construed to affect in
16 any manner or to any extent any existing authority or
17 responsibility with respect to any specific service
18 sector.
19 (b) SERVICE INDUSTRIES DEVELOPMENT PROGRAM.—
20 (1) IN GENERAL.—The Secretary of Commerce
21 shall establish a service industries development pro-
22 gram designed to—
23 (A) promote the competitiveness of United
24 States service firms and American employees
25 through appropriate economic policies; and

1 (B) promote actively the use and sale of
2 United States services abroad and develop trade
3 opportunities for United States service firms.
4 (2) PROGRAM ELEMENTS.—Such program shall—
5 (A) develop a data base for assessing the
6 adequacy of current, and for developing future
7 Government policies and activities pertaining to
8 services, including, but not limited to, export and
9 import data on individual service industries;
10 (B) collect and analyze, in consultation with
11 appropriate agencies, information pertaining to the
12 international operations and competitiveness of
13 United States service industries, including infor-
14 mation with respect to—
15 (i) United States regulation of service
16 industries,
17 (ii) tax treatment of services, with par-
18 ticular emphasis on the effect of United
19 States taxation on the international competi-
20 tiveness of United States firms and exports,
21 (iii) treatment of services in internation-
22 al agreements of the United States, and
23 (iv) adequacy of current United States
24 policies and activities in the service sector;

1 (C) conduct studies of individual domestic
2 service industries;
3 (D) collect comparative international infor-
4 mation on service industries and policies of foreign
5 governments toward services;
6 (E) conduct a program of research and anal-
7 ysis of service-related issues and problems, includ-
8 ing forecasts and industrial strategies; and
9 (F) develop policies to strengthen the export
10 competitiveness of domestic service industries.
11 (3) AVAILABILITY OF FUNDS.—The Secretary of
12 Commerce shall carry out the program under this sub-
13 section from funds otherwise made available to him
14 which may be used for such purposes.
15 (c) COORDINATION WITH STATES.—
16 (1) STATEMENT OF POLICY.—It is the policy of
17 Congress that the President shall, as he deems appro-
18 priate—
19 (A) consult with State governments on issues
20 of trade policy, including negotiating objectives
21 and implementation of trade agreements, affecting
22 the regulatory authority of non-Federal govern-
23 ments, or their procurement of goods and serv-
24 ices;

1 (B) establish one or more intergovernmental
2 policy advisory committees on trade which shall
3 serve as a principal forum in which State and
4 local governments may consult with the Federal
5 Government with respect to the matters described
6 in subparagraph (A); and
7 (C) provide to State and local governments
8 and to service industries, upon their request,
9 advice, assistance, and (except as may be other-
10 wise prohibited by law) data, analyses, and infor-
11 mation concerning United States policies on inter-
12 national trade in services.
13 (2) ESTABLISHMENT OF NON-FEDERAL GOVERN-
14 MENTAL TRADE ADVISORY COMMITTEES.—Section
15 135 (19 U.S.C. 2155) is amended—
16 (A) by inserting "and the non-Federal gov-
17 ernmental sector" after "private sector" in sub-
18 section (a),
19 (B) by adding at the end of subsection (c) the
20 following new paragraph:
21 "(3) The President—
22 "(A) may establish policy advisory commit-
23 tees representing non-Federal governmental inter-
24 ests to provide, where the President finds it nec-
25 essary, policy advice—

"(i) on matters referred to in subsection (a), and

"(ii) with respect to implementation of trade agreements, and

"(B) shall include as members of committees established under paragraph (1) representatives of non-Federal governmental interests where he finds such inclusion appropriate after consultation by the Trade Representative with such representatives.";

(C) by inserting "or non-Federal government" after "private" each place it appears in subsections (g) and (j);

(D) by inserting "government," before "labor" in subsection (j); and

(E) by adding at the end thereof the following new subsection:

"(m) NON-FEDERAL GOVERNMENT DEFINED.—The term 'non-Federal government' means—

"(1) any State, territory, or possession of the United States, or the District of Columbia, or any political subdivision thereof, or

"(2) any agency or instrumentality of any entity described in paragraph (1).'"; and

1 (F) by inserting "or Public" after "Private"
2 in the heading thereof.
3 (3) CONFORMING AMENDMENTS.—
4 (A) Section 104(c) (19 U.S.C. 2114(c)) is
5 amended by inserting "or non-Federal govern-
6 mental" after "private".
7 (B) Sections 303 (19 U.S.C. 2413) and
8 304(b)(2) (19 U.S.C. 2414(b)(2)) are each amend-
9 ed by striking out "private sector".
10 (C) The table of sections for chapter 3 of
11 title I is amended by inserting "and public" after
12 "private" in the item relating to section 135.

Mr. FLORIO. I would like to recognize now the ranking member of the minority, Mr. Lent.

Mr. LENT. Thank you, Mr. Chairman.

I want to first take this opportunity to thank you and commend you for your leadership in this area of trade in services, and I look forward to cooperatively working with you. I would like to particularly commend your scheduling of this hearing so promptly.

The Service Industries Commerce Development Act of 1983 is a good piece of legislation, and it should have hearings. I believe this legislation is needed, particularly at a time when our manufacturing sector has been experiencing serious economic difficulties, and the service sector has been a major source of new jobs.

I also believe the legislation is timely. It will serve to counteract the rising tide of protectionism here and abroad. By so doing, it will expand rather than restrict the opportunities for trade and economic growth.

I would like to welcome all of our witnesses, and look forward to their thoughts and their comments on the specifics of this particular piece of legislation. I look forward, as I said earlier, to working with you, Mr. Chairman, as the subcommittee proceeds on this legislation.

[The prepared statement of Mr. Bill Richardson follows:]

PREPARED STATEMENT OF HON. BILL RICHARDSON

Mr. Chairman, I want to commend you for holding today's hearing on the important question of possible foreign barriers of trade for the services industry. For more than a decade, the United States has been a leader in the development of service industries and trade. Our leadership has been manifest in the movement of our domestic economy from an industrial base to one which is more and more service industry dominated.

Yet, even though the United States has been a world leader in this area, the fact is that during the past decade our share of total world trade in services has fallen from 20 percent to 15 percent. Many companies in the services industry attribute this deline to the growth of protectionist trade barriers erected by foreign nations to limit U.S. trade in services.

Whether in fact this is the cause for the decline is a question I hope today's hearing will answer. No international trade agreement for services has been reached, and it is clear that without an agreement foreign nations are free to protect their domestic service industries. But there is very little data available on international trade in services and the absence of reliable data is hampering or ability to develop a sound and effective trade policy in this area.

I also want to say that although I am deeply concerned about any actions which hamper the financial viability of the services industry, I believe we live today in an international economy. Our economic fate is tied to our trading partners and I do not want to see more trade barriers erected Nonetheless, Chairman Florio's bill, H.R. 794, is simply an attempt to establish reciprocity. I realize that striking a balance on this question means walking a fine line. And I am certain that today's hearing will offer a great deal of guidance on this issue.

Mr. FLORIO. Thank you very much.

We are pleased to have as our first witness the Honorable Lionel H. Olmer, Under Secretary for International Trade of the U.S. Department of Commerce. Mr. Olmer, welcome.

STATEMENT OF LIONEL H. OLMER, UNDER SECRETARY FOR INTERNATIONAL TRADE, DEPARTMENT OF COMMERCE

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

I am very pleased to be here to give you the Department's views on H.R. 794. I have a statement for the record which I would like

to introduce, and perhaps just to very briefly summarize it, and give you my judgment on what the high points of your bill are, which I believe is a very important contribution to an area that most definitely needs some congressional attention and increased administration attention as well.

Mr. FLORIO. Without objection, your statement will be made a part of the record in its entirety, and with all of our witnesses today, their statements will be entered into the record, and they may feel free to proceed in a summary fashion.

Mr. OLMER. H.R. 794 is very important because it recognizes increasing export competitiveness of U.S. service industries. It requires not a single bit of action, but a coordinated program of both the policy initiatives and analytic support. At the same time, in our mind, it ought to recognize the need for direct promotional assistance by the Government to American firms.

In some respects, the Department has taken measures to integrate these various aspects of the services export promotion effort in the Department. We do think that H.R. 794 would strengthen our ability and would in a number of particular areas increase the opportunities available to the Government to help these efforts.

In one respect, we have begun a series of industry consultations, most recently with the insurance industry, when Secretary Baldrige of the Department hosted in conjunction with the President's Export Council a meeting of chief executive officers from leading American insurance firms to discuss a variety of problems they believe are at the top of their agenda, including most importantly in my mind, at any rate, the means by which they hope to increase their access to foreign markets.

A key element of the proposed service industries development program in our mind is the authority to collect additional data on international services. That data is required to define the scope and the magnitude of the problems that are confronted by the industry, and thereby help us put in priority order the tasks which the industry feels need to be done.

Unless we can accurately identify the developing patterns of services trade on a sector basis and assess the gains and losses from the barriers that are put up, we cannot adequately represent U.S. interests at the negotiating table.

The Government data in the United States that is presently available comes from essentially two sources. No. 1 is the balance of payments surveys, and No. 2 is what is called a benchmark survey of direct foreign investment. Both of these are produced by the Bureau of Economic Analysis in the Department of Commerce.

But at the present time, we simply are unable to obtain the industry specific data that is required from the balance of payments surveys. On the other hand, the benchmark survey of foreign investment is taken only every 5 years, and while it is helpful, it is often out of date. The Bureau of Census of the Department of Commerce is presently conducting its 1982 census of service industries. That includes a number of questions for the first time ever about sales of services to nonresidents of the United States.

In sum, Mr. Chairman, we need a more accurate measure of the total volume of foreign business which is done by U.S. service industries, whether by export from the United States or by sales

from an affiliate abroad. We need to know the effect of this business on the U.S. economy. We also have no information on the sale of services by U.S. firms that are nominally classified in nonservice industries, such as General Motors, Boeing, or IBM.

We know this is a very important part of the service sector trade economy. We do not now have, as you well know, the clear statutory authority nor the resources necessary to produce the kind of data that is required.

In an interagency committee, there is an effort under way to develop a specific articulation of exactly what is needed, what we now have, and how we think we can obtain the difference between the two. We hope that over the course of the next several months, that definitive study on all sectors in the service economy will be completed.

The programs that are needed to enhance the export competitiveness of U.S. firms clearly have little chance of succeeding without the right of equitable market access.

I support the intent of the provisions in H.R. 794. However, in the Department, we do not support the broad retaliatory authority that we think is embodied in the bill as it is presently written. We do think that section 301 of the Trade Act of 1974 has sufficient authority to take actions against foreign discriminatory barriers in the service sector. And while it may require some amendments, those amendments have already been proposed in various pieces of legislation, and we have supported those amendments to section 301 authority.

Mr. Chairman, the bill that you have put forth does contain, as I have indicated, a variety of things that we do support and that we would like to see enacted. In the area of providing the Department with statutory authority, it may presently be too broad, or broader than necessary. It may in fact turn out as written, if it were enacted into law, turn out to be somewhat of a burden on the business community that it is intended to assist.

It is our judgment that if we work together over the course of the next several months, we will be able to better define with some precision what it is that we need from the business community in the form of data. We would better be able to advise you as to how we can do it with minimal burden to the business community.

However, I would like to underscore our basic enthusiastic support for the intention of the bill and for the majority of it as written.

Thank you, sir.

[Mr. Olmer's prepared statement follows:]

Statement of

Lionel H. Olmer

Under Secretary for International Trade

before the

Subcommittee on Commerce, Transportation and Tourism

of the

House Committee on Energy and Commerce

March 15, 1983

I am pleased to appear before the Committee to give the Department of Commerce views on H.R. 794, the Service Industries Commerce Development Act of 1983. Your bill would establish within the Commerce Department a program to enhance the international competitiveness of the U.S. service sector, through special analyses of U.S. and foreign restrictions and improved data gathering. The bill would also provide new Presidential authority to counter foreign barriers to services trade.

We support the provision of a statutory mandate for a service industries development program within the Department of Commerce and look forward to discussions with the Committee to determine exactly what authority is needed to collect adequate data.

Improving the Competitiveness of U.S. Service Firms

Improving the international competitiveness of the U.S. services sector is an important goal. This sector is a vital part of the U.S. economy and our international trading relationships. Services now represent over half of domestic employment and output.

Services account for almost one-fourth of total world trade -- growing at more than double the rate of trade in goods over the last decade. U.S. businesses now account for almost twenty percent of total world trade in services.

H.R. 794 recognizes that enhancing the export competitiveness of U.S. service industries requires a coordinated program of analytical and policy initiatives. It should also recognize the need for direct promotional assistance to service firms.

We have already taken important steps to integrate these aspects of our services program in the Department. H.R. 794 would strengthen our ability to continue and expand our efforts in services trade.

We are really only beginning to scratch the surface in terms of identifying and understanding the problems affecting trade-in-services, and in developing appropriate responses to them. We will need, and have been turning to, the guidance of industry.

Several weeks ago, for example, Secretary Baldrige, in conjunction with the President's Export Council, hosted a meeting of insurance industry CEOs to discuss access to foreign insurance markets.

On the promotion side, we are seeking to integrate services into the Department's traditional export promotion programs and to develop techniques specifically for services. In doing so, we have found that we have an enormous untapped well of potential exporters. Often these are small and medium size firms who possess unique expertise.

A key point to remember is that the various service sectors often have more differences among them than similarities. So programs must be custom-tailored for each sector.

Virtually all of the emerging high technology industries require service support systems -- such as maintenance and software. The continuing services development program will make an important contribution to the free flow of such services.

The Need for Adequate Data

A key element of the proposed service industries development program is authority to collect additional data on international services transactions. Enhancing services trade data to better define the scope and magnitude of services trade problems is one of the most pressing needs in working toward services negotiations.

Unless we can accurately identify the patterns of services trade on a sector-by-sector basis and assess the gains and losses from barriers, we cannot adequately represent our interests at the negotiating table.

Official Sources of Data

The U.S. Government data we now have on international trade and investment in services come almost entirely from two sources: (1) balance of payments surveys, and (2) the benchmark surveys of direct foreign investment, both conducted by the Bureau of Economic Analysis.

Presently, we just can't get the kind of industry-specific data we need from the U.S. balance of payments surveys. The benchmark surveys of foreign investment, taken every five years, have been more helpful in meeting our data needs. This is because much of the foreign activity of U.S. service firms is carried out abroad through affiliates, rather than through the parents' offices in the United States. However, since the benchmark surveys are conducted no more often than every five years, we face a significant time-lag.

In addition, the Bureau of the Census is now conducting its 1982 Census of Service Industries, which includes questions, for the first time, about sales of services to non-residents of the United States.

What Additional Data Would We Like to Have?

What it boils down to is that we need a more accurate measure of the total volume of foreign business done by U.S. service industries, whether by "export" from the U.S. or by sales from an affiliate abroad and the effect of this business on the U.S. economy.

A full understanding of services activity would also require data on: (1) "imports" of services and the purchases of services by U.S. affiliates abroad, (2) where the business is being done, (3) the U.S. goods exports associated with the sale of services, (4) the number of jobs in the U.S. associated with the sale of services abroad or to non-residents of the U.S., and (5) the amount of repatriated earnings from foreign affiliates.

We also have no information on the sale of services by U.S. firms nominally classified in non-service industries. This is important because services activities are accounting for larger shares of manufacturers' business.

How to Get this Additional Data?

We do not have clear statutory authority or the resources to produce this type of data. We are working with USTR, Commerce's statistical bureaus, other agencies and the private sector in a joint program to determine exactly what data we need and how to go about getting

it at the least cost. This may, for example, involve the use of private sector data sources -- such as trade associations -- not just establishing a new Federal Government effort.

H.R. 794 contains a thoughtful approach for providing the necessary authority. Other approaches may also be possible and we would be pleased to work with the Committee to develop the best alternative.

The Need for Equitable Market Access

Programs to enhance the export competitiveness of U.S. service firms have no chance of succeeding without the fundamental right of equitable market access.

We have made clear that we will not ignore market access barriers and we do need leverage to convince our trading partners of the need to negotiate international rules for trade in services. However, we do not support the new, and broad, retaliatory authority set forth in this bill. Under section 301 of the Trade Act of 1974, there is authority to take certain actions against foreign discriminatory barriers in services.

That statute may require amendment to clarify its application to services. We have supported several amendments to the section 301 authority.

Mr. Chairman, this bill contains elements that would help give services their rightful place in our trade programs. We stand ready to work with this Committee and the Congress to develop suitable legislation.

Mr. FLORIO. Thank you very much, Mr. Secretary.

I was pleased to hear you say that one of the most important concerns is the collection of data, because that obviously is one of the key points motivating those of us who support the bill. I am just wondering how one reconciles that with what we understand to be some of the intentions of the administration with regard to the benchmark survey, particularly the resources devoted to the benchmark survey.

As you have indicated, the benchmark survey is the only way at this point that you are able to collect specific data on industries. As I understand it, it is the intention of the Department to change the threshold for the survey from companies with revenues of $500,000 to those that have at least $3 million. As I understand it, OMB has proposed increasing the threshold to $10 million, which would, of course, mean that we would be talking about a much smaller survey, when in fact the major criticism has been that there is not enough data.

Likewise, is it my understanding that either you or OMB is suggesting that this be a 7-year survey period rather than a 5-year survey? Could I ask how one reconciles going in the opposite direction, rather than providing more data, anticipating collecting less data?

Mr. OLMER. Those are not my views, Mr. Chairman, and I would argue against extending the period of the survey beyond the 5 years or extending the threshold from $3 million to $10 million, but I have to plead a certain lack of familiarity with the specifics of this suggestion that you have just alluded to. I will check into it most quickly, I can assure you. I have to accept your point. It is an inconsistency to assert a need for better data, more accurate data, more timely data, and at the same time to not provide adequately for a means of obtaining it.

But I am not familiar with the OMB proposal that you allude to.

Mr. FLORIO. Most of the services that we understand take place overseas are conducted through affiliates of domestic companies, and of course part of the problem is to establish the affiliates, we are talking about a financial investment overseas. In many instances, restriction on investment overseas is the way that nontariff barriers are in fact erected against American service industries.

My recollection is that there was an effort in the GATT discussions to expand even the very preliminary steps that were taken so as to look into the question of restrictions on financial investments overseas so as to encompass that as part of service analysis, and that was rejected.

What are your thoughts as to if in fact we did eliminate the ability to look into financial investments overseas as part of an overall service approach, as to whether we are really dealing effectively with the problem, and what is the Department's position as to whether financial services, financial investments overseas should be included as part of a service industry initiative?

Mr. OLMER. I think it belongs very much as a part of such a survey. I would have to defer to your witness from the U.S. Trade Representative's Office, who I know has been very actively involved in the negotiating effort to bring services within the agenda of the GATT.

It is my view that if we fail to bring the GATT—to bring to the attention of the GATT the need to incorporate such investment surveys within the study of services, we should attempt to do it on a bilateral basis. That is, I just do not think we can afford to sit and wait for periodic ministerial conferences to debate whether or not the GATT as a whole is willing to deal with it, while we may be able to make incremental improvements on a bilateral basis.

Mr. FLORIO. You raised some questions about your apprehensions about the bill, the comparable powers in our bill to 301 authority, what we think are comparable powers, and you have suggested perhaps they are too expansive. I was wondering, maybe just retreating back to a basic philosophic point, we understand the Japanese are targeting some industries for development that would effectively penetrate our markets and in fact are restricting some of their own markets, we understand, the telecommunications area particularly.

I am wondering if you have a philosophic point of view of support for what we are talking about in the concept of reciprocity, saying if in fact there is going to be exclusion of U.S. service industries from the Japanese market while they consciously target their resources so as to be able to penetrate our markets.

If you support the idea, perhaps, through action of the sort we are talking about in this legislation, we could convey to the Japanese that until they open their markets to our pharmaceuticals as well as some of our service industries that have been excluded, insurance being one that I am familiar with, that until that happens, they would not have access to our market in the area of telecommunications in the way that they are seeking access.

Mr. OLMER. Mr. Chairman, it is not so much where they are seeking access. It is where they are solidifying and consolidating the inroads they have already made. In that respect, the barn door has been open for an awful long time.

I feel, however, that the authority to demand equivalence and to take retaliatory action exists in the law as presently written or as it would be modified, as had been proposed in the last Congress, and most recently in this Congress. I am referring to Senator Danforth's proposal on reciprocity. The argument has been that the executive has been unwilling to use that retaliatory authority. That is an argument that I would rather defer on right now, but the authority to do it does exist, and if you are asking for my opinion as to whether or not it ought to be used more often in the future in order to demand equivalent treatment, my answer would be, yes, indeed, it should.

Mr. FLORIO. To say that it exists and to say that one supports the Danforth approach is really not consistent, it seems to me, because what we are talking about are modifications and expansions so as to make sure that it exists. I am really wondering if in fact you are not so much opposed to modifications of 301 that we think we are effectively achieving, even though we are not doing it by modifying 301, but you are really just concerned about creating the authority outside the scope of the Trade Act rather than expansion of 301 as modified by Danforth, or if we achieve the same purpose outside of 301.

Mr. OLMER. That is it exactly. I think it would be sensible to specify services as one of the sectors to be covered by reciprocal treatment provisions. I think that is useful, although the lawyers have argued that it is not and has not been essential, but if your fundamental point is the existence of the authority is not tantamount to its assured use, clearly, that is the case.

Mr. FLORIO. That is not my point, though. My point is, there have been suggestions that 301 now does not provide for the type of coverage of service areas that we would like it to. I think in a sense you almost concede that by saying that Danforth will provide for enhanced authority through modifying 301. What we are suggesting is that there may be some desirability in freestanding authority to deal with service or nontariff barriers and the concept of reciprocity.

Now, whether you do one or the other, I think, that concedes that the status quo, the existing state of the law, is not sufficient. The motivation last year, and it may very well be the same motivation this year for getting the services, is separate and apart from the Danforth approach. It was in the interest of getting something on the books to deal with services in an effective way, and the thought last year was that by separating it, it did not appear to be as controversial. We could therefore go forward in a more rapid way rather than mixing it up with the goods or products questions of the trade.

But I think if I get—correct me if I am wrong. You are suggesting and conceding that, yes, the existing law, 301, is not sufficient to deal with the questions of reciprocity on all of the areas of the service industry that we would like to have authority for the President to use, and of course there is no way to insure when you talk about discretion of authority that it will be used, but it should be there.

Mr. OLMER. It should be there. It had been my view that 301 as written was arguably sufficient. Legal counsel suggested that to make absolutely sure and to put other countries on notice, it would be desirable to modify 301 to make specific referrals to the service sector. I have no quarrel with that, but if the basic point is that the President, for example, does not have present authority to deal with the inequitable market access problems in the services area, my judgment is that he does, and it could be used under the existing 301, but you may get much more clarity and perhaps even send a signal to our trading partners that here is a specific congressional mandate that he approach equitable treatment in the service sector. We are providing for it in the legislation. I think that would be helpful, yes.

Mr. FLORIO. Just one last point on the question of adequate export financing to sell American products overseas. We were all pleased to see the President in the state of the Union message advocate the need for targeted trade policy. Implicit, I thought, was the need for expansion of opportunities for export financing, and then, of course, the next week the Export-Import Bank funding was contained in the budget which was submitted, and that funding, if I recall it, in real dollars was substantially less than the amount that was available in the last year of the previous administration,

so that we have not seen Export-Import Bank appropriations of an amount that some of us felt was appropriate.

Likewise, the policies of the Export-Import Bank have not been competitive with the financing opportunities that were available to our trading partners through their comparable institutions. I wonder what the position of the department is toward increased funding as well as change of policies at the Bank so as to be competitive with the opportunities that foreign trading partners have in dealing with their comparable institutions.

Mr. OLMER. As you know, Mr. Chairman, the Bank's legislative authority will be coming up for renewal very shortly. I believe there are hearings scheduled next week. The Department of Commerce will be represented at those hearings. With respect to funding levels, it seems to me that this administration has taken a rather dramatic change in my judgment in a very positive way by the President's support for a funding increase in the loan guarantee authority available to the Bank, which under his proposal now is at a $10 billion level.

That, it seems to me, is going to make a very substantial difference over the years. In the direct loan authority there has not been a direct increase, but there are a couple of points I would like to make in that respect. We have made great progress in convincing the industrialized countries of the world to alter their subsidized export financing programs. We have a consensus arrangement that was worked out a year ago, and negotiations to further refine it will be continued later this spring, which will have an effect of further eliminating or reducing, I should say, the need for subsidized export financing.

Mr. FLORIO. Are you making the representation across-the-board or are you talking about just services? I took part in a conference on agriculture with European trade partners, and I did not come away with the idea that they have been persuaded.

Mr. OLMER. Agriculture is a world apart. I was referring to trade in goods, and specifically the consensus arrangement under the Organization for Economic Cooperation and Development, in which we have achieved some major progress in getting the interest rates to come very much closer to market rates, and our intention over time is to eliminate the need for export subsidies.

I think it is hard to argue against the desirability of that long-term objective. It has been the department's view that in the road we are on to achieve that objective, we should not in the interim cutoff our negotiating leverage as available through the Export-Import Bank of the United States.

I think that we have achieved a number of the objectives we have had, as I say, in the consensus arrangement, and I think we are now to a point where we are with the Bank having the loan guarantee authority which has a multiplier, I am told, between three and four to one, that is, its relationship to direct loan authority is about a multiple of four to one, that we will come a good deal closer than we had been before.

Now, some service sectors are included and have been, but there is no desire on the part of the Bank to cut out part of its budget and identify it either for service sectors in particular or some other specific area. They prefer to have maximum latitude and flexibility

in determining who and what to lend money to or guarantee loans to.

Mr. FLORIO. Is it your thought that that is desirable? For example, engineering apparently is not eligible as a service industry for Export-Import Bank financing.

Mr. OLMER. You mean engineering services?

Mr. FLORIO. Yes.

Mr. OLMER. I would have to look at that. I personally have felt that there are some areas that the Government ought to give a special boost to at a particular point, because either a sector was a little bit behind or was in danger of falling behind because it is an emerging industry or because it is facing sudden unanticipated competition, and it might be useful to particularly earmark some funds.

I know we have spent a great deal of time to encourage small and medium-sized businesses in America to get involved in exporting, and the Congress action last year with the export trading legislation is a manifestation of that objective on our part.

I kind of would like to see the Export-Import Bank have an area earmarked for small or medium-sized businesses. I have been discussing that with Mr. Draper.

Mr. FLORIO. You have just raised a very fundamental question as to who should make the decisions about those things in terms of targeting, in terms of isolating this particular need to be of assistance to one of our industries. What you have just said, of course, is that the Export-Import Bank should have some discretion to make those decisions. Is that really where we want to make those decisions, and does that not go to the question of reorganization of our trade policy?

And while we are on the subject, my recollection is that 2 years ago you were before us and said it would take about 2 years to evaluate the trade structure that we had.

It is now 2 years later, and we are wondering if in fact you would share with us the results of your evaluation, and what is the appropriate structure.

I understand there are some proposals floating around to put the Trade Representative and the Commerce Department together in some way. I wonder what your thoughts are on that and anything else you would like to share with us.

Mr. OLMER. That is quite an invitation, Mr. Chairman. The point you raise about the Eximbank and how it selects projects for the loans it makes, I believe it is bimonthly; on occasion it may even be a weekly board meeting, in which the Department of Commerce and other interested agencies participate and consider specific loan applications. Those loans are generally awarded on the basis of a consensus, or on occasion, I suppose, a majority vote unless there is a dissent that is a particularly passionate one, in which it might be deferred for higher level consideration.

But the Chairman-President of the Bank sits as the head of that board of directors meeting, and the board of advisers meeting. I believe we are adequately represented at that kind of a session. Perhaps more fundamental is the question of whether in advance you have a strategic plan looking forward a year or 2 years at how the Bank ought to target its loan authorizations, and I think we are

probably not as far along in that area as we might want to be. We have not thought about that.

Mr. FLORIO. That just goes to the question of financing. If we are really going to talk about trade promotion, one aspect of which is financing, you are really talking about whether we should have an overall plan, and perhaps even a duration of longer than 2 years, for development of trade opportunities, promotion of access means into other markets, and that gets to the second part of my point, with a question about your thoughts and the administration's thoughts on a structure for trade promotion.

Mr. OLMER. We do that now in our trade development program. We do look out a couple of years at the very least in terms of the areas of the world that we intend to target for trade promotion opportunities, trade missions, trade fairs, Government-sponsored but industry-operated trade seminars, and a whole variety of other things. We do have relatively, by Government standards, a relatively long range plan in that respect which I would be happy to share with you, to give you an idea.

Mr. FLORIO. Is it then your testimony that as a result of your 2-year evaluation of the existing structure that the status quo is acceptable?

Mr. OLMER. No. That is a very small part of it, Mr. Chairman. The trade aspects are by no means—I would not say that I am satisfied that what we do is either the best way that can be done or the best that we can do. I think we are in the process of making improvements, and there are a lot of things we have to do significantly better than we have been, but I think we are on the right track with respect to the question of macro-organization as a Government.

Senator Roth's proposal for the creation of a Department of Trade will be considered at a hearing scheduled now, I believe, for March 18. At that hearing, I believe, will appear my boss, Secretary of Commerce Malcolm Baldrige, at which time the administration's view should be reflected in the course of his testimony.

I do hate to reserve and defer. I think I have to on that question, because he ought to be in the position of being the first to announce the administration's position on it.

Mr. FLORIO. I understand.

Mr. OLMER. But I do not have any hesitation in saying in my own mind there are always improvements that can be made to any organization, and on the other hand, organizations are not in and of themselves the answer to our problems. There are some things we can clearly do better and we should do better, and some of those fixes ought to be obtainable through an organizational fix, but it does not have to be an immense one. It could be a rather small one. We could be back to you very soon on that.

Mr. FLORIO. Thank you.

Mr. Lent?

Mr. LENT. Mr. Secretary, it is my understanding that the lesser developed nations of the world are more prone to establish barriers to trade and services than are the more industrial nations. Would this legislation help, in your opinion, in reversing that trend?

Mr. OLMER. It is hard to say, Congressman Lent. It clearly would not hurt it. But the question of what motivates the LDC's and what

causes them to create barriers to trade which we think are contrary to their best interests is a vexing question. Many times we think we see them taking actions which have the opposite effect of their intent. The process of convincing the LDC's, the poorer countries of the world, that what they need is to encourage greater access by the rich countries of the world sounds good for us to assert, but it is far more difficult for us to convince them that not only is there a sincere belief on our part, but that is not a figleaf for further taking advantage of their small economies.

Most recently under a group of 77 of the LDC's, under the sponsorship of the UNCTAD in the United Nations, a very, very positive meeting was held on the subject of insurance, and sector studies have been done in that area, and people from my department who were represented at it remarked that it was one of the very, very first times that the session was absent of rhetoric, sort of a north-south rhetoric of criticism and defense, that it was genuinely an exchange on substantive issues, and that it held out great promise for reducing what we would call barriers and what they would call merely changes in their inward investment policies that would enable the establishment of, for example, insurance companies.

They have tended to look at premiums paid as merely outflows and forget sometimes that reimbursements on claims are inflows. It is a long process. I think the bill will help sharpen the administration's thinking on the need to acquire better access and maybe spur on the enthusiasm with which we approach the negotiating table.

Mr. LENT. On page 2 of your testimony, you indicate that H.R. 794 should also recognize the need for direct promotional assistance to service firms. Could you elaborate on what you have in mind?

Mr. OLMER. Again, it would be a desirable aspect of the legislation from our point of view to have a clear congressional statement of intent that the Government undertake promotional assistance. I believe we have such a mandate in the department's charter. Clearly, what we have done in the last 2 years would manifest our belief in promotional responsibilities, but I think it would be helpful for the Congress to indicate that it does endorse the Government undertaking affirmative steps in the area of promoting services trade.

Mr. LENT. Later today we are going to hear from some witnesses from industry who will express some concern about the subpena authority and the $10,000 civil penalty provision in section 3 of this legislation. In your opinion, are these provisions essential to the implementation of the service industries development program?

Mr. OLMER. I am told that they are not unusual as provisions in legislation aimed at giving a part of the executive the authority to obtain data and penalties for failure on the part of the private sector to provide it. At this point, I would like to merely state my general belief that that section of the bill needs our further scrutiny and consultation with the committee, because I am not certain that we need either all that authority or the punishment authority that is contained within it.

Mr. LENT. You indicate further on in page 2 that you have already begun to work on a coordinated program of analytical initiatives, and that you have been turning to industry for guidance. Are

there, in your opinion, any alternative approaches that would serve the industry's interest in collecting this sort of data and yet not be truly punitive in nature?

Mr. OLMER. The industry is the objective of the legislation and of the department's activities. They are the ones who are trying to benefit. We need their help in telling us what it is they need. We are not making the sale. We are not the ones out there actually getting access to those foreign markets. All we are doing, hopefully, is providing the even playing field on which they can operate.

In the area of acquiring data, even more importantly, we will never know enough. The Government will never know as much as the industry does. In part, that is because of the diversity of the services sector, and in part it is because even in one particular area you need people in that industry to tell you what it is they need to know in order to go out and succeed.

But there are things that the private sector is not going to be able to obtain in and of itself. It is sort of the balancing of that with the desire not to burden innocent bystanders in the process of obtaining that information that we are trying with them to work out. We have come a far piece already, and as I say, in this interagency effort over the next 6 to 9 months we will be able to provide you with a far greater and more definitive exposition of what it is we think ought to go in that part of the bill.

Mr. LENT. Thank you.

Thank you, Mr. Chairman.

Mr. FLORIO. Mr. Richardson.

Mr. RICHARDSON. Thank you very much, Mr. Chairman. I want to commend you for holding this hearing.

I have been just briefly glancing at the testimony, and what strikes me in reviewing the testimony of many witnesses here is that basically we have got several problems with our trade policy. I sense from the representatives of industry, and was reading some of the discriminatory practices that Sheraton Hotels have to undergo, and I have been reading about some of the other, I guess, indignities that we seem to be suffering. I sense that basically everybody, Mr. Chairman, supports your bill except for the retaliatory provision which basically in my mind says we support your intent for introducing this legislation, but when it comes to putting a little teeth and muscle, we are a little reluctant to do so.

I guess my first question is, Mr. Chairman, I was not here 2 years ago, but when you mentioned you were hopeful that there was going to be a reorganization of our trade policy and our negotiations on this subject, and apparently what I hear from the witness is that this has not happened. I want you to know that when I worked here several years ago, about 8 or 10 years ago, the same problem existed.

Who had authority on these matters relating to trade and services? Was it the President's Trade Office? Was it the Department of Commerce? It seems to me that we are back in the same situation as we were 10 years ago, and I noticed in the testimony of Mr. Cloney of the Chamber of Commerce, one of the suggestions he makes, and I think it is a very good one is that the lead agency be the President's Special Trade Representative. I sense from his testi-

mony that he feels there is a lack of coordination, a lack of focus. How do you feel about this?

Mr. OLMER. I would like, Mr. Richardson, I guess I would like to know more specifically what he feels there is a lack of. On each and every item to which I have testified, or to the questions that I have responded to, I cannot think of an area that represents a divergence within the administration of either as to who has the responsibility in negotiating, which is clearly Ambassador Brock, or as to that part of the Government which is responsible for promoting and implementing those trade agreements, which is the Department of Commerce.

A great deal of work has not been done in the areas that are addressed within the legislation, and that is to know better what it is we need to know. We are really just beginning to scratch the surface of this enormous area known as services. That is one of the major problems, I think, that confronts the negotiators. We are dealing with countries that either understand far less than we do or—I should say and because of that lack of understanding, are very suspicious of it.

I am not ready to concede that in the services area we are deficient organizationally or deficient because we do not understand our own omission.

Mr. RICHARDSON. I will let you read his testimony, but very clearly one of the recommendations of the chamber is that a process be established for interagency policy coordination, and it should clearly be set out under the STR office, and the No. 1 objective would be so that the STR office would have the lead-trade-policy responsibility, and the authority necessary, et cetera.

My main point is this. It seems to me that we all stand here and say we are for good things, and I think the chairman's bill is excellent in that regard. We are all for export promotion. We are all for protecting our industries. We are all against foreign barriers. We are all for data collection.

But then, when it comes to taking some kind of reciprocal action, and I think the chairman's language on section—I guess it is 3(a) is flexible. It gives the President authority. Yes, there are some penalties set out. And it just seems to me that the reason for the administration's opposition to perhaps what might be the most viable signal that we would send to our trading partners and countries which—I was just reading some of the things that Iraq and Mexico have done to Sheraton Hotels. The best way to send a signal and maybe to give leverage to Mr. Brock in his negotiations is to enact something like this.

What is the reason we oppose this? Is it the State Department saying "We are going to get all these countries mad at us?" Or is it just the fact that we are unable to come to grips with a negotiating policy when we meet with the Japanese, and the British, and all of our trading partners?

I have been a free trader all my life, but I keep losing patience. I keep reaching the point where this free tradism in me is rapidly vanishing. When I see us not having strong negotiating muscle and just sending signals—if we can just do that. I do not see us doing this. It bothers me that again we are saying, well, we are studying this. We have to wait for a policy. The lack of clarity between who

is handling this issue—I guess I have given you a speech, but those are my feelings, and I just think that if we are going to be protective and just fair to our industry, and I see American Express. We are not necessarily talking about a labor issue. We are talking about a U.S. industry issue.

Can we not do a little better than just saying we are for the intent of the chairman's bill? We are all for those things. We are all for protection, and taking care of our people. But when it comes to having some kind of little muscle, why can we not say, yes, let us do it?

Mr. OLMER. Last time I checked, the services sector is doing pretty well internationally. It has been our flagship in the area of exports and in terms of competitiveness. This does not mean that we should be any less concerned about the future. Perhaps we ought to be at this point even more concerned about the future of services.

Second, the reason for a reluctance to endorse the retaliatory authority provided in section 794 is that we simply do not believe it is necessary to be provided in section 794, that it might have the very effect that you were alluding to, that you do not want to see, that is, the appearance of a division of authority.

There is no uncertainty as to where the negotiating authority for all trade matters rests. That is, it is with the U.S. Trade Representative's Office. I do not know of any problem that exists in an understanding of that fact.

We have the feeling, as I indicated earlier, that the President can take retaliatory measures under section 301 of the Trade Act of 1974 and is prepared to do that when it seems justified.

I would also point out that in the last couple of years, things have been getting better for individual service sector companies in Japan as well. It is not as difficult to establish an insurance operation in Japan. I have met a couple of companies who have recently, that is, within the last 6 or 9 months, experienced success. They said, just do not get yourself involved, Mr. U.S. Government. Stay out of it. We are now doing fine. Maybe some of that is because of our efforts up to that point, and I would like to believe that. Maybe it is so.

But on the other hand, they do not want a bull running around there—I am mixing metaphors—doing whatever a bull might do to scare the Japanese into being more forthcoming faster.

Mr. RICHARDSON. Mr. Secretary, I hope you will stick around for some of the testimony later in the morning, but I have just been glancing at Mr. McInerney's statement from the Sheraton Corp. on behalf of the Hotel and Motel Association, and my point is that there seems to be a lot of, and if you read this, you will sense that they have got some problems and some unfair practices lodged against them. I think they are basically coming to us and saying, we do not want you to bail us out, but at least give us a little support. That is all I am saying.

Mr. OLMER. There is complete willingness to give them whatever support they want and seems appropriate under the circumstances, after we have had a chance to evaluate it. I cannot count the number of times that we have stepped in to help an American exporter of goods or of services into LDC countries as well as into the

developed world in the last couple of years through our foreign commercial service, through our U.S. Ambassadors, who are growing more attentive to the needs of exporting.

We deal with specifics, and when we have them, we will fight. A number of times we have won, and sometimes we have not been so successful, but there is simply no lack of willingness to enter the fray on behalf of the American exporter.

Mr. FLORIO. Would the gentleman yield?

Mr. RICHARDSON. Yes.

Mr. FLORIO. Just on a couple of occasions, I think two occasions, you have mentioned about the fact that there is not any dispute as to who has negotiating authority. I would concur. There is no dispute as to who has the negotiating authority. It is the Trade Representative.

But that is not the point we are discussing. What we are discussing is not whether negotiating capability and the discussions that the Trade Representative participates in are sufficient in the area of trade, but rather, should we not be having a more aggressive advocacy role played by someone, whether it be the Trade Representative or the Department of Commerce, a new agency, or whomever, so as to provide for the opportunity for our businesses to have an advocate overseas to insure that there is access to overseas markets?

So, really, what we are talking about is the hope that the reciprocity powers would never have to be used, and that in fact those powers would much less be used if in fact there was an agency or there was a policy in this country that would have the ability to use them so as to induce people to provide access to other people's markets for our service companies.

I would just suggest that the people that we talk to are not as optimistic about the trends in the future in terms of access to overseas markets on the part of our service industries. I was in Greece, and some of our insurance companies are not very happy about new policies, and these are policies within the last 6 months that are evolving there.

Their concern is that where we have dominated to a certain extent in the service industries in the past, and those industries have been our most competitive, our most productive industries, that there is a new awareness on the part of our trading partners that they want to develop their own service industry capabilities and capacity. To do that, they are going to be creating more nontariff barriers rather than less or fewer in the future, so the apprehension is that unless we send out signals that we are prepared to use reciprocal powers as provided for in this bill or bills like this, that we are going to have our service industries facing more inhibitions or more problems in other countries rather than fewer.

I just wanted to express and wonder if you share the analysis that I have just suggested, that unless we have more power in some agencies, that our service industries are going to be facing more problems rather than fewer problems in the future.

Mr. OLMER. I completely share your call for greater activity on the part of the Government in support of U.S. exports. There is no question whatsoever in my mind that that will be work well spent. The taxpayers' dollar will be repaid many times over.

Mr. FLORIO. Thank you. Thank you, Mr. Richardson.

Mr. RICHARDSON. I would just like to say, Mr. Chairman, I would like to add my name as cosponsor of your bill. Thank you.

Mr. FLORIO. Thank you.

Mr. OLMER. Mr. Chairman, may I comment regarding a question you asked earlier about the benchmark survey? I am advised that the $3 million threshold was approved, and that the $10 million had been the threshold proposed by OMB, which is not any longer, as some say, viable.

The $3 million was a recommendation of the Bureau of Economic Analysis based on the need to bring the threshold criteria up to date, as I say, accounting for inflation since 1977, and cut down on what they believed was unnecessary paperwork. The $3 million threshold they believe will provide an adequate statistical basis, and again, it has been approved, so we will be using that.

Mr. FLORIO. That, of course, is an increase off of the $500,000 figure that had been previously used. We are not saying that inflation since 1977 has gone from $500,000 to $3 million.

Mr. OLMER. Two reasons. One was to account for inflation. The other was to reduce some unnecessary paperwork. I will personally look at it, but I am advised that in the mind of the econometricians that the larger number would not minimize the value of the data collected. That was still a statistical sample that should be available. But I will look at it.

Mr. FLORIO. Thank you very much.

Mr. Tauzin.

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

If I might echo my colleague from New Mexico, I not only would like to add my name as a coauthor to the legislation, but I would like to write it as big as John Hancock did.

Mr. Chairman, I apologize for being late. I was providing some constituent services.

I am amazed, frankly, at the attitude of Commerce on this bill and the suggestion made by the chairman. If I might draw an analogy, sir, it would be equivalent to the Defense Department testifying today that we should not have a nuclear strike retaliatory capability because that is going to encourage somebody else to build armaments. We are probably going to hear that argument this week. We ought to shelve all of our weapons, because we do not want to encourage anybody else to build any. Well, that is nice. Unfortunately, they are building them out there, and unfortunately, if history is a teacher, and if we are smart enough to learn from it and not repeat its mistakes, the lesson we have learned about the way foreign countries have treated some of our very dominant industries in this country in terms of limiting its ability to export American products is apt to be repeated in the service industry.

It is clear as a bell it is going to happen. This is our most productive industry now, the one that is most successful on the foreign export markets. We are all agreed to that. It has got to be the next target. Let me tell you a quick story. Then I am going to ask you a question.

We were debating the domestic content bill not long ago. I do not like a lot of what is embodied in domestic content. I voted for it, and supported it. I made up my mind on it firmly when I got a call

from a dealer in my district, who called to say it was a terrible bill, I ought not to support it. Everybody was telling me that the Japanese have barriers to trade. They were giving me bad stories. And I stood in a Buick dealership in Tokyo, Japan, myself. We were selling Buicks out there. I said, how are they selling? He said, not too well. I said, why not? He said, the quality. It is the quality of those vehicles.

I said, what do you mean? He said, you realize the Japanese have such quality standards they require us to paint that Buick seven times before we put it on the market here, and he named some other things that they are required to do to that Buick before they can market it in Japan in order to maintain a certain quality standard in that market. The result was a $1,700 addition to the cost of that Buick from those requirements alone.

There are no trade barriers, and no quotas, no import quotas, no big tariffs or anything else. The country was literally following its agreements under GATT, and at the same time they were dooming and embalming our capacity to export in a dominant industry.

If history is at all valuable to us, it teaches lessons like that. And cannot the Commerce Department foresee that same thing happening in this very productive and forceful foreign export service market, and cannot the Commerce Department recognize that in passing a bill such as the chairman suggested, we are not going to do anything to anybody unless they do it to us first?

We are simply saying that we reserve the right to treat you as an exporter of products into our markets no different than the way you treat us in the future as an importer of products under your market. Now, what is wrong with that basic statement of principle in the law, a clear, nice, firm signal to everybody in the world who made trade with us in the future that that is the way we are going to treat them? We will be as free and as fair in our foreign trade as they are free and fair with us. What is wrong with doing that? Please, sir?

Mr. OLMER. I am not saying so much that there is anything wrong with it as that it is unnecessary because it already exists in a present law that we have.

Mr. TAUZIN. Is it working well?

Mr. OLMER. I do not know that H.R. 794, if passed as written, would necessarily work any better. To say it again is not necessarily an assurance that it is going to have the desired outcome.

Mr. TAUZIN. I can tell you this. I get the firm impression that nobody in the international market really thinks we mean it if we have it in the law already. I think there is some real value in congress making a strong statement, if we have to do it again and again and again. I have little kids, and sometimes repetition works. I think maybe another firm congressional statement, another firm addition to Presidential authority in this area may indeed send the right kind of signal to trading partners. Can you not see some utility in that?

Mr. OLMER. On the one hand, it is a desire of the Congress and the administration to make very clear the organization that we have for trade matters, both policy and implementation. It seems to me it would be desirable to consolidate in one piece of legislation

both the negotiating authorities available to the executive as well as the retaliatory authorities provided to it.

Mr. TAUZIN. Let me say something while you are on that. I think it is time we stopped talking about it as retaliatory. Why do we not call it something a little more civilized? Why do we not call it reciprocity and reciprocal action instead of retaliatory? When you folks speak in those terms, I think you accomplish what you predict would occur. You have accomplished some negative reaction on the part of trading partners. I think if we talk about these things as reciprocal actions rather than retaliatory, we are simply going to do in our trade policy what you want us to do by doing it in your own market.

You set the policy of this country by setting your own policy, in effect. I think that would be a better term. But I am not going to quibble with you about where we should put the authority. I think that is something perhaps the chairman and the Commerce Department might want to discuss in more detail as this bill proceeds. But it does not make a lot of difference to me, frankly, frankly.

What I am more concerned about is that we make a clear, concise, strong statement in legislation that apparently, at least in my view, is not yet strong enough, that this is going to be the policy of this country, and that we expect the administration, this one and future administrations, whatever label they bear, to follow that policy.

Mr. FLORIO. Would the gentleman yield?

Mr. TAUZIN. I would certainly yield.

Mr. FLORIO. Is it not the case that there is a substantial body of opinion that says section 301 powers over services on the Trading Act really applies only to services that may be provided in conjunction with the sale of goods such that services provided totally independent of a sale of goods would not be covered under section 301?

Mr. OLMER. That is arguable. I think that is one of the reasons that we have supported Senator Danforth's reciprocity legislation.

Mr. FLORIO. That would also justify supporting the approach that we follow in this bill, which of course would make it clear and unequivocal that the President has authority, reciprocal power authority, over services industry and service industries that operate totally independent of the providing of goods.

Mr. OLMER. I am all for making that part clear. Yes, Mr. Chairman.

Mr. FLORIO. Thank you very much. I appreciate it.

Mr. TAUZIN. I thank the chairman. It was an excellent, excellent point to make. I guess what he is saying is, despite your testimony that the authority already exists in the law, there was at least some confusion about the extent of that authority. It would do us well to clarify in this legislation.

Mr. OLMER. Yes, I said that before. I would support that.

Mr. TAUZIN. I am very happy to hear that.

Mr. Chairman, I do not want to belabor it. I thank you for the time. I thank you, Mr. Olmer, for your testimony.

Mr. FLORIO. Thank you very much.

Mr. Dowdy.

Mr. DOWDY. No, thank you.

Mr. FLORIO. I am sorry. Mr. Ritter.

Mr. RITTER. I have no questions.

Mr. FLORIO. Mr. Secretary, thank you very much. I appreciate your help.

We are now pleased to have back with us the senior assistant for the U.S. Trade Representative for Trade Policy Development and Coordination, Mr. Feketekuty. I apologize. We always welcome you here, and over the years, I have still not been able to master your name. I would appreciate your assistance in clarifying the record.

[The following letter was submitted for the record:]

UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade
Washington, D.C. 20230

APR 5 1983

Honorable James J. Florio
Chairman, Subcommittee on Commerce
Transportation, and Tourism
Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

At the hearing on H.R. 794 held by your Subcommittee on March 15, you asked me about the threshold levels and time frame for the Benchmark Survey of U.S. Foreign Direct Investment Abroad. This survey is conducted by Commerce's Bureau of Economic Analysis. I am pleased to provide further information on this subject.

The threshold for the 1977 survey was $500,000. The 1982 survey, now in progress, has a threshold of $3,000,000. This increase reflects the balancing of three factors: (1) inflation has made the $500,000 figure less meaningful, (2) the smaller number of reporters permits better use of BEA resources without significantly affecting the integrity of the survey results, and (3) easing of the reporting burden on the public. It was never proposed to raise the threshold for the entire survey to $10,000,000. OMB, at the request of the survey respondents, did propose raising the threshold of one part of the survey (detailed financial and operating data of majority-owned affiliates) from $3,000,000 in 1977 to $10,000,000 in 1982. Due to agency opposition, this proposal was not accepted, and the threshold for this part of the survey remains at $3,000,000.

The benchmark survey cycle is being changed to seven years, but only on a one-time basis. The Benchmark Survey on Foreign Direct Investment in the United States, last conducted in 1980, will next be conducted in 1987. The reason for the two-year slippage is to place this survey on the same cycle as the Census Bureau's domestic economic census, which collects complementary data. As BEA does not have the resources to conduct two benchmark surveys at the same time, the next outward investment survey will be conducted in 1989. Following this one-time realignment, which was approved by Congress as part of the International Investment Survey Act of 1976, Amendments (P.L. 97-33), both surveys will again be performed on a five-year cycle.

Sincerely,

Lionel H. Olmer

STATEMENT OF GEZA FEKETEKUTY, SENIOR ASSISTANT TRADE REPRESENTATIVE FOR TRADE POLICY DEVELOPMENT AND COORDINATION, OFFICE OF THE U.S. TRADE REPRESENTATIVE, EXECUTIVE OFFICE OF THE PRESIDENT

Mr. FEKETEKUTY. Thank you, Mr. Chairman.

Mr. Chairman, like Mr. Olmer, I have a prepared statement. I would like to summarize some portions.

I very much appreciate the opportunity to appear again before your subcommittee as it considers H.R. 794. I very much benefitted from our discussion last year, and I am sure this will be just as productive.

I want to commend your personal efforts in the past year to improve the legislative basis for our work on trade in services. The discussions generated by your hearings and by your work in this area have been making major contributions to the development of this issue.

Mr. Chairman, we agree that your bill, H.R. 794, is a good piece of legislation, and would contribute to the Government's ability to defend and promote the trade interests of the United States. I want to come back to the details later. Like Mr. Olmer, we have some concerns about the last element of the legislation, but I want to address those later.

In my written statement, I outline the great importance of trade in services to our economy and the different problems our exporters of services face abroad. As you know, Mr. Chairman, our office has compiled a catalog of over 250 such barriers, and I do not want to get into all of the specifics at this time, since we have gone over it in the past. I would just like to make two general points which are frequently not well understood.

Many, if not most, obstacles to trade in services arise from the domestic regulation of services. Some foreign regulations that create obstacles to trade in services are imposed for clearly protectionist reasons. Other regulations restricting trade in services are imposed without any notion of trade protection in mind, but as genuine attempts by governments to promote their social, cultural, or security objectives. At other times, governments claim the protectionist regulations are merely meant to achieve other objectives.

In other words, what we must then try to do in this area is to develop methods for sorting out the black sheep from the white sheep. What are obstacles to trade that are meant to be barriers? What are obstacles that are not meant to be barriers but could be avoided by an alternative, equally effective approach to regulation? What are obstacles that result from legitimate domestic regulatory objectives and are unavoidable?

We need to know a great deal more in order to sort out these issues.

There is another side of the regulatory picture that deserves attention in the trade context. This relates to the specific problems of U.S. industries encountered as a consequence of the general trend of deregulation in this country, in contrast to the regulatory environment abroad.

U.S. firms find themselves frequently at a serious disadvantage in doing business domestically and internationally when they are

faced with a more open, competitive situation stemming from deregulation. We have experienced this problem in at least two specific instances recently, the deregulation of trucking and the deregulation of enhanced services provided internationally by telecommunications firms.

The problem also exists in shipping and aviation. In each instance, foreign entities were able to exploit a more open market while preserving their own regulated environment. There is nothing unfair about the reaction of these foreign firms, but their activities do present real commercial problems that must be addressed.

As we continue in the trend of deregulation of certain sectors, we must carefully take into account the trade effects that deregulation could have both at home and abroad. Further on, we must engage our trading partners in discussions over the implications of deregulation so that we can prevent certain commercial tensions that result as a consequence of deregulation.

Those of us wishing to promote the free and open interchange of commercial services must be flexible in seeking progress. We must be alert and ready to address trade problems facing services in both bilateral and multilateral forums at every opportunity. This would require an aggressive policy of raising services trade problems bilaterally with our trading partners, as you repeatedly emphasized this morning.

We have established, I think, a reasonably good reputation for our willingness to pursue difficulties U.S. service industries have encountered in foreign markets, and in that process a number of tangible results have been achieved. U.S. insurance companies, for instance, have a more open market to compete in the Republic of Korea as the result of our interventions on their behalf.

A major problem involving the ability of U.S. firms to process data received from Japanese sources was resolved as the result of these efforts. For the first time, U.S. liners are realizing some opportunities to ship tobacco to Japan as a consequence of our raising this problem at the appropriate government level.

Many U.S. service firms prefer that their grievances be addressed without the filing of a formal complaint under section 301 of the Trade Act. So long as the problem is viewed as legitimate, we are quite willing to raise it outside of formal legal mechanisms, and have done so on numerous occasions.

Indeed, of necessity, the focus over the next few years of our efforts to limit the proliferation of new barriers and to reduce or eliminate existing barriers will be through bilateral discussions and negotiations. You have made that point repeatedly, and I fully agree with that.

In the last 2 years, we have placed service issues on the agenda for trade meetings with numerous foreign governments. This signifies the importance we give to service problems, and often helps to resolve an array of trade problems existing between the two countries. Last May, for instance, Japan significantly expedited the consideration of applications of many foreign insurance companies after we raised the issue in the context of discussions. This had been a troublesome issue for some time, and we were able to facilitate its resolution by getting people to look at it as a trade problem.

We are in the process of developing a bilateral program for services in which careful research of both the problems as well as the potentially available leverage we have for each of them will be pursued for those trading partners where we have numerous problems.

In addition, we will be prepared to use the provisions of section 301 of the Trade Act where complaints are brought forward and action is merited. We do not know exactly when a set of multilateral rules on services trade can be established in a forum such as the GATT, but we must prepare ourselves in the interim for aggressively pursuing the resolution of these problems through effective bilateral negotiations.

At the same time, we should recognize that bilateral or unilateral means will solve only a limited number of service trade problems, and that a multilateral set of rules and principles remain the most effective long-term mechanism for dealing with these issues. As I indicated earlier, some services trade barriers will be perceived by the affected country as legitimate regulatory practices which, in the absence of international principles, require no adjustment. The amount of commercial leverage we can exert, regardless of how carefully it has been put together, will be limited for many services in many countries. In some cases, we just do not have that kind of leverage.

We also must remember that a substantial number of U.S. service sectors, because of their strong competitive advantage, have substantial overseas markets that they will not want to see jeopardized by unilateral action that brings a small dividend or risks causing counteractions. Thus, while we must continue to devote our considerable energies to a multilateral framework that will govern services trade practices, only when we have a set of common rules or principles for services can we begin to sort out individual problems in a rational and less contentious manner.

In November the GATT took an important first step toward the examination of services trade issues. In its Ministerial the contracting parties agreed that services are an important element in world trade and that national studies should be undertaken to examine the appropriate aspects of services trade.

In addition, the trade ministers agreed that a process of informal consultations should be undertaken in the GATT on services trade, and that a decision should be taken in 1984 as to what kinds of future negotiations should occur.

While the agreement to informal consultations was short of the U.S. call for a formal GATT study on this issue, the Ministerial declaration is an important milestone in beginning the arduous process of defining problems multilaterally and outlining possible solutions.

Next week, in fact, the first consultations will take place among GATT contracting parties in Geneva. It will begin with a discussion of a suggested format for the national studies and how we might develop some of these issues in the future. This hopefully will become the basis for the formal consultations leading up the 1984 decisions on negotiations.

The U.S. Trade Representative is now in the process of organizing the U.S. national study with the goal of submitting it to the GATT sometime in the fall. This will be a comprehensive undertak-

ing. It will include an updated inventory of services trade barriers abroad and analysis of overseas problems affecting the principal U.S. services sectors.

The core of the U.S. study will be a full discussion of the many problems peculiar to all service sectors, followed by possible approaches in dealing with these problems multilaterally. The U.S. study is likely to be the first such national study submitted to the GATT, and we will hope that it will provide some useful direction for future GATT work in services.

Our basic goal in the national study is to articulate a well-conceived plan of action that could be the foundation for a multilateral understanding acceptable to a broad range of countries. The GATT is the only multilateral trade institution with a set of rules and principles that are potentially enforceable through its dispute settlement procedures. It therefore has a special attraction for setting up a set of disciplines that have some teeth, but we do not intend to put all of our marbles in the GATT basket, especially given the earlier reticence of the developing countries to engage in a meaningful dialog there.

Discussions on services in the OECD has made considerable progress over the years, and we will continue to be very active in that forum to advance the resolution of service problems affecting individual sectors, as well as those horizontal issues common to all service sectors.

The OECD has a very aggressive and talented secretariat that has assisted governments in focusing on the many complicated problems affecting services trade. The OECD is an important forum to establish a consensus on future steps as well as to resolve some problems. That is why it will continue to play a key role in the services area.

Now, let me address those provisions of H.R. 794 that are of particular interest. I continue to fully support the services industries development program which was a feature of your services bill, H.R. 5519, in the last Congress. It is an important first step toward developing a more comprehensive analysis of our competitiveness in services at home and abroad.

I particularly endorse the provision calling for improvement in services data which is clearly inadequate by any standard. We are already at work on this. The U.S. Trade Representative chairs an interagency task force which is examining ways of improving our data collection methods so that services trade can be more accurately reflected in official U.S. Government statistics.

The provision calling for the President to act against foreign practices that burden or discriminate against U.S. services exports is, of course, quite similar to existing authority under section 301 of the Trade Act. Although I have a reservation about making such Presidential authority a cause of action separate from the provisions under section 301, I, of course, support the principle of having the legal tools for dealing with unfair trade problems facing U.S. service industries, especially in the absence of international rules.

I would urge that you restore the language from H.R. 5519 dealing with the States. It is important for Congress to stress the importance of a close consultative relationship between the Federal

Government and the States, especially in the services area where the States have exclusive regulatory sovereignty in some sectors.

In conclusion, Mr. Chairman, we can point to some very significant progress in the last year toward moving services trade problems into the arena of international trade debate. The GATT Ministerial action itself is an important watershed in this process. However, we cannot lose sight of the really difficult challenges that are ahead of us.

As greater sophistication is realized in services trade problems, new questions inevitably arise that make the task more complicated. At the same time, there is a greater awareness of just how important this segment of the economy is to international trade and the need to make progress in resolving some of the problems that go with selling services abroad.

I think congressional leadership is vital to this entire process, and your bill is viewed by this agency as a positive contribution toward coming to grips with some of the tough issues in the services area.

Thank you, Mr. Chairman.

[Mr. Feketekuty's prepared statement follows:]

STATEMENT OF

GEZA FEKETEKUTY

SENIOR ASSISTANT U.S. TRADE REPRESENTATIVE

FOR

POLICY DEVELOPMENT AND SERVICES

Mr. Chairman:

I am Geza Feketekuty, Senior Assistant U.S. Trade Representative for Policy Development and Services. I appreciate the opportunity to appear again before this Subcommittee as it considers H.R. 794, a bill addressing problems in services trade. Your personal efforts in the past year to stress the importance of services trade in our economy and to recommend courses of policy action have been a major contribution to an issue that has come into the forefront of the trade policy agenda.

My testimony today discusses some of the problems facing service sector exporters, suggests approaches for dealing with them, reviews the work underway in some of the international trade institutions - particularly the GATT, and, of course, addresses the provisions of H.R. 794.

International trade in services is critical to today's economic growth. It is essential to and frequently inseparable from trade in goods. Services such as data processing, computer programming, scientific research, insurance, engineering and consulting are an important and rapidly growing element in international trade. The application of new technologies in communication, data processing, finance and transport has made it possible to provide a wide variety of services at distant geographical locations, and has resulted in new trade opportunities. Today an analyst in London or Tokyo can have

instantaneous access to data banks located in Philadelphia or Kansas City. An engineer in Pakistan can work on drawings commissioned by a construction company in San Francisco and a computer programmer in India can work on software commissioned by a computer company in Silico Valley.

International trade in traditional services like shipping, aviation, communications, banking and insurance have always been important to trade in goods and, in fact, trade in goods could not take place without these services. Where the flow of these services is hampered, trade in goods is hampered also; and where restrictions increase the cost of providing these services, trade in goods is reduced.

Services are also essential for the functioning of international businesses, of multinational enterprises, which are important agencies of development in many countries. Many of the economic linkages between a parent firm and its subsidiaries abroad entail transfers of service activities ranging from management, accounting, insurance, and legal assistance to financing, marketing, advertising and research. The unhampered international movement of services is thus critical to the operation of multinational enterprises. But it is also of critical importance to small businesses who are interested in selling abroad. These enterprises must have the most efficient services at competitive prices in order to market effectively in foreign markets.

I mention these linkages because too many people lose sight of the potentially devastating trade dimensions when

a country restricts or prohibits the availability of foreign services. Some of our bilateral efforts to reduce or estimate a foreign service trade barrier affecting a bank or an insurance company are viewed solely as an undertaking that will simply add one more market for that enterprise. In fact freer flows of services help provide a healthy, more competitive environment in which to trade, for everyone.

We all know that there are significant and growing barriers to trade in services. The real impact on trade of these barriers vary widely. In insurance, for instance, many of the barriers are analogous to trade distortions affecting goods. In communications, barriers frequently are more subtle, if equally burdensome, whether they are in the form of privacy protection laws or the monopolistic practices of PTT's. The Office of the U.S. Trade Representative has catalogued over 250 such barriers, and the nature of the problems service industries encounter are as varied as the range of service sectors themselves.

Some foreign regulations that create obstacles to trade in services are imposed for clearly protectionist reasons. Other regulations restricting trade in services are imposed without any notion of trade protectionism in mind, but as genuine attempts by governments to promote their social, cultural, or security objectives. At other times governments claim that protectionist regulations are really meant to achieve other objectives. The ambiguity of reasons governments have, or say they have, for imposing regulations that throw up obstacles to trade in services presents a real challenge to trade officials.

There is one important side of the regulatory picture that deserves attention in a trade context. This relates to the specific problems U.S. industries encounter as a consequence of the general trend of deregulation in this country, in contrast to the regulatory environment abroad. U.S. firms find themselves frequently at a serious disadvantage in doing business domestically and internationally when they are faced with a more open competitive situation stemming from deregulation. We have experienced this problem in at least two specific instances -- the deregulation of trucking and the deregulation of enhanced services provided internationally by telecommunications firms. In each instance, foreign entities were able to exploit a more open market while preserving their own regulated environment. There is nothing "unfair" about the reactions of these foreign firms, but their activities do present real commercial problems that must be addressed. As we continue in the trend of deregulation of certain sectors, we must carefully take into account the trade effects deregulation could have both at home and abroad. Furthermore, we must engage our trading partners in discussions over the implications of deregulation so that we can prevent certain commercial tensions that result as a consequence of deregulation.

Those of us wishing to promote the free and open international exchange of services must be flexible in seeking progress. We must be alert and ready to address trade problems facing services in both bilateral and multilateral forums at every opportunity. This will require an aggressive policy of

raising services trade problems bilaterally with our trading partners. We have established a good reputation for a willingness to pursue difficulties U.S. service industries have encountered in foreign markets, and in that process a number of tangible results have been achieved. U.S. insurance companies, for instance, have a more open market to compete in the Republic of Korea as the result of our interventions on their behalf. A major problem involving the ability of U.S. firms to process data received from Japanese sources was resolved as the result of our efforts. For the first time, U.S. liners are realizing some opportunities to ship tobacco to Japan as a consequence of our raising this problem at the appropriate governmental level. Many U.S. services firms prefer that their grievances be addressed without the filing of a formal complaint under Section 301 of the Trade Act. So long as the problem is viewed as legitimate, we are quite willing to raise it outside of formal legal mechanisms and have done so on numerous occasions.

Indeed, of necessity, the focus over the next few years of our efforts to limit the proliferation of new barriers and to reduce or eliminate existing foreign service barriers will be through bilateral discussions and negotiations. In the last two years we have placed services issues on the agenda for trade meetings with numerous foreign governments. This signifies the importance we give to services problems, and often helps resolve an array of trade problems existing between two countries. Last May, for instance, when the Japanese

announced a series of actions to eliminate some of the trade grievances we had presented them, there was included in the package the granting of a number of foreign insurance applications that had been pending for some time. This was an issue the United States raised repeatedly at the series of bilateral trade meetings preceding these actions. Up to the time of that announcement, the Japanese Government had refused to issue licenses to a number of U.S. insurance companies who had been attempting to do business in Japan.

We are in the process of developing a bilateral program for services in which careful research of both the problems as well as the potentially available leverage we have for each of them will be pursued for those trading partners where we have numerous problems. In addition we will be prepared to use the provisions of Section 301 of the Trade Act where complaints are brought forward and action is merited. We do not know exactly when a set of multilateral rules on services trade can be established in a forum such as the GATT, but we must prepare ourselves in the interim for aggressively pursuing the resolution to these problems through effective bilateral negotiations.

At the same time we should recognize that bilateral or unilateral means will solve only a limited number of services trade problems, and that a multilateral set of rules and principles remain the most effective long-term mechanism for dealing with these issues. As I indicated earlier, some services trade barriers will be perceived by the affected country as legitimate regulatory practices which, in the absence of

international principles, require no adjustment. The amount of commercial leverage we can exert, regardless of how carefully it has been put together, will be limited for many services in many countries. We also must remember that a substantial number of U.S. service sectors, because of their strong comparative advantage, have substantial overseas markets that they will not want to see jeopardized by a unilateral action that brings a small dividend or risks costly counteractions.

That is why we must continue to devote our considerable energies to a multilateral framework that will govern services trade practices. Only when we have a set of common rules or principles for services can we begin to sort out individual problems in a rational and less contentious manner. In November, the GATT took an important first step toward the examination of services trade issues. At its Ministerial, the Contracting Parties agreed that services are an important element in world trade and that national studies should be undertaken to examine appropriate aspects of services trade. In addition the Trade Ministers agreed that a process of informal consultations should be undertaken in the GATT on services trade and that a decision would be taken in 1984 as to what future activity should occur. While the agreement to informal consultations was short of the U.S. call for a formal GATT study on this issue, the Ministerial declaration is an important milestone in beginning the arduous process of defining problems and outlining possible solutions in that forum. Next week, the first consultation among the GATT Contracting Parties will take place in Geneva. It will begin with a discussion of a suggested

format for the national studies, which hopefully will become the basis for formal consultations leading up to the 1984 decision.

The U.S. Trade Representative is now in the process of organizing the U.S. national study with the goal of submitting it to the GATT sometime next Fall. This will be a comprehensive undertaking. It will include an updated inventory of service trade barriers, and an analysis of overseas problems affecting the principal U.S. services sectors. The core of the U.S. study will be a full discussion of the many problems peculiar to all service sectors followed by possible approaches in dealing with these problems multilaterally. The U.S. study is likely to be the first such national study submitted to the GATT, and we hope that it will provide some useful direction for future GATT work in services. Our basic goal in the national study is to articulate a well-conceived plan of action that could be the foundation for a multilateral understanding acceptable to a broad range of countries.

The GATT is the only multilateral trade institution with a set of rules and principles that are potentially enforceable through its dispute settlement procedures. It therefore has a special attraction for setting up a set of disciplines that have some teeth. But we don't intend to put all of our marbles in the GATT basket, especially given the early reticence of the developing countries to engage in a meaningful dialogue there. Discussion on services in the OECD has made considerable progress over the years, and we will continue to be very active in that forum to advance the resolution of service problems affecting individual sectors as well as those

"horizontal" issues common to all service sectors. The OECD has a very aggressive and talented Secretariat that has assisted Governments in focusing on the many complicated problems affecting services trade. The OECD is an important forum to establish a consensus on future steps as well as to resolve some problems. That is why it will continue to play a key role in the services area.

Now let me address those provisions of H.R. 794 that are of particular interest. I continue to fully support the Services Industries Development Program, which was a feature of your services bill (H.R. 5519) in the last Congress. It is an important first step toward developing a more comprehensive analysis of our competitiveness in services at home and abroad.

I particularly endorse the provision calling for the improvement in services data, which is clearly inadequate by any standard. We are already at work on this. The U.S. Trade Representative chairs an interagency task force which is examining ways of improving our data collection methods so that services trade can be more accurately reflected in official U.S. Government statistics.

The provision calling for the President to act against foreign practices that burden or discriminate against U.S. service exports is, of course, quite similar to existing authority under Section 301 of the Trade Act. Although I have a reservation about making such Presidential authority a cause of action separate from the provisions of Section 301, I, of course, support the principle of having the legal tools for dealing with unfair trade problems facing U.S. service industries, especially in the absence of international rules.

I would urge that you restore the language from H.R. 5519 dealing with the states. It is important for Congress to stress the importance of a close consultative relationship between the Federal Government and the States, especially in the services area where the states have exclusive regulatory sovereignty in some sectors.

In conclusion, Mr. Chairman, we can point to some very significant progress in the last year toward moving services trade problems into the arena of international trade debate. The GATT Ministerial action itself is an important watershed in this process. However, we can not lose sight of the really difficult challenges that are ahead of us. As greater sophistication is realized in services trade problems, new questions inevitably arise that make the task more complicated. At the same time, there is a greater awareness of just how important this segment of the economy is to international trade, and the need to make progress in resolving some of the problems that go with selling services abroad. Congressional leadership is vital to this entire process, and your bill is viewed by this agency as a positive contribution toward coming to grips with some of the tough issues in the services area.

Mr. FLORIO. Thank you very much. I just have one or two questions.

One, the GATT proposal was regarded by some as exceedingly modest, that in fact the survey provision was not thought to be a major new proposal. If one accepts that criticism or that description, the elimination of investment issues out of the survey makes it in some people's minds almost not relevant to the real world of services industries overseas, because investment policy is so important for the establishment of affiliates overseas, which is the way that most business is conducted.

What would be your observation on what appears to be a fairly substantial hole in even the most modest proposal that has been put forth in the national surveys, and how would you propose to fill that gap or that hole?

Mr. FEKETEKUTY. I agree with you that investment certainly is important and very key. I think what we have to do is to deal with this issue the best we can, which is probably right now in the OECD. That does still leave a hole. How you deal with investment problems with respect to developing countries. That is a problem we have struggled to fill for some time.

When it gets to the GATT, we have to know how to walk before we can run. The GATT has never effectively found a way of dealing with investment issues, so what we have to do is at least try to deal with trade issues at this time. At the same time we must continue to look at possible avenues for dealing with investment more broadly.

Mr. FLORIO. You are suggesting, of course, that it is inherent in this legislation and legislation of this type that bilateral negotiations between our Nation and another nation, that may very well be following policies that are inappropriate with regard to our investments in their nation for the purpose of services, would be not only the immediate mechanism for restoring some equity between the relationships, but would also provide the incentive for allowing further discussions on a multilateral basis. But absent the bilateral power and the potential for using that power, there is no incentive on the part of an offending trading partner to be part of a multilateral discussion.

I assume you have no difficulty with that approach.

Mr. FEKETEKUTY. I agree with that fully. Let me say that we do in fact have a program of bilateral negotiations in the investment area. We are in the process of negotiating bilateral investment treaties. We have negotiated several of those, and over time we will be seeking to complete such negotiations with all the developing countries. Of course, those bilateral investment treaties are very much designed to cover services as well as goods manufacturing investments.

Mr. FLORIO. The suggestion has been made by some that in fact we should consolidate our trade policy development and utilize the Trade Representative Office as the lead agency. Do you regard that it is in any way inconsistent that the Trade Representative, who is obviously the negotiator for trade matters, would be in some way at a disadvantage in its capacity as a negotiator if he was also given the prime responsibility for being the aggressive advocate for American trade policy initiatives.

We are talking about one and the same agency being the aggressive advocate and then also being in a position to sit down and negotiate. The suggestion has been made by some that those functions are inconsistent and incompatible. Can I have your thoughts on that?

Mr. FEKETEKUTY. I do not believe they are inconsistent, Mr. Chairman, for the very same reasons you mentioned earlier: that is, you need a prod, you need an incentive to have effective negotiation. The same person has to be able to wield them in order to be an effective negotiator.

Mr. FLORIO. Thank you.

Mr. LENT. Thank you, Mr. Chairman.

Several witnesses, including Under Secretary Olmer and the chamber of commerce, recommend that there be a priority for services trade. According to the chamber's testimony, "Trade in services has traditionally received the lower level of attention within U.S. export promotion programs than its attention to our national economy warrants."

Do you agree with this, and can you comment?

Mr. FEKETEKUTY. I think the interests of our service industries have received less attention than new goods industries in all the various Government programs. I could not comment specifically on the export promotion program, since I am not personally very familiar with them, but certainly the general proposition is true.

Mr. LENT. In your testimony you refer to the interaction between goods and services and make the point that freer flows of services help provide a healthy, more competitive environment in which to trade for everyone.

As you know, our manufacturing sector as well has been experiencing serious economic difficulties for some time. Would, in your opinion, legislation such as this be of help, perhaps not a panacea but be of help to our manufacturing side?

Mr. FEKETEKUTY. You are absolutely right. I think it is vital.

Mr. LENT. Mr. Chairman, I have no further questions.

Mr. FLORIO. The gentleman from New Mexico.

Mr. RICHARDSON. Thank you, Mr. Chairman.

I would like to ask, sir, was not the President's Trade Representative Office created because the feeling was that the Department of State and the Department of Commerce were not bureaucratically equipped to handle trade matters? Was that not the original intent of the creation of your Office?

Mr. FEKETEKUTY. I am not sure that it was because they were not bureaucratically equipped, but perhaps because they were not well enough positioned to factor in all of the various considerations in assessing the overall interest of the United States and pursuing that in a coordinated fashion.

Mr. RICHARDSON. It was my understanding that the Department of State and Commerce were not tough enough; that we had a bunch of situations where I think the feeling was if we had one mechanism, one person directly responsible to the President, that this person or this office would have direct authority to negotiate.

What seems to be happening is sort of a Catch-22 situation. I notice here on page 6 of your testimony you say, "In addition, we will be prepared to use the provisions of section 301 of the Trade

Act if complaints are brought forward and action is merited. We do know exactly what is said of multilateral rules on services trade can be established in a forum such as GATT, but we must prepare ourselves in the interim for aggressively pursuing the resolution to these problems through effective bilateral negotiations"—which means that if you are conducting bilateral negotiations. Let us say we have a complaint from Nigeria. Again, we have the same case for the Department of State or Commerce whoever is dealing with this issue on a bilateral basis. Yet on a multilateral basis when you go to GATT, it seems that the best we can do is put some of these items on the agenda. I am a little baffled as to how we are going to achieve the end result of obtaining reciprocity.

Mr. FEKETEKUTY. I think the solution is to aggressively pursue these questions bilaterally. The multilateral process is one that is going to take time, because we have to build an international consensus, and we just started.

In terms of the kind of time that is required in any major international negotiation, the time we spent thus far has been relatively short; but I certainly agree with you that what we must do is aggressively pursue these issues bilaterally.

Now, we make it a pratice of doing that when companies come to us to seek help. We do not involve ourselves in an issue unless companies ask us for help, because in some cases they many not want our help.

Mr. RICHARDSON. Again, on page 6 you left me in great suspense when you mentioned the issue of the Japanese foreign insurance issue. You say here this was an issue that the United States raised repeatedly in a series of bilateral trade meetings. Preceding these actions up until the time of the action the Japanese Government had refused to issue licenses to a number of U.S. insurance companies who had been attempting to do business in Japan. Did they eventually issue a license?

Mr. FEKETEKUTY. Yes.

Mr. RICHARDSON. So you had some success.

Mr. FEKETEKUTY. Yes. But they never admitted they did anything wrong. It just happened that the applications were all acted upon.

Mr. RICHARDSON. What I am just trying to understand is you mentioned here that in the fall in Geneva, I guess, the new GATT negotiations will be initiated, is that correct?

Mr. FEKETEKUTY. Yes, sir.

Mr. RICHARDSON. What better leverage will you have when you start negotiating, when you start establishing a set of multilateral principles? I would hope that negotiating in GATT is not like negotiating at the United Nations where you cannot get anything done, so that you would have a mandate from the U.S. Congress and from the service industry in this country.

We would like to see some real reciprocity. If Nigeria does this to Sheraton, maybe this matter can be addressed in the multilateral scope so that it does not happen again, because I fear—I mean if we are going to leave our services people to be protected by a Commerce Department council and a State Department official in Nigeria, the last thing that man or woman wants to do is to offend the foreign government.

It is a classic case of who is helping and assisting U.S. industry abroad. And it would seem to me that your office, that you would very aggressively pursue these matters and put some teeth into your effort.

Mr. FEKETEKUTY. You are absolutely right, Congressman. I do not disagree with you.

Mr. RICHARDSON. Thank you, Mr. Chairman.

Mr. FLORIO. Mr. Dowdy.

Mr. DOWDY. In your statement on page 4 you talk about a problem in the telecommunications industry. Could you tell us a little bit more about that, please, sir?

Mr. FEKETEKUTY. I might address the issue through on analogy with trucking. Since we deregulated trucking but our neighbors to the north and south did not, we had many trucks coming in from Canada and Mexico while our truckers were experiencing problems in gaining appropriate access to those markets. In some cases there were legitimate problems. In other cases it was a problem of perception because the Canadians continued to regulate while we, of course, had given up regulation. So we solved the problem by partially reregulating Canadian access to our market. We have worked out an arrangement to deal with this issue. What I tried to say was this is a generic problem that we face in any services industry where we deregulate.

Mr. DOWDY. What about the telecommunications industry? What is the problem?

Mr. FEKETEKUTY. It is very much a real problem with the telecommunications industry. We have not solved that problem. It is something we are struggling with.

Mr. DOWDY. Who is taking advantage of this trouble?

Mr. FEKETEKUTY. I would not say that any particular country is taking advantage of it, but in all negotiations between our carriers and the foreign regulated carriers or the foreign monopoly carriers there is an unequal situation. We do not have quite the negotiating weight because we do not have the same regulatory structure. So in trying to make sure we get full reciprocal treatment we have some handicaps, and we are very much aware of that.

We are working on this issue and trying to think how we can best, and most effectively defend U.S. interests.

Mr. FLORIO. Will the gentleman yield?

I think it was yesterday's Times that has a story about trans border difficulties, and the story to a degree was accurate. It was indicating there is a very serious problem that is growing. I know West Germany, if I recall, requires that in order to use computer data processing facilities one has to have your central location within the borders of West Germany, which of course cuts the ability of an American company to utilize its sufficient transmission facilities.

So the gentleman from Mississippi's point on that last one is very timely. And I understand it is growing worse rather than getting better.

Mr. FEKETEKUTY. You are absolutely right, Congressman. This is a difficult issue. In the German case we have had prolonged discussions with Germany. We have not fully resolved it, though all the American companies involved have been able to reach an appropri-

ate accommodation with the German authority. We do not have any company right now that feels it is being disadvantaged.

Mr. FLORIO. If the gentleman would yield, Mr. Lent and I were in Europe at a conference and this subject came up on a West German experience, and the representative from West Germany there said that their concern was in a sense almost a citizen protection concern; that unless the centralized collection point was on the borders of West Germany, they were concerned about the question of access to information on West German citizens was not under the control of the West German officials.

Superficially that sounds like a plausible concern, but the feeling is that one could come up with fairly elaborate rationalizations on noneconomic grounds that do cloak more protectionist motivations.

Is this something you find happening, that when there are nontariff barriers that are erected that there are semiplausible sounding justifications for those types of barriers.

Mr. FEKETEKUTY. You are absolutely right.

Mr. FLORIO. And in the West German situation that you just stated, I think problems have been resolved. The problems have been resolved because you relieved the apprehension of the West German officials that notwithstanding the fact that the central collection point is not within their borders, that their citizens would be protected for inappropriate use of data against West German citizens.

Mr. FEKETEKUTY. The German Government may have had these concerns that you have raised, but they did not push the privacy issue to the point where it actually created problems. But we have another problem with the Germans, and that is over the control of these lines by the Bundespost, their telecommunications monopoly. That is where we have, I think, an unresolved problem even though our companies have been able to negotiate satisfactory accommodations

But we still have a basic problem of principle; and that is, the Bundespost tries to limit the availability of leased lines for data communications, and there is a suspicion that there is some protection involved. You are absolutely correct.

Mr. FLORIO. I thank the gentleman.

Mr. DOWDY. I have no further questions.

Mr. FLORIO. I just wanted to conclude. I appreciate your testimony. It has been very helpful this year as it has been in the past. As I said, Mr. Lent and I were at this conference, and when we talk about multilateral negotiations and services, we really do have a long way to go because the result of our discussions with European trading partners, who are certainly not undeveloped in any way, revealed to us, I believe, that as far as the framework for discussions, we are not even in the same ballpark; we are not even in the same arena.

If that is the case with developed trade partners, it seems to me that in the long term the less-developed countries are not even in the same country much less the same ballpark.

One of the things we had pointed out to us was that some of our European partners were critical of the United States for enacting what they thought of as protectionist measures in those industries or in those areas where we are not as productive as we used to be,

on textiles and steel. But then when we pointed out that in those areas where we were very productive and very competitive, services particularly and other products, pharmaceutical products, agriculture; therefore, they were incorporating protectionist measures that would inhibit us from access to their fields.

Their approach was that they are still growing. We are just developing in the service industries, and we are not as competitive, and therefore, to protect our infant industries, we have to inhibit you from having full access.

There was not any appreciation of the inconsistency between criticism of us for attempting to protect or insulate some less-than-productive industries and their own procedures in sheltering their infant industries in this field. And if there is not that type of appreciation of the inconsistencies with very sophisticated trading partners, it seems to me that it is a long way down the road before we are going to have the opportunity for negotiation of multilateral treaties, whether it be in GATT or outside of GATT, to focus on service industries. So I think that we have got to go forward in a unilateral way, not only to preserve equity but to induce a more focusing approach on these problems in service industries that we currently have.

Mr. Ritter.

Mr. RITTER. No questions.

Mr. FLORIO. If there are no further questions, thank you very much.

Mr. FEKETEKUTY. Thank you, Mr. Chairman.

Mr. FLORIO. It is our understanding that Ambassador Strauss is on his way. I think we will go forward with our next panel of witnesses, and I would ask Mr. Harry Freeman, senior vice president for corporate affairs and communications of the American Express Co., Mr. Gilbert Simonetti, Jr., of Price Waterhouse, and Mr. Peter J. Finnerty, vice president for public affairs of Sea-Land Industries to come forward.

Gentlemen, we welcome you to our committee. Your statements will be made a part of the record in their entirety. I would ask that you go forward in a summary fashion.

Mr. Freeman, welcome back to our subcommittee.

Mr. FREEMAN. Thank you very much.

Mr. FLORIO. We are very pleased to hear from you.

STATEMENTS OF HARRY H. FREEMAN, SENIOR VICE PRESIDENT, CORPORATE AFFAIRS AND COMMUNICATIONS, AMERICAN EXPRESS CO.; GILBERT SIMONETTI, JR., CHAIRMAN, COMMITTEE ON SERVICE INDUSTRIES, NATIONAL FOREIGN TRADE COUNCIL; AND PETER J. FINNERTY, ON BEHALF OF COALITION OF SERVICES INDUSTRIES, INC.

Mr. FREEMAN. Thank you very much, Mr. Chairman. It is a privilege to be here. I will make my comments very brief and submit my statement for the record. I am very, very encouraged by your comments and the comments of your colleagues on this committee. We agree with everything you are saying. I am pleased to be here today on behalf of my company, American Express Co. We welcome

the opportunity to endorse in the strongest possible terms H.R. 794, the Service Industries Commerce Development Act.

I am particularly pleased to be here because I think you, Mr. Chairman, and Mr. Lent and others here have been leaders in a struggle which has been going on for a couple of years. I think we are beginning to make some major progress. I will not dwell on the importance of the service sector. That has been covered many times. And it is also in my statement.

But I did want to make some very general comments. I think the subject that we are discussing here today is really the future of the whole U.S. economy. The challenge before us, as your committee knows so well, is to adjust American domestic economic policy and foreign policy in trade laws so as to reflect the new economic reality. The need is for both the U.S. Government, the States and the cities, and the private sector to think, plan, and decide on the economic topography of today and tomorrow, not that of yesterday. This bill, H.R. 794, represents an important step in this direction.

We are also talking about changing the mind set of the public and private sector here and abroad. The passage of H.R. 794 would accomplish at least three critical objectives of high priority, I believe, for the whole country.

First, it would centralize and improve the analysis of service sector performance data. Mr. Chairman, I cannot stress enough, and I agree with your comments on statistics, that this is how you go about changing the mind set of people in the government, the private sector and the media. Everyday I look at newspapers and magazines that talk about the economy as it was perhaps 10 or 20 years ago, and the data that we constantly see is really inadequate. This legislation will reorganize the priorities and therefore the mind sets and the thinking of those that gather and use the statistics. The statistics are terribly important in the government and terribly important to the private sector.

Second, H.R. 794 will authorize the President to purposefully respond to the discriminatory service trade practices of foreign governments as they arise. And they certainly are arising. I was interested in the questions and comments made you by and others—Mr. Feketekuty and Mr. Olmer—on the section 301 issue in particular. Having been a lawyer for some time in the past, I certainly would never suggest that section 301 does not apply fully to any kind of problem my company or other companies have.

But the reason we are all here and the reason there has been such interest in this is that we want additional assurance, and the best way to get that additional assurance is to get legislation to clarify section 301 while taking the position that it is sufficiently broad. I think there is really no argument with those who have thought about it in this context.

Second, on the whole question of reciprocity, I think reciprocity is a phrase that has gotten to be a flash word, a chameleon kind of phrase. There are some that say, my gosh, if it is reciprocity, it is a bad thing. Actually, the basic trade law of the United States is the Reciprocal Trade Agreement Act of 1934 that sets up all of the trade regimes that we have benefited from.

I think there is nothing wrong in having remedies that we now have and adding to those remedies, sending the signals that you gentlemen have mentioned.

I think this is the time to do it. I think we need legislation very badly in this area, and that action is here today in this bill in the House and in this committee. Other people have referred to the Senate, the Danforth bill. Well, fine, but I think the task here is to discuss support, and move this bill to markup, to full committee, to the floor and pass it. I think we would urge that at the soonest possible time.

I think a third reason, sir, for our support of this bill, is that H.R. 794 will send a very clear and unambiguous signal to our trading partners. I think this is very much called for for the reasons that you have already said this morning. I think the lack of congressional action in this area has hampered conduct of foreign economic policy by the executive branch.

I have no particular complaints with the executive branch, but I think legislation such as and including H.R. 794 would at this point be extremely timely as trade problems increase. And I think they are increasing geometrically. We saw a report from the GATT which said that trade in the world had dropped 2 percent. That may sound like a small percentage. It is several hundred billion dollars. But this will exacerbate the problems here and abroad. It will exacerbate the problems in developing countries and the world economy that are so interlocked.

Mr. FLORIO. Mr. Freeman, you made an interesting point. I was wondering what your thoughts are as to what the outcome of the GATT negotiations might have been in this area, had this legislation passed last year prior to the GATT ministerial meetings. Do you think there might have been a different approach?

Mr. FREEMAN. It might have come out a lot better. I think the GATT was written a couple of times. It has gotten a bum rap in some areas. I think Ambassador Brock and his colleagues, such as Mr. Feketekuty, did an excellent job. Had we had legislation like H.R. 794 or any other legislation at that time, I think that our trading partners would have taken our position much more seriously.

So I do think our efforts at GATT would have been materially helped, and I think there will be other sessions. Although the ministerials do not come that often, there are on-going talks at GATT and a work program on services and other areas.

So I think legislation is needed. The direct answer to your question, Mr. Chairman, is yes, it would have helped. H.R. 794 would indicate to our trading partners our seriousness. And I agree with your earlier comments, Mr. Chairman, that in Europe and other areas, there is really a lack of understanding of these issues and a suspicion about what the United States motives are.

I think our motives are very clear. We see a burgeoning part of the world economy, and we do not want the same kind of troubles and difficulties creeping further into services that have beleaguered some major industrial goods areas.

So to repeat our position, it is to move this legislation and to work with you as soon as possible. Thank you.

[Mr. Freeman's prepared statement follows:]

STATEMENT

OF

HARRY L. FREEMAN
Senior Vice President
Corporate Affairs and Communications
American Express Company

Mr. Chairman and distinguished members. My name is Harry Freeman and I am a Senior Vice President, Corporate Affairs and Communications in the American Express Company. I am pleased to be here today on behalf of American Express and I welcome the opportunity to endorse HR 794, the "Service Industries Commerce Development Act". I am especially pleased to be able to address your subcommittee Mr. Chairman. As many of us in the private sector know, you have been a leader in the effort to raise our national awareness of the crucial economic importance of the US service sector.

Today I would like to address the overall importance of the service sector to the American economy and comment on the importance of this bill.

The US Service Sector

Increasingly, one of the most successful and dynamic sectors of the American economy is the service sector. As you and the Subcommittee members are aware, services --such as finance, insurance, telecommunications, engineering and data processing-- are playing an increasingly significant role in our economy. As the attached charts show, services now account for 67 percent of our GNP; over half of the private sector work force is employed in the service sector and, when government employees are added, this figures rises to 70 percent.

The service sector also makes a significant contribution to the US balance of payments. In 1981, our services exports generated a services trade surplus of over $54 billion. A recent International Trade Commission Study has shown that in 1982, services exports have contributed $135 billion to the US current account, a 52 percent increase over 1980. Clearly, the US service sector plays a vital role in preserving the health of the US economy.

As you know Mr. Chairman, the rise of the service sector marks the second great transformation in the history of the American economy. The ninteenth century witnessed our first great transformation --from an economy dominated by agriculture to one dominated by industry, manufacturing and mining. Today we are experiencing another transformation --from an economy driven by manufacturing, mining and agriculture to one in which services are ascendant. This is good news for our economy.

For at a time of recession and slow economic growth, the service sector has been a bright spot in our economy. For example, services have been a strong source of new jobs. Job growth in the service sector is twice as fast as employment growth in manufacturing. Moreover, service workers are productive. Between 1967 and 1979, for example, productivity in goods increased by 10 percent. Productivity in services, however, increased by 20 percent. Service workers are also

skilled. Increasingly so. The technological revolution which fuels the growth of service industries requires legions of highly educated, trained and sophisticated employees.

Most importantly, services increase the productivity of manufacturing industries. They make industrial production and international trade more efficient. They promote and facilitate the flow and exchange of goods.

Mr. Chairman, a generation ago, the dominant symbol of economic America was the smokestack. Today, another symbol has earned a place beside the smokestack -- the humming computer. Both are essential. Both work together. Each needs the other.

The challenge before us Mr. Chairman, as you and the members of your Subcommittee know so well, is to adjust US economic policy and trade law so that it reflects the new economic reality of the services revolution. HR 794 represents an important step in this direction.

The passage of the "Service Industries Commerce Development Act", HR 794, would accomplish three critical objectives of high priority to the service sector. First, it would centralize and improve the collection and analysis of service sector performance data. Currently, service sector data is gathered by a wide range of government agencies and offices.

This information is rarely comprehensive and lacks a uniform and coherent presentation. Yet as service industries continue to grow they will increasingly require access to additional data on the overall sector and its individual industries. We cannot formulate effective domestic and international economic policy when our picture of the US economy is incomplete. Nor can businesses effectively plan to compete in overseas markets without adequate data. HR 794 will fill a vital gap in the collection and distribution of services information.

Secondly, Mr. Chairman, the passage of HR 794 will authorize the President to purposefully respond to the discriminatory service trade practices of foreign governments. As services exports have grown in recent years US service industries have experienced increasing protectionist pressure in foreign markets. For example, many countries currently restrict companies' access to private telecommunications lines and data processing facilities. Other governments restrict services exports through discriminatory licensing requirements or tax treatment which penalizes foreign business operations. This Presidential authorization is essential if US service industries are to be protected from the discriminatory trade practices of foreign governments.

A third reason, Mr. Chairman, for our support of this bill, is that HR 794 will send a clear and unambiguous signal to our

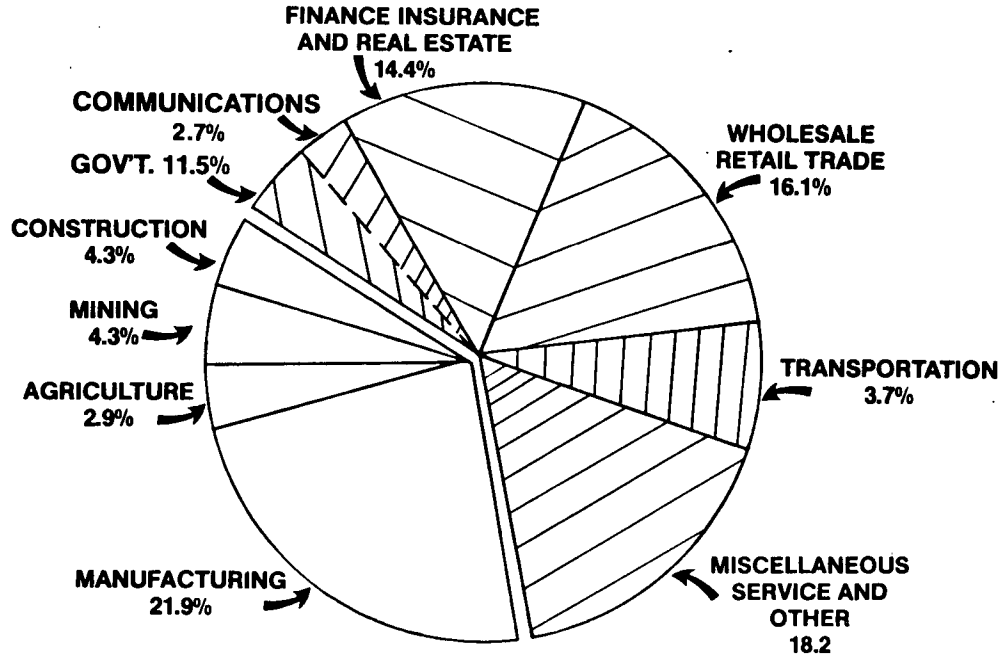
trading partners that the United States Congress has recognized the importance of the US service sector and supports efforts of to bring services into the same liberal international trading framework as goods. In the aftermath of the GATT Minsterial there is a crucial need for this kind of signal. The passage of HR 794 will clearly indicate to our trading partners the US remains committed to liberalizing trade in services and provide a new impetus to those efforts.

Conclusion

In conclusion, Mr. Chairman, we view HR 794 as an important first step towards the broader services industries legislation which this country needs. Although HR 794 represents important and useful progress towards the service sector's goals, we feel there is a need for services trade legislation which recognizes the importance of services exports and clearly extends Section 301 of the Trade Act to cover trade in services as well as goods. In addition, we feel it is vital for Congress to give the President the necessary legislative authority to negotiate for the liberalization of trade in services. Such legislation would powerfully reinforce the message which HR 794 contains and would ensure the US will benefit fully from the economic vitality and dynamism which its service sector has to offer. Thank you. I will now be happy to answer any questions you might have.

COMPOSITION OF GROSS NATIONAL PRODUCT 1981

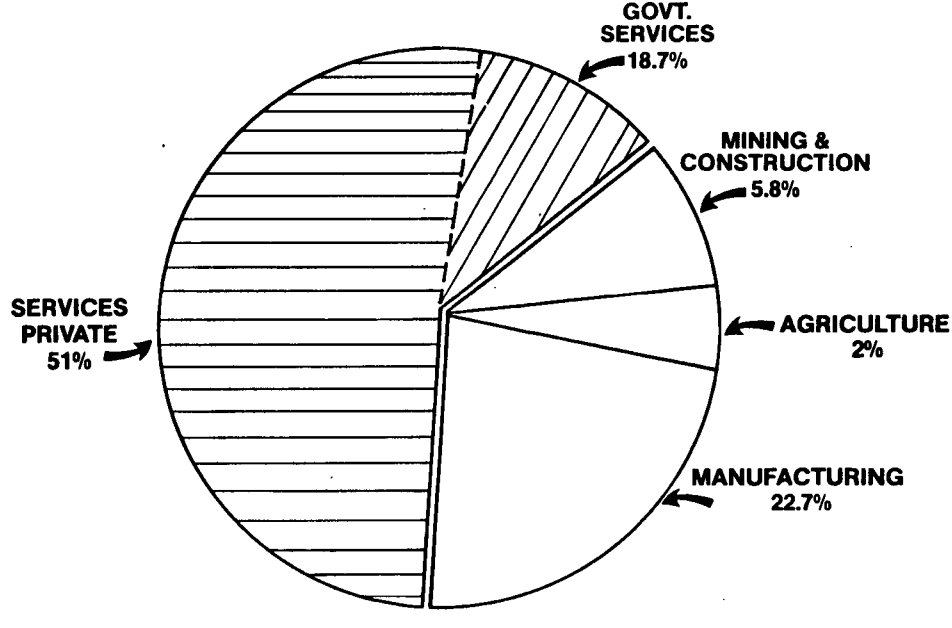
(BILLIONS OF CURRENT DOLLARS)



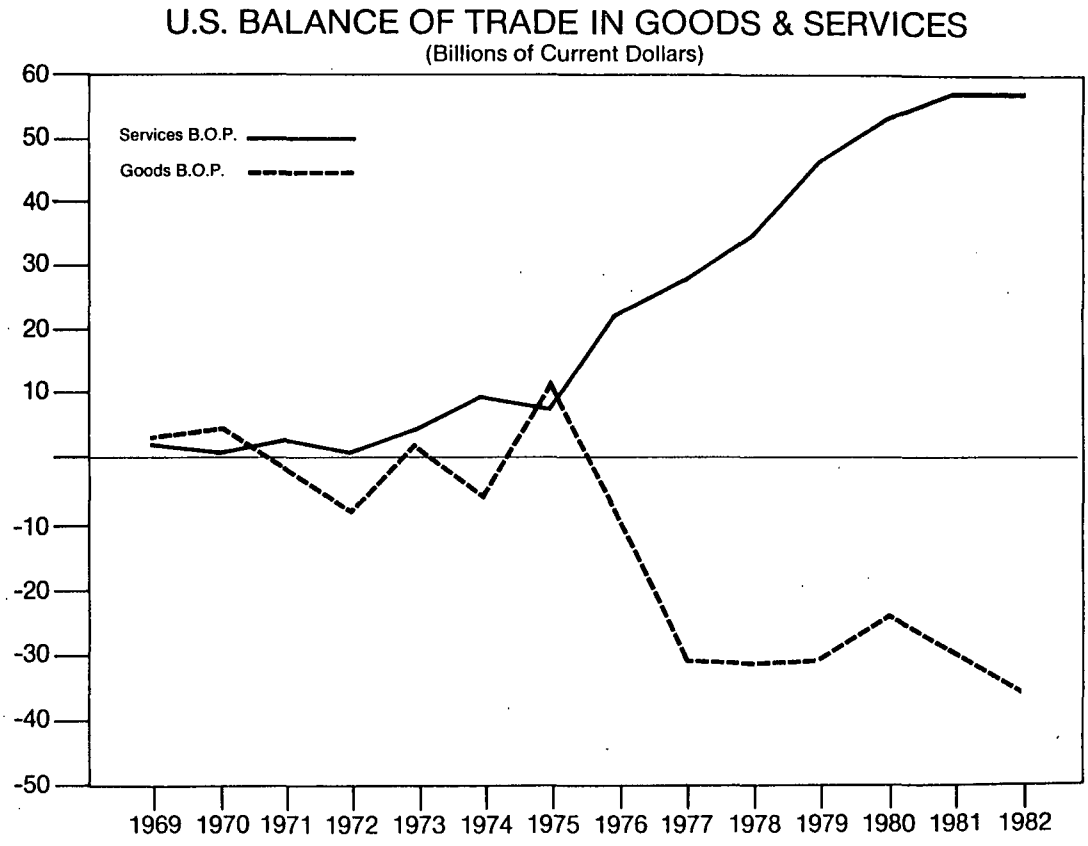
ALL SERVICES 66.6%
GOVERNMENT 11.5%

U.S. DEPT. OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS
SURVEY OF CURRENT BUSINESS, JULY 1982, p. 76

1981 DISTRIBUTION OF FULL TIME EQUIVALENT EMPLOYEES AMONG INDUSTRIES



U.S. DEPT. OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS
SURVEY OF CURRENT BUSINESS, JULY 1982, TABLE 6.8B



Source: U.S. Dept. of Commerce, Survey of Current Business, Feb. 1983, Table 4.1 (unpublished)

Mr. FLORIO. Thank you very much.
Mr. Simonetti.

STATEMENT OF GILBERT SIMONETTI, JR.

Mr. SIMONETTI. Thank you, Mr. Chairman. I am appearing here this morning on behalf of the National Foreign Trade Council, and it is the first appearance before this committee. I would like to set forth the views of the association, which consists of over 600 companies engaged in international trade and investment.

Our statement today deals with our views on trade policy generally and specifically with respect to trade in services and H.R. 794. Many of the principles I will discuss are set forth in the NFTC's 1983 policy declaration charting a realistic trade policy, which is just off the press. I commend it to your attention for further consideration.

Let me briefly summarize the points made in our prepared statement. The NFTC favors a free and open international trading system and opposes the view that the United States should move toward increased protectionism. Rather, this country should continue its current policy of expanding opportunity and investment by seeking liberalization of foreign markets instead of raising barriers in our own. But as we do so, we must become much tougher in protecting our trade rights from being undermined by the unfair and restrictive practices of others.

To that end, we must fully and aggressively utilize existing multilateral and domestic mechanisms such as GATT and the section 301 authority of the 1974 Trade Act. And we should negotiate strongly with our trading partners on a bilateral basis as well as a multilateral basis.

Generally, our overall objective should be national treatment—each country should accord foreign service firms regardless of country of origin no less favorable treatment than has been accorded to domestic service firms.

Mr. Chairman, there is no denying that protective barriers are on the rise all over the world. My firm's recent 73-nation survey of nontax, nontariff restrictions on inflowing foreign investment strongly supports this conclusion. The report is based on data supplied by Price Waterhouse offices located in the 73 countries covered by the survey. For example, 58 countries have ownership restrictions and 33 of them may be considered harsh. We have not performed a similar survey on barriers to trade in services, but there is ample evidence that indicates that the protectionist trend is especially strong in the services sector.

The United States has been a strong participant in the trend toward growth in the services sector and expansion of services exports. Because of the very lack of data that H.R. 794 is meant to address, honorable people may differ as to just what percentage of GNP, employment, and exports is accounted for by the services sector.

Nevertheless, we all know that the trend of the services sector is upward in this country and must be supported in the competitive environment of world trade. It is imperative that prompt action be

taken to deal with the problems and to improve U.S. access to services markets throughout the world.

But before we can do this effectively, we need to know much more about the actual role services play in our domestic economy and in U.S. export trade, about our competitive position related to that of other service-exporting countries, and about the nontarrif barriers that exist not only in other countries but in our own.

Let me make some brief comments now, if I may, with respect to the specific provisions of H.R. 794. Let me say generally we wholeheartedly agree with the need to develop better information and an improved environment for services trade worldwide.

First, we believe that a successful policy for the promotion and support of our services industries will require coordination with the State and Federal regulatory authorities. We therefore recommend that you consider a provision for intragovernmental policy advisory committees and for consultation between the administration and independent regulatory agencies.

Second, we recommend that the Presidential authority provision of section 4 of the bill be explicitly integrated with existing U.S. law and section 301 of the Trade Act of 1974.

Third, in connection with the data gathering effort, we wish to express some concern about the subpena authority. It is overly broad and lends a punitive air to what should be a cooperative public-private effort. We believe most companies will perceive it to be in their own best interests to supply as much of the required information as is reasonable and possible and that withholding any information will be based on legitimate concerns.

Let me conclude, Mr. Chairman, by indicating that while we have these reservations concerning the bill, they are not meant to impede the progress of this legislation through this committee and Congress. We endorse the concept of the legislation and urge that any modifications be done promptly and in concert with the objectives of the legislation. Thank you very much, Mr. Chairman.

[Mr. Simonetti's prepared statement follows:]

STATEMENT OF
GILBERT SIMONETTI, JR.
CHAIRMAN, COMMITTEE ON SERVICE INDUSTRIES
NATIONAL FOREIGN TRADE COUNCIL
BEFORE THE
SUBCOMMITTEE ON
COMMERCE, TRANSPORTATION AND TOURISM
OF THE
COMMITTEE ON ENERGY AND COMMERCE
U.S. HOUSE OF REPRESENTATIVES
HEARING ON H.R.794

March 15, 1983

My name is Gilbert Simonetti, Jr. I am a partner in the international accounting firm of Price Waterhouse. I am appearing before the Subcommittee in my capacity as Chairman of the Committee on Service Industries of the National Foreign Trade Council or NFTC. The Council is an association of over 600 companies engaged in international trade and investment. Our membership represents more than half of U.S. exports of manufactured goods and services.

Our statement today will deal with our views on trade policy generally, as well as specifically on trade in services and H.R.794, which would establish a service industries development program in the Department of Commerce. Many of the principles I will discuss are set forth in the NFTC's 1983 Policy Declaration, "Charting A Realistic Trade Policy." I respectfully request that this document, which I have here, be made a part of the hearing record.

NFTC Position on
U.S. Trade Policy

The NFTC favors a free and open international trading system and opposes the view that the United States should follow many of its trading partners who are moving towards increased protectionism. Rather, this country should continue its current policy of expanding opportunities for trade and investment by seeking liberalization of foreign markets instead of raising barriers in our own. But, as we do so, we must become much tougher in protecting our trade rights from being undermined by the unfair and restrictive practices of others. To that end we must fully and aggressively utilize existing multilateral and domestic mechanisms, such as the General Agreement on Tariffs and Trade (GATT) and the Section 301 authority of the 1974 Trade Act, to uphold U.S. trade rights. And we should negotiate strongly with our trading partners on a bilateral as well as a multilateral basis as is appropriate to reduce barriers to trade in services.

Our overall objective should be "national treatment." That is, each country should accord foreign service firms, regardless of country of origin, the same market access that is accorded to domestic service firms. National treatment has long been the established policy in the United States, and we should be aggressive in persuading other countries to follow our example.

I would like to emphasize one point here. In discussion of the services trade issue, some have expressed the conviction that the U.S. is becoming a "services economy," and that our traditional manufacturing sector is obsolete and should receive less attention. We do not share this viewpoint. It is not a question of either goods or services. Our point is that the same attention that has been given to reducing barriers to trade in goods in

the past should now be given to reducing barriers to services. Services are important not only in their own right, but they also support and facilitate trade in goods. The two go hand-in-hand.

Rise of Protectionism in Services Sector

There is no denying that protective barriers are on the rise all over the world. My firm's second annual 73-nation survey of nontax and nontariff restrictions on inflowing foreign investment strongly supports this conclusion. The report is based on data supplied by Price Waterhouse offices located in the 73 countries covered by the survey.

Like the 1981 report, the 1982 update indicates strong nontax and nontariff restrictions on foreign investment. Of the 73 countries surveyed, 58 impose ownership restrictions (same as 1981), 53 have exhange controls (52 in 1981), 46 impose restrictions on repatriation or remittances (same as 1981), 71 have employment restrictions (same as 1981), and 30 have local material content requirements (29 in 1981).

Comparing the 1982 Report to the 1981 edition, the impression is that restrictions on foreign investment are growing. Certainly they are not being relaxed. As the world recession continues, protectionist pressures mount.

Since a growing portion of our overseas investment is in the services area, these barriers are damaging the competitive position of U.S. suppliers of services.

We have not performed a similar survey on barriers to trade in services, but there is every indication that the protectionist trend is especially strong in the service sector. There are

almost no rules governing international trade in services. The 1976 OECD Declaration on International Investment and Multinational Enterprise provides some guidelines only in relation to investments in services, and trade in services is covered only marginally by GATT. Thus, it is tempting to use services as a target for protectionism because many countries, especially the lesser developed countries (LDCs), are experiencing dramatic growth in the services sector and are expanding services exports.

The United States has been a strong participant in the trend toward growth in the services sector and expansion of services exports. Because of the very lack of data that H.R.794 is meant to address, honorable people may differ as to just what percentage of GNP, employment, and exports is accounted for by the services sector, especially since it is difficult to determine just what industries comprise that sector. But all data collected by the government and private organizations, however inadequate, indicate that services are overtaking goods in terms of importance to our domestic economy and our international trade position.

In 1981, for example, based on Commerce Department figures in the Survey of Current Business, those industries which can be classified as services (not including government services), accounted for approximately 55 percent of the Gross National Product. Moreover, trade in services has enabled us to maintain a positive balance on goods and services exports over the last decade, helping to offset the huge merchandise trade deficits that began to appear after the oil crisis of the early 1970s. For example, the service sector added a net $35 billion, including investment earnings, to the 1980 balance of payments, while trade in goods accounted for a deficit of approximately $30 billion.

Because of the growing importance of services to the U.S., the trend toward greater protectionism is particularly distressing. In attempting to continue to expand services provided abroad, American companies are encountering more and more nontariff barriers. Nationalistic tendencies keep U.S. overseas investors and exporters from continuing to serve growing foreign markets. At the same time, countries which have set up these barriers are taking advantage of the relatively open markets of countries like the United States to increase their own services exports and investments.

Views on H.R.794

Data Collection

It is imperative that prompt action be taken to deal with these problems and to improve U.S. access to services markets throughout the world. But before we can do this effectively, we need to know much more about the actual role services play in our domestic economy and in U.S. export trade, about our competitive position related to that of other service exporting countries, and about what nontariff barriers exist not only in other countries, but in our own.

Current data on services collected by both the U.S. government and private sector entities does not tell us what we need to know. Data on service transactions has not been collected with the frequency and level of detail comparable to available data on "visible" trade. We do not even have acceptable definitions of what constitutes the service sector or what constitutes an international service transaction.

I will not take time here to reiterate the findings of the two exhaustive studies on services data which were performed for the Office of the U.S. Trade Representative and the Departments of Commerce and State by Economic Consulting Services and the research team of Robert Sammons and Evelyn and Walther Lederer. Suffice it to say that they made an excellent case for a complete overhaul of government data collection on service industries and exports.

Some progress is being made toward improving our services data base. Using the ECS and Lederer/Sammons studies as a foundation, the U.S. government has launched a major effort in this area in close cooperation with the private sector. For example, the Interagency Task Force on Services Trade Data Needs has been established to pursue this issue. It is chaired by the U.S. Trade Representative, and its membership includes the Departments of Commerce, State, Treasury, Labor and Justice, and OMB, with some participation by the Transportation and Agriculture Departments and the National Science Foundation. A counterpart private sector group, the Services Trade Data Working Party, has been established by the U.S. Chamber of Commerce. It consists of representatives of service companies and trade associations. The Coalition of Service Industries also has a data collection task force. These groups are examining the data needs for individual sectors, definition and measurement problems, and means of obtaining the required data.

One set of data improvements already is taking place. The Commerce Department's benchmark survey of international investment for 1982, although reduced in overall reporting requirements for respondents, will include detailed data for about one dozen service sectors not previously published separately (e.g., computer franchising, equipment rental and leasing, employment,

health, education). The survey will also request from all respondents a separate breakdown or estimate for sales of services as distinct from goods. Questionnaires for the survey are being mailed this month.

There is a need for a more integrated view of the service industries than is presently provided by these separate exercises. This is the goal of the Services Industries Development Program proposed in H.R. 794. We wholeheartedly agree with the need to develop better information, but we wish to express our concern about the subpoena authority. It is overly broad and lends a punitive air to what should be a cooperative public/private sector effort. I believe most companies will perceive it to be in their own best interest to supply as much of the required information as is reasonable and possible and that withholding any information will be based on legitimate concerns.

A final point with regard to the proposed study and analysis of the impact of barriers erected by "major trading countries" (Section 3(c)4) should be emphasized. The greatest proliferation of such barriers is now to be found in some of the developing or newly-industrialized countries, and proper attention should be given to these countries.

Coordination With Other Federal Agencies and With States

We believe that a successful policy for the promotion and support of our service industries will require coordination with state and federal regulatory authorities. We therefore recommend

that H.R.794 be amended to provide for intergovernmental policy advisory committees and for consultation between the Administration and the independent regulatory agencies of the federal government.

Presidential Authority

Regarding the Presidential authority conferred in Section 4, we believe the primary intent of action against unfair trade barriers should be to encourage bilateral or multilateral negotiations. Restrictive conditions and limitations should not be set unilaterally, but should be used as "bargaining chips" to persuade our trading partners to curtail any practices or policies which limit access of U.S. service suppliers to their markets.

In order to successfully pursue this policy of encouraging others to negotiate rather than retaliate, it is important that our own actions not appear arbitrary or inconsistent with established U.S. practice. To do otherwise would cause erosion of the national treatment principle. We recommend therefore that the Presidential authority provision in Section 4 of H.R.794 be explicitly integrated with existing U.S. law and Section 301 of the Trade Act of 1974, as amended.

We further recommend that the language "notwithstanding any other provision of law" in Section 4(a) be clarified and limited to allow flexibility of the President to use his authority to conduct trade policy in a manner consistent with the independent status of state and federal regulatory bodies.

Negotiating Mandate

We believe that H.R.794 could further enhance prospects for international negotiations to remove barriers to trade in services by establishing such negotiations as a clear objective of U.S. trade policy. As was made clear by the outcome of the November GATT Ministerial meeting, extending GATT to services is going to be an uphill fight. We need as much ammunition as possible, and a clear Congressional mandate to pursue negotiations would be helpful.

A Multilateral Framework for Services Trade

Section 301 and bilateral trade agreements are short-term solutions. Our ultimate objective should be a framework of multilateral rules and procedures governing international trade in services, based on the principle of national treatment.

We believe GATT is an appropriate instrument for developing this framework. The U.S. may not have secured everything it wanted at the GATT meeting, but the door has been opened. The final Ministerial document states that interested countries should conduct studies on the role of services in their economies and exchange information in international forums such as the GATT. Then, in 1984, countries will again meet to consider whether multilateral action is called for.

This is an opportunity we cannot afford to miss. The U.S. study should be ready by this fall. U.S. Trade Representative William Brock has stressed the importance of completing it quickly to show the urgency the U.S. government attaches to this issue and provide guidance to other countries wishing to prepare

studies. We understand that the study will focus on this country's efforts to develop better data on trade in services and on the need for other countries to initiate similar efforts.

It is hoped that the study will not fall on deaf ears. Not many countries have taken seriously the need for developing more comprehensive and refined data on trade in services. Some of our OECD trading partners, such as the United Kingdom, have been responsive; but the LDCs, Brazil in particular, have even resisted the idea that GATT is the proper forum to study the issue.

Clearly, the problem of adequate and comparable information must be addressed before negotiations can take place. The OECD may offer greater early opportunities to do this as we continue efforts to place services within the GATT framework.

In closing, I would like to reiterate the major points of the NFTC's position:

- First, the United States should continue its policy of national treatment and be aggressive in persuading other countries to follow our example.
- Second, the U.S. government should take every possible action, within the framework of national treatment, to protect the international competitive position of both goods and services, including negotiation of bilateral and multilateral agreements.
- Third, we believe that, with the changes we have suggested, the proposed legislation can significantly strengthen the U.S. government's negotiating position on trade issues.
- Finally, we applaud, in particular, the Chairman's attention to this issue, and we will be happy to continue to work with you and your staff.

That concludes my prepared statement. I will be happy to answer any questions.

Mr. FLORIO. Thank you very much.
Mr. Finnerty.

STATEMENT OF PETER J. FINNERTY

Mr. FINNERTY. Thank you, Mr. Chairman. My name is Peter Finnerty. I am vice president, public affairs of Sea-Land Industries, which is headquartered in Iselin, N.J.

I am here to testify on behalf of the Coalition of Service Industries. The coalition is the primary national organization representing the service sector of the U.S. economy. The coalition member companies are drawn from a wide range of service industries, including banking, insurance, investment, communications, retailing, advertising, shipping, and construction. A list of our full membership is attached to my testimony.

If I may, Mr. Chairman, I will summarize my remarks and submit my full statement for the record.

We are here as a coalition to support H.R. 794, the Service Industries Development Act of 1983. We also agree with the data collection aspect of the bill, but we would qualify that the language perhaps is overly broad and might require some further review to become more precise.

We do strongly support section 4 clarifying a clear Presidential authority on acting against other countries in the issue of market access where there are problems. As I say, I will submit the full statement, but I would like very much to elaborate on certain points that have been raised earlier and perhaps draw on my own experience in the shipping industry. Sea-Land, as you may know, is the largest American shipping company. It is the only major nonsubsidized company and pioneered this technology some 26 years ago in Port Elizabeth, N.J.

I want to point out, although the word has been used a number of times earlier, our company certainly, and I believe most of my colleagues are not necessarily seeking "protection" in the service industries. What we are looking for is more a matter of equity and a defense of open markets and equitable competition. In the shipping industry, Mr. Chairman, we have experienced and continue to experience situations that one would expect to see primarily from developing countries or others who supposedly do not adhere to OECD open-trade principles. In fact, some of our primary problems are with our European and Japanese trading partners.

I am, in fact, going to travel again next week to London with an American Government delegation as an adviser for the third in a series of meetings. I offer this as an example of a need for more aggressive tactics by the United States to defend open markets in the service industries. European ships, European-registered vessels, presently enjoy a 60-percent market share in the U.S. foreign commerce of trade between the United States and countries other than their flag of registry.

This is an amount of business that approximates $8.5 billion. These same countries have officially indicated to the United States in the last year or so their intention later in 1983 along with Japan to ratify an UNCTAD liner shipping convention. It is one of the first conventions that have been advanced by that organization and

will drastically close markets, greatly increase foreign government control, decrease access to those foreign markets and strongly work to the disadvantage of American-flag shipping companies.

In response to this, the United States is continuing to discuss the matter with the Europeans. And the European position is that they will close up to 40 percent of the shipping markets between European countries and the developing world. They do not want the United States to take any action in response. And they presently enjoy and would continue to enjoy $8.5 billion of our trade here in the United States.

This, I point out, is some of the inequity that is involved, and the ambiguity that is involved in the trade policy debate.

Mr. FLORIO. What would be the form of those restrictions?

Mr. FINNERTY. It would be a restriction allowing participation in those markets based on flag of registry and in effect, an American-flag ship would no longer be eligible to carry cargo unless the foreign government gave it permission to do so. It is in effect a governmental political rule imposed instead of market forces.

I might add that comments that have been voiced earlier about the ultimate objective of multilateral solutions, we would support. However, in the shorter term, I think that progress is going to come in a bilateral nature. That is indeed what we think is the optimum opportunity with respect to shipping, and we have so advocated that to this administration and to the Congress for the past several years.

The point made earlier is basically a good point by my colleague here at the table, that "national treatment" is a good benchmark for trying to establish satisfactory trading relationships.

I would like to qualify that to the extent that it is not always adequate. Industries such as shipping, which do not take place inside a foreign national economy, but rather transact our business between national borders, have found that the treatment rule is not enough. There needs to be more specificity in approaching that situation.

Ultimately, we think that will come if more support is lent to the service industries area internationally by a bill such as H.R. 794. Thank you, Mr. Chairman.

[Mr. Finnerty's prepared statement follows:]

TESTIMONY OF PETER J. FINNERTY

COALITION OF SERVICES INDUSTRIES, INC.

Before the House Subcommittee on Commerce,
Transportation and Tourism on H.R. 794,
the "Service Industries Commerce Development Act of 1983"

March 15, 1983

Good morning, Mr. Chairman.

My name is Peter J. Finnerty. I am Vice President of Public Affairs of Sea-Land Industries, Inc., and I am here to testify on behalf of the Coalition of Service Industries. With me this morning is the Coalition's counsel, Richard R. Rivers of Akin, Gump, Strauss, Hauer & Feld. It is a pleasure to appear before you this morning on behalf of the Coalition, the first and only national organization representing the service sector of our economy. The Coalition's member companies are drawn from a wide range of service industries, including banking, insurance, investment, communications, retailing, advertising, shipping and construction. A list of our member companies is attached to this testimony.

Mr. Chairman, we are here on behalf of the Coalition to offer our support for H.R. 794, the "Service Industries Commerce Development Act of 1983". As you and the members of the Subcommittee are aware, the importance of the service sector and its contribution to our economy is significant. Services currently produce 67% of our GNP; over half of the

private sector work force is employed by services companies and, when government workers are added, this figure rises to 70%. In 1981 our services exports were so large as to yield over a $54 billion services trade surplus. Not surprisingly, in a time of great domestic economic difficulty, national attention has turned to this relatively bright spot in our economy. We have seen this dramatically within the Coalition itself. In the Coalition's one-year life, its membership has nearly quadrupled, from eight founding companies to twenty-nine current members.

The Service Industries Commerce Development Act of 1983, H.R. 794, would accomplish critical objectives of high priority to the service sector. It would serve notice to our trading partners that the Congress of the United States has thrown its full weight behind the American service sector and the efforts of the Executive Branch in the international arena to bring services under the same trading framework as goods. This signal is all the more critical, following upon the heels of the recent General Agreement on Tariffs and Trade ("GATT") Ministerial, where the U.S. -- in particular, USTR Ambassador Bill Brock -- achieved a step forward, which the Coalition strongly supports, in bringing services within the GATT. This was no mean task, especially given the widespread lack of understanding among foreign trade leaders about the importance

of services to their economies. Such lack of awareness is hardly surprising, since until recently U.S. trade experts have been equally in the dark.

Passage of H.R. 794 would provide added momentum to our GATT Ministerial achievement in prompting our trading partners to take seriously the need for maintaining and improving a liberal world exchange in the service sector. The potential for expanded service sector trade is threatened by barriers to foreign trade. Non-tariff barriers abroad will continue to proliferate. Nations will seek to protect infant industries in, for example, highly technological areas such as data processing, or in established sectors where industries have become accustomed to monopolistic or quasi-monopolistic status in their respective countries. Canada, for instance, requires that all foreign banks maintain and process data within Canadian borders. Australia forbids the screening of television commercials filmed abroad, and Norway has not licensed a foreign insurance company in four decades. We must work vigorously to restrain these types of services trade barriers and prevent their further growth.

This legislation would provide centralized focus for the conduct of trade policy in the United States. Our independent regulatory agencies have not traditionally been created for the purpose of regulating access to U.S. markets. Typically, at the time these agencies were created, no one

was thinking in terms of foreign providers of services doing business in the United States. Our view is that independent regulatory agencies should be principally concerned with the traditional agenda for these agencies and that the question of access to particular sectors of the U.S. economy should be part and parcel of a comprehensive national trade policy.

Secondly, Mr. Chairman, the establishment of a service industries development and reporting program would further one of the major objectives of the Coalition; it would provide needed improvement on the adequacy of service sector statistics both from a domestic and international viewpoint. In many cases, domestic economic data need to be improved to reflect the increased role of service industries in production and employment. Statistics on trade in services need to be improved to reflect the rapid growth in trade in services and the impact such services have on international trade and investment. The Coalition supports whole-heartedly the development of statistical reporting systems to produce more complete and accurate data on international trade and investment in services. However, although we recognize that the implementation of these systems will create greater reporting requirements, we seriously question the degree to which those requirements should be mandatory. The inclusion of subpoena authority in this legislation undermines the cooperative spirit

upon which any efforts to improve data collection systems on services should be based.

Mr. Chairman, the Coalition has agreed to work closely with the Administration and with our counterparts in other nations, such as the London-based Committee for the Liberalization of Trade in Services ("LOTIS"), to assure that the process of removing service trade barriers is not stalled. We will also work closely with Ambassador Brock in developing a national study to suggest a framework in which service trade problems can be dealt with in the GATT. The Coalition feels this legislation would help to put services on an equal footing with manufactured goods in our trade laws and enthusiastically supports the passage of H.R. 794. Mr. Rivers and I would be pleased to answer any questions you may have.

Mr. FLORIO. Thank you very much.

The gentleman from Mississippi was concerned before about transported data flow problems. It has been represented to me that Brazil has been a recent offender in this area by putting into operation quotas on imported software in a way that it in a sense cannot be excused on any particular social or noneconomic ground.

Are any of the gentlemen at the table familiar with what Brazil has done in this area?

Mr. FREEMAN. Mr. Chairman, I am not specifically familiar with Brazil, but I think you referred earlier to this large article on the front page of the New York Times on Sunday. That was a very, very accurate, well-researched article on transborder data flow. What Brazil is starting to do is to treat information as a commodity and to think in terms of taxing it and setting quotas, if my information is correct.

It would be serious if limited only to Brazil. If that concept is copied around the world, not only would U.S. companies be in a lot of trouble, but I think the whole world trading system would be in very, very difficult shape. This kind of trend is spreading.

I recall very vividly a debate with an official of the Canadian Government. We were talking about restrictions on data flow and the reasons for them. She quickly dismissed the idea of sovereignty. And there is something to sovereignty. She quickly dismissed the idea of privacy. I think we are all proprivacy. She said, look, Freeman, what we are really talking about on transborder data flow are jobs. It is really a matter of economic nationalism and protectionism.

The worst thing in the area of data flow would be to have that descend into a trade war on information. Everybody would lose. The United States particularly would lose, but everybody would lose. The way to avoid that is legislation such as this, for the reasons that have been stated. Mr. Tauzin stated very eloquently earlier that you can see this coming right down the track, you can see the artillery being set up. Now is the time to act to prevent what I think would be in the very bad interests of this country and indeed the rest of the world.

Mr. FLORIO. Mr. Simonetti.

Mr. SIMONETTI. Mr. Chairman, I am not familiar with the Brazil situation, but there is the broad issue of concern with respect to multinationals generally and specifically in the profession in which I am involved, accountancy. Data flow is extremely critical. We see evidence of the problems of restrictions on data flow with respect to individual companies, as well as specific groups. For example, the difference between the kinds of data, that must be provided by U.S. multinational companies as opposed to other MNC in the European Community, amounts to discrimination. More data would be required of U.S. multinationals than those of the EC.

Mr. FLORIO. I would just conclude by sharing with you the story that Mr. Lent and I have brought home from this Athens conference. I suppose it is a response to Mr. Tauzin's multipaint job story on the Japanese-American automobiles in Japan. In the insurance field in Greece a new law has been passed by the Government in Greece that says that any time anyone applies for credit at one of the banks, the nationalized banks—and that is all they have apparently in Greece is nationalized banks—when you apply for credit, mortgage loan or whatever, the bank is required to suggest to you that the insurance affiliates of those nationalized banks are prepared to respond to any and all of your insurance needs.

The feeling, of course, is if you go to a banker and he is evaulating your credit application and he suggests to you that they are prepared to provide your insurance needs, the suggestion is something more than just a suggestion. So it is a particularly ingenious way of in a sense tilting away from the opportunity for other nonbank-affiliated insurance companies to sell their services.

So I would at this point call on Mr. Lent.

Mr. LENT. Thank you.

Gentlemen, some concern has been expressed by some of the witnesses, particularly the chamber of commerce and the National Foreign Trade Council, regarding the stringency of the subpena authority provided for the Secretary of Commerce under section 3(a)(3) of the bill. Do any of the members of this panel share this concern? And can any of you, if you do, suggest an alternative approach?

Mr. FREEMAN. Let me mention, I think most individuals, including myself, who have read the bill have a little concern. Let me state very frankly and openly what happens. The large corporations such as mine and Mr. Finnerty's business, may get a very formal looking document from the Government demanding a lot of information with a lot of penalties listed.

We get tons of mail everyday, and God knows who that is going to go to. Frequently, what happens is some poor terrified man or

woman down the line says, my God, I am going to go to jail if I do not come up with this tomorrow, when obviously that is not the intent.

I think the legislation is about 90 percent fine in this area. Certainly, the Secretary should have this kind of power. I think there should perhaps be some language put in to make it very clear what kind of information is within the power of the Secretary to require. If that is clear, you are really not talking about the deepest secrets that a company or individual has, and I do not think anybody would have a reasonable objection.

Mr. LENT. I thank the gentleman.

Did anyone else have a comment?

Mr. FINNERTY. Mr. Lent, I would just like to add I am not an expert on this by any means, but I would certainly support Mr. Freeman's response. The comment that was made to me is that it is more a desire on our part to try to conform in the manner in which this data would be collected to the approaches that now exist for census. There is an adequacy and sufficient authority involved there and a procedure that suffices on getting the information without being too onerous. I cannot give you the specifics as to where to draw that line, however.

Mr. LENT. Mr. Chairman, I have some further questions, but in view of the time constraints, I will withhold them and perhaps submit them to the witnesses through the mail and hold the record open.

Mr. FLORIO. Certainly.

Mr. Richardson.

Mr. RICHARDSON. No questions.

Mr. FLORIO. Mr. Tauzin.

Mr. TAUZIN. I cannot resist, Mr. Chairman. One very brief one. In relation to this data problem and barriers that may be developing, is the U.S. effort to restrain the exportation of high technology impacting upon this problem in the international community? Can you comment on that?

Mr. SIMONETTI. If I can make a stab at that, I think it is. The high technology companies are concerned about data flow and I would call to the Congressman's attention the recent agreement that has been reached between the United States and Japan specifically with respect to, among other things, data collection in the high-technology field.

This agreement has not received very widespread publicity, but I think it is a milestone in dealing with, as Mr. Finnerty put it, some of the bilateral efforts that may offer the best short-run opportunities as we go forward with respect to a multilateral agreement.

The agreement on high technology data with Japan is for the collection, on a public-private sector basis, of the costs, the bookings, the billing, and the accounting methods particularly with respect to the semiconductor industry in both countries. The objective is to see if we can find some common basis of agreeing or disagreeing on whether there is undercutting, for example, by our Japanese competitors.

So I suggest that there is a problem. I think it is in the process of being handled in a most expeditious way.

Mr. TAUZIN. I thank the gentleman.

Mr. FLORIO. Mr. Dowdy.

Mr. DOWDY. No questions.

Mr. FLORIO. Mr. Ritter.

Mr. RITTER. In the interest of saving time, I will submit my questions.

Mr. FLORIO. Gentlemen, thank you very much. We appreciate your help.

We are pleased to have back before our committee former Trade Representative Ambassador Robert S. Strauss. Mr. Ambassador, welcome to the committee.

STATEMENT OF ROBERT L. STRAUSS, WASHINGTON, D.C.

Mr. STRAUSS. Thank you, Mr. Chairman and members of the committee. I will take but a few minutes of your time for a statement.

Let me just briefly say to you that I applaud you for having these hearings and I certainly look with favor upon this legislation. You have probably heard more detail than you are interested in this morning. I have certainly heard a great deal more than I am interested in on this subject over the past few months.

Let me just broadly say that probably one of the primary things that will come out of this hearing and out of this legislation is that it will assist in what I think is most essential; that is, it will begin to build a national interest in the service industries and, second—and of even greater importance—that it will begin to lay the groundwork for building an international consensus that something has to be done in this area.

We all know the emerging importance of the service sector. Let me also say that it is no secret that there is a great lack of interest in it throughout the world. I have been invited to attend or trade policy research center conference in England next month which is being held at Ditchley and which will address the subject of barriers to international trade in services. There we will hopefully have people from all over the world who will attend either because they are interested in the subject and want to participate or they, like me, are not only interested in the subject but also interested in seeing Ditchley. And if they come, we will get our hands on them and get them interested in the subject.

The French really have no interest in doing very much with this. EC has generally paid little attention to it. The British have not given it any push. The Japanese have not indicated any great desire to move forward. So this Nation again is going to have to take the lead, just as we did in the Toyko round, or nothing is going to happen.

I think these hearings are important. I think this legislation is important. I think we are very fortunate to have Ambassador Brock as Special Trade Representative' since he has put this on the front burner and has tried to generate and keep in motion some interest in this area.

With the kind of work that are doing—and I hope the rest of us can contribute—we will be on the road to doing something about this very significant sector.

Mr. FLORIO. Mr. Ambassador, how important, as a result of your experience in this field—how important is export financing in general as part of a trade policy with regard to the service industries?

Mr. STRAUSS. I think that export financing is very important. I am not critical of the administration in a partisan way. I am critical of a policy that provides export financing for brick and mortar or machinery and equipment, but not in the area of services.

I would point out for the record that the inability to get financing assistance for a feasibility study that would require, at the most, a $2 million or $3 million contribution in export financing, recently rendered this Nation totally unable to compete with European nations for the award of a contract for $200 to $300 million.

It means that work is gone because we do not have export financing.

Mr. FLORIO. Likewise with regard to your experience, how important do you regard the data collection function to your ability to be able to function as a trade representative in the past, as well as our Nation's ability to negotiate?

Mr. STRAUSS. We have in years past had a great void, as you know, in this area. We need to catch up a little bit. But it is of vital importance, of course. There has been a great theory around that this Nation does not have experienced negotiators and well-trained diplomatic negotiators to compete with those of other lands, and that may be partially true.

It is also true that we do not have the historical background. We do not have the collection of data. We do not have available to us the kind of information we need, so it is important. It is vital.

Mr. FLORIO. Can you give us an example of how data is of benefit in actually negotiating with other nations? What would be the usage?

Mr. STRAUSS. I suspect there is no area where we are taking a bigger pasting right now than in the area of agricultural subsidies.

We are talking about the agriculture of California, the agriculture of Louisiana, the agriculture of the Northeast. This Nation is not only the most efficient and certainly the most competitive, and yet we lose out to foreign subsidies.

We do not really have adequate data collection in the area of subsidies. We do not really have the ability to do the kind of work we need to do. The same thing is true in financial services or any of these areas. There is just much that needs to be done that has not been done.

Mr. FLORIO. The frustrating part of this—and agriculture is an example which is a bit off of our topic today—but I have talked with Japanese agricultural officials. Mr. Lent and I talked with some European agricultural officials.

The bottom line as far as their concerns are is that American agriculture is more efficient, more competitive. You always will be and, therefore, we have to protect our industries from your efficiency and your competitiveness. Hence, we have got to conjure up ways of insuring that protection.

Mr. STRAUSS. The same thing is true if you look at the service industry. If you look at insurance, for example, and other financial services where we are better, we are more efficient, we are more

competitive, we are not going to be permitted into these markets unless we force our way in and insure that this is a two-way street.

The authority in your legislation that is given to the President, by the way, is a significant power which he already has in some other areas. But it represents good judgment to have it in this legislation.

In the area of agriculture the truth of the matter is that we are no longer effective because we are not competing with the farmers of the other land. We are competing with their governments. Our farmer is competing with a foreign government not a foreign farmer. That does make a difference.

Mr. FLORIO. Mr. Lent.

Mr. LENT. Thank you, Mr. Chairman. I have no questions. I know the witness complimented Bill Brock. I would just like to add that we should not lose sight of the fact that Mr. Brock's predecessor did an outstanding job and served this Nation very well as U.S. Trade Representative, and I want to thank you, Mr. Ambassador, for doing such a good job.

Mr. STRAUSS. Thank you very much. I might say that nobody likes a nice compliment better than I, but let me also say that in the area of services we did not do as much as we should have.

We had so much to do that we just had to take our priorities as we could and in-between worry about the raisins of California or the rice in Louisiana. We had a devil of a time, and we did not get to services. We knew how important it was and was going to be.

I thank you very much for what you have just said.

Mr. FLORIO. Mr. Richardson.

Mr. RICHARDSON. Ambassador Strauss has given us, I think, a very good rationale for supporting and passing this legislation. I noted with interest the statements about the various European partners and their supposed lack of interest in doing something in this area.

I think that is one strong reason to pass this legislation and send a signal I wondered if the Ambassador had also seen the section in the bill, section 3(a), which includes some retaliatory provisions in the act—reciprocity. I am corrected by my senior colleague. Basically the Office of the STR and the Department of Commerce, in essence is saying we oppose that provision although they claim they are in favor of protecting our service industry.

They support data collection. They support all the apple pie except the teeth. I wondered if you felt in terms of your tenure as Special Trade Representative whether a signal from Congress in this area, with the reciprocity provision, would be useful when you negotiate.

Mr. STRAUSS. Let me kind of back into that gingerly, if I may, and say this to you, sir. I think that it is important that Congress show a resolve and I think it is important to any negotiator that there be both a carrot and a stick.

I think we are in a dangerous and treacherous time right now. It certainly is most important that men and women such as yourselves are aware of it. In the field of trade we find ourselves with a match and a can of kerosene. Any demagogue who wants to stand on the floor of the House or the Senate with the right kind of inflamatory language could really move along some protectionist

legislation that would be not in the best interests of this Nation or, indeed, of the world.

So long as we are cautious, however, and so long as we see that we are not overdoing it, a little of this does help. Of course, it is only a matter of degree. It is only a matter of striking a balance, in my judgment.

Mr. RICHARDSON. Thank you, Mr. Ambassador.

Mr. STRAUSS. Thank you, sir.

Mr. RICHARDSON. I have no further questions.

Mr. FLORIO. Mr. Tauzin.

Mr. TAUZIN. Thank you, Mr. Chairman. Thank you, Mr. Ambassador, for appearing with us today.

The chairman touched on an issue which is of concern to me in regard to how we deal with this growing problem of trade relations, and that is the size of the U.S. capabilities in the international market.

I was recently in Honduras with the Trade Delegation and talking to, I think, the chamber of commerce in Tegucigalpa and, in fact, the Economic Minister that day, with reference to the Caribbean Basin Initiative. They, of course, are very much in favor of that. I asked them if they might not consider some reciprocal action.

Of course, they immediately bristled and said, now wait a minute. You cannot impose the great weight, the great size and depth and width of the U.S. economic capabilities upon our little nation. If we open up our trade barriers to you, you are going to dominate everything we have.

Of course, they made a legitimate point there. How do we deal with that in terms of asking for fairness in national policies in regard to this expanding service industry?

Mr. STRAUSS. I think we have to talk about it in overall terms rather than just in terms of service industries. To begin with, Mr. Tauzin, it seems to me that one thing we must keep in mind is that when we do something for a developing nation or an undeveloped nation we are not just doing it for them. If we help that economy, we are doing it for ourselves because without any customers it does not make any difference what we have to sell.

I remember my father had a little store in west Texas in the heart of the depression, with 4-cent cotton and droughts in west Texas. It did not make any difference what he was selling or at what price; nobody had anything to buy. So we have to be sure that our potential customers have something to buy.

On the other hand, I think there is a time when these developing countries must be treated as a developed nation in the areas in which they have become developed. Some of these countries are terribly undeveloped in one area and fully developed in the other. In terms of traded services, there are very few that have any real developing capacity. If you go into something like textiles, they are overdeveloped insofar as their ability to deal with this country is concerned.

I think we just have to consider them one by one. We are a long way from where we ought to be. Ten, fifteen, or twenty years from now the great financial services companies such as you see before you here—I just noticed the gentleman from American Express—

should be offering financial services all over the world. In every little hamlet, in every little airport, on every street corner.

And, by the same token, the services would be offered in this country. We cannot really—that is the ultimate goal of an open trade in services society.

There would be concern in these small, undeveloped countries that they not be so dominated that they could never get anything off the ground, and that is something we have to take into consideration. I share their concerns to some extent.

Mr. TAUZIN. I made a suggestion to them, and perhaps with your experience you could make comments as to whether it is feasible and whether it has worked in the past. Honduras, for example, has a terrible problem with health care. The life expectancy there is much lower than it ought to be simply because they are drinking the same water they are using for sanitary disposal. They have no treatment, in many cases.

It seemed to me that in terms of providing those services, medical services, and sanitary services, for example, that this country has made great strides in technology. Perhaps there could be some lowering of the barriers to those products which the country needs badly for its own people in return for such inventives as what the Caribbean Basin could provide.

Did you have that experience in your trade negotiations?

Mr. STRAUSS. Yes. I have not personally had that experience, but I have had experiences that would lead me to believe that there is validity in your statement. It does make some sense.

Specifically, in the area of trade in services, the benefits that a small, undeveloped country gets from a free flow of trade in insurance, for example, where they suffer great penalties and great disadvantages are numerous. If there were guarantees and more stability there, we could be a better customer to some of those countries and their products could come into this country more efficiently and less expensively.

Mr. TAUZIN. Thank you, Mr. Ambassador. Thank you for the time, Mr. Chairman.

Mr. FLORIO. Mr. Dowdy.

Mr. DOWDY. Mr. Ambassador, I have no questions. We are looking forward to having you in our home State this week before you go to Ditchley.

Mr. STRAUSS. I am looking forward to being there, I assure you. I will be there for a JJ dinner and we will denounce those Republicans that deserve everything I am sure we will discuss, Mr. Dowdy. I would not say that publicly here, of course.

Thank you very much, Mr. Chairman.

Mr. FLORIO. With that, I am pleased to recognize Mr. Ritter.

Mr. RITTER. Thank you very much, Mr. Chairman. I did not know the Ambassador had partisan feelings with all those kind things he was saying about this administration.

I would like to ask you whether the losses we might be taking in such feasibility studies, perhaps engineering feasibility studies, financing of major projects, insuring those projects in their construction stage, and just the general flow of information through various new networks that are developing in computer operations, on tele-

communications, what impact do you feel this is having on our trade in goods?

You mentioned one case where we did not compete for a $300 million project, but generically what is the level, what is the size of impact that this may be having on goods, and could it be that some of the rather precipitious decline we are seeing in our trade in goods is linked somehow to the fact that some of these other countries are developing sophisticated service industries and not allowing the United States in on it?

Mr. STRAUSS. Mr. Ritter, that is a good question. I would not want to make an outrageous statement in speculation. I can only say to you that there is no question in my mind that it is having significant adverse impact.

When you are competing with the Dutch and others around the world, whether it is in pipeline construction or any of these other fields, there is no question in my mind that we are failing to do the things that we should do if we are really going to be competitive. When you lose half a dozen significant jobs, big construction jobs, let's say, where everything from hand tools to the large equipment would come from this country, and you lose because of $15 million worth of feasibility studies it does not take very long before you are into billions of dollars of work in this country, which not only means corporate profits but, of equal or more importance today, it means jobs.

It means restored communities.

Mr. RITTER. A dozen such jobs are starting to arrive at the order of magnitude of the deficit in goods.

Mr. STRAUSS. Yes, there is no question, sir.

Mr. RITTER. I have another question. You stated that any demogogue who wants to stand on the floor of the House could really move along protectionist legislation. Are you afraid of this happening?

Mr. STRAUSS. Yes. I am concerned that it may happen. I had great support, as you know, from the Congress on a bipartisan basis, and I think we passed legislation in the House with only a loss of six or seven or eight votes. That is all. It was due to one simple thing.

We came up and we explained our position a one-on-one basis where necessary, on a State-by-State basis where necessary, on a constituency-by-constituency basis where necessary. We explained what we were doing and why. If we explain the need for enlightened trade legislation and explain it properly, the Congress is a wise body and they will act wisely.

It is when we do not do that, that we risk oversimplifying and blowing up these issues.

Lets take the Steel Caucus for example. They were harsh because the problems were harsh. They saw poverty and suffering and pain, but when you came up and discussed it in what hopefully was a wise and intelligent manner we got somewhat enlightened responses. They did not ignore the problems of the constituents, but they understood what had to be done. But they were not curing them with inflammatory legislation.

So I think yes, I am concerned, but not concerned as long as people come up here and you have hearings and people who understand the subject testify.

Mr. RITTER. What would you think would be impact of a major protectionist piece of legislation on the country, because you hear a lot that well, we are the United States of America. We still have the world's largest and richest market. When everybody else is shutting us out, why shouldn't we shut them out as well?

Mr. STRAUSS. Well, Mr. Congressman, you know, we are not Simon pure in this country. We are not without stain in our own conduct, so I think when we talk in terms of what these other nations are doing to us, they, of course, think in terms of what we are doing to them.

Just to be philosophical for another minute or two, it seems to me that basically what we need to do in this country is separate out into two sides.

One would be the area in which we are not competitive. There is a serious question as to our ability to compete in automobiles, for example. We have fallen behind seriously in the last 10 or 15 years. The same thing can be said for steel and other smokestack industries. There is a limit to what the American is willing to pay or should have to pay. Indeed, he or she feels that they can buy a more competitive product either for their business or for heavy industry or for personal use.

On the other hand, we take a field like services—high technology, agriculture—where we are clearly competitive and clearly efficient. In those areas we require a different kind of treatment. There we should see that those industries are not destroyed and those sectors are not destroyed by unfair trade practices, predatory practices, dumping and targeting and what have you.

I do not believe that our farmer should have his grain compete with a ton of flour that bears a $90 subsidy, if you will—$80 or $90 subsidy —coming out of the EC. He is competing, as I said earlier, with a government. So I think we need to separate out those areas where we really are as competitive and efficient as anybody in the world. And there we cannot let them destroy us.

There is however, a limit to how much protection we can give areas where we have just fallen behind because of our own foolishness, our own laziness, our own poor judgment, not because of trade practices. Now if they need a certain amount of protection in those areas, that would be a matter of degree again.

Those steel mills have to keep going and those automobile factories have to keep going, but you cannot over protect them. You cannot shut out and build walls. The price is too high and the retaliation would be too severe, and we still, keep in mind, must sell a tremendous amount of merchandise overseas or we are not going to be able to make it here.

What we need to be thinking about is increased trade with countries that do not have programs of austerity. Those countries which are running austerity programs do not have the money to purchase our goods.

What we really need in this country, I think, is for the President to take a real leadership in this area and really jawbone the heads of state in Europe and Japan and other places to see to it that we

come to grips with these problems. Together we could do something about growth in this nation.

I think we passed up a great opportunity now of preaching at Versailles. I hope that when we meet at Williamsburg that this Nation will go forward.

Mr. RITTER. Do you think our next President should be strongly oriented toward world trade?

Mr. STRAUSS. Do I think the next President, did you say?

Mr. RITTER. Whoever that President will be.

Mr. STRAUSS. I think any President of this country has to be strongly oriented toward world trade. I say that on a purely bipartisan basis, of course, and I do not think the President is negative in that area at all. I think he understands. He has always been for an open trade policy.

I think he missed an opportunity in Versailles and some of these places. If we have had a President in recent years who is able to jawbone, it is this one. He is pretty damn good, and I think the more he does and the sterner he gets, the more leadership he takes, the better I will like him personally.

Mr. RITTER. Thank you very much.

Mr. FLORIO. Mr. Strauss, may I just conclude on a point that you described very appropriately—the situation in the lesser developed countries as being very fluid, that some are more developed in some areas than others. I wonder if you would just venture a thought on whether GATT has become so diverse, with such differing conditions of development in the nations that may very well hamper their arriving at a consensus in areas such as services.

Mr. STRAUSS. It is very, very tough. There are those who think that ought to be done outside of GATT, but I do not. Inspite of the fact that their is a very negative world impression of what took place at the last GATT meeting in this area. The fact that they did focus on some of these subjects, in itself raised the level of interest, of concern, and that was worthwhile.

Mr. FLORIO. Mr. Ambassador, thank you very much. We appreciate your being with us today.

Mr. STRAUSS. Thank you very much. I thank each one of you for your courtesy, I appreciate it.

Mr. FLORIO. Thank you. Our next group of witnesses is comprised of panel 3, Mr. Ernest Sando, director of governmental relations of Flexi-Van Corp.; Mr. Ronald Shelp, vice president, international relations of American International Group; and Mr. Joseph McInerney, senior vice president of the Sheraton Corp.

Gentlemen, welcome to the committee. Your statements will be put into the record. I appreciate your going forward in a summary fashion. Mr. Sando.

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STATEMENTS OF ERNEST SANDO, DIRECTOR, GOVERNMENTAL RELATIONS, FLEXI-VAN CORP.; RONALD K. SHELP, VICE PRESIDENT, AMERICAN INTERNATIONAL GROUP; AND JOSEPH McINERNEY, ON BEHALF OF THE AMERICAN HOTEL & MOTEL ASSOCIATION

Mr. SANDO. Mr. Chairman, it is a privilege to appear before this subcommittee. My name is Ernest Sando, I am director of governmental relations for Flexi-Van Corp.

Mr. FLORIO. Mr. Sando, if you could perhaps move the microphone in a little bit.

Mr. SANDO. I am here today repesenting Mr. Lewis Rubin, Flexi-Van's president and chief executive officer who was unavoidably called out of the country on an important business matter. Flexi-Van is a New York Stock Exchange company engaged primarily in a transportation equipment leasing business throughout the world. Flexi-Van is here today as an active member of the Coalition of Service Industries, and as a representative of the leasing industry, an industry which in 1980 accounted for nearly 4 percent of the U.S. export services. That is one of the latest years available for any statistics on that figure.

Mr. Chairman, we were, of course, saddened by the jurisdictional inertia which last year stalled H.R. 5519, and we are hopeful that in your capable hands, the 98th Congress will move expeditiously to consider and enact a successor bill, H.R. 794.

Our company is before you today and has eagerly joined the Coalition of Service Industries, not so much to publish our parade of problems, the barriers we have to trade and various services, but to support our brethren in the service industries who, like we, foresee a world awakening to realities and economies of the service export business.

We have, over the years, witnessed a demise of the American manufacturing industries. While all of their problems cannot be said to be trade related, over the years lessons have been learned from observing the conduct of our international trading partners, many of whom have different concepts of fair play and fair competition. We want to be sure that a monitoring and disciplinary mechanism is set in place early on so that the large trade surplus we presently enjoy in services can be maintained unfettered by arbitrary or unfair foreign restrictions. H.R. 794 is a first step in that direction and must be enacted this year.

Mr. Chairman, the issues we have cited here today are but tremors, hardly discernible on the Richter scale but perhaps foreshadowing more violent trembles in the future. Flexi-Van presently enjoys a strong position in our major effort of leasing activity, but as other industrialized nations begin to direct their economies to the strong positions in the service industries you can bet a fullscale earthquake will erupt. When that day comes, and it will come soon, we need to be armed with the facts, figures, and legislative mandate to take such remedial action as will insure that the game is played honestly, fairly, and in a nondiscriminatory fashion.

H.R. 794 sets the framework for that preparedness. I strongly urge you and the members of this subcommittee to give this legislation your highest priority and personal support, lest the after-

shocks of unfair competition leave our burgeoning service industry with too little too late.

Thank you, Mr. Chairman.

[The statement of Flexi-Van Corp., follows:]

STATEMENT OF LEWIS RUBIN
PRESIDENT AND CHIEF EXECUTIVE OFFICER
FLEXI-VAN CORPORATION

BEFORE THE
SUBCOMMITTEE ON COMMERCE, TRANSPORTATION AND TOURISM
OF THE
HOUSE COMMITTEE ON ENERGY AND COMMERCE
MARCH 15, 1983

Mr. Chairman and distinguished members, it is a privilege to appear before this Subcommittee On Commerce, Transportation and Tourism. My name is Lewis Rubin and I am President and Chief Executive Officer of Flexi-Van Corporation, a New York Stock Exchange company engaged primarily in the transportation equipment leasing business throughout the world. I'm here today as an active member of the Coalition of Service Industries and as a representative of the leasing industry, an industry which in 1980 accounted for nearly four percent of U.S. exports of services.

It would be unconscionable of me to plunge headlong into my testimony today without first acknowledging the exceptional leadership and persistence which you and Mr. Dingell have displayed over the years in supporting and introducing legislation which addresses the crucial trade issues confronting the service sector today. Members of the industry have for three years now attempted to impress upon Congress the urgent need to enact a service industries development act, commencing with the grandfather of H.R.794 known as S.1233. We all, of course, were saddened by the jurisdictional inertia which last year stalled H.R.5519 and we are hopeful that in your capable hands, the 98th Congress will move expeditiously to consider and enact the successor bill, H.R.794.

The primary business of Flexi-Van Corporation is the leasing of containers, chassis and trailers. Our assets are nearly one billion dollars and our business is worldwide and is conducted in 253 locations, 173 of which are in foreign countries.

Flexi-Van's containers are used for the intermodal transportation of cargo on ocean-going trade routes and related overland transportation. "Intermodal" refers to the ability of the containers to be moved on and between vessels, trucks or rail terminals without the loading or unloading of their contents. Our chassis are designed to move containers between vessels and rail and truck terminals for overland transportation and our trailers are engaged in highway freight transportation.

Flexi-Van's international business is divided into four regions: the Far East; Latin America; Europe and North America. We have operations in some 45 different countries. On a worldwide basis Flexi-Van ranks as the second largest container lessor, the largest lessor of chassis and the second largest lessor of highway trailers. To give you some idea of what that means, if all of our containers were placed end to end from Washington D.C. northward, they would stretch all the way to Boston, Massachusetts and back again, or approximately 900 miles. If you added our 55,000 chassis units, a line west would stretch from Washington to Dallas, Texas.

Our company is before you today and has eagerly joined the Coalition of Service Industries not so much to publish our parade of horribles--the barriers we have faced to fair trade in

services--but to support our brethren in the service industries, who like we, foresee a world awakening to the realities and economies of the service export business. We have, over the years, witnessed the demise of American manufacturing industries. While all of their problems cannot be said to have been trade related, over the years lessons have been learned from observing the conduct of our international trading partners, many of whom have different concepts of fair play and free competition. We want to be sure that a monitoring and disciplinary mechanism is set in place early on, so that the large trade surplus we presently enjoy in services can be maintained unfettered by arbitrary or unfair foreign restrictions. H.R.794 is a first step in that direction and must be enacted this year.

Let me now briefly set forth a few examples of the "horribles" our company has experienced over the last few years in marketing its product overseas. The basic problems are readily divisible into three parts, access to markets, the influence of foreign governmental policy upon trade practices and discriminatory regulatory standards.

Acess To Foreign Markets

For several years now we have attempted to export our chassis rental business to most of the major trading countries. We have often met naked resistance to even initial entry in the form

of statutory or regulatory prohibitions against establishment. To do business in Italy, the Philippines, Argentina and Brazil, for example, we have been forced to enter into joint ventures with foreign nationals whereunder a controlling interest is relinquished to such nationals. In Japan the discrimination is a bit more subtle. In addition to an amazingly high import duty imposed upon foreign chassis, we have learned that the trucking and chassis industries are inexorably linked by governmental practice and policy so that a competitive chassis leasing enterprise will face a virtual boycott. On the other hand, our Japanese counterpart was allowed to actively and aggressively compete against Flexi-Van in U.S. markets.

Perhaps the most pernicious area of competitive and exclusionary foreign practices affecting our industry relates to customs regulations. An intermodal container is classified under our customs laws and international practice as an Instrument for International Traffic (IIT). An IIT is not considered to be a good since it enters a foreign country solely as a vehicle for the delivery of other goods which in turn are subject to that country's tariff regulations.

When a foreign container transporting goods arrives in the U.S., that container is permitted to stay in this country without duty until, for all intents and purposes, it is ready to be loaded with U.S. goods and transported elsewhere. If the container

is damaged or destroyed in an accident, it can either be turned into scrap and sold, forfeited to the U.S. Government or removed from the country. If sold for scrap, the U.S. duty is rather modest, only five percent of its depreciated value.

Furthermore, the U.S. permits those foreign containers to be utilized for the transportation of domestic goods in the process of delivering the container to a port of departure. In other words, if a French container comes into this country loaded with cheese destined for Newark, the shipper can reload that container with domestic goods for shipment from Newark to Baltimore, the port of the container's departure.

In Argentina, Brazil, Venezuela and other countries it's quite a different story. If the container is not removed from the country within 90 days, the government may physically take possession of the container and keep it. If it is damaged or destroyed in an accident and sold for scrap, the government will exact a prohibitive import tariff, in many cases approaching 300 percent of new value. If you choose to abandon the damaged container the foreign government will impose daily fines. Furthermore, few nations will ameliorate our non-revenue "deadhead" returns to port by allowing free loading of domestic goods for shipment to an international port. Thus our company cannot quote a competitive price to a shipper whose final destination is Brasilia, for example, since we cannot recover the cost of shipping an empty

container to, for example, Rio de Janeiro, where there is a ready export market for international shipping.

The leasing business is peculiar among other service industries in that it always involves a tangible good -- the item which is leased. As a result, there are aspects of the problems that Flexi-Van and other leasing companies face in carrying on their businesses overseas which may appear to be goods problems resolvable within the existing legal framework. This, for example, might be thought true of the problem of damaged containers described above. The fact of the matter is, however, that most of these "goods" problems are not adequately addressed by the present national and international trade regulatory framework -- else they wouldn't be problems at all. We feel that this state of affairs is largely the result of a lack of comprehensive information gathering about service industries, and this is what H.R.794 is designed to remedy.

The Influence of Foreign Government Policy Upon Trade Practices

We're beginning now to see our business affected by the creation of competitors in countries where the economy is manipulated by governmental policy. In Japan, for example, one of our larger competitors is owned by a conglomerate of 20-30 banks; the same conglomerate which owns most of the merchant vessels. Not

surprisingly, we have recently seen the preferential use of this competitor's containers on Japanese freighters.

The bankruptcy laws of some countries provide another example. Under our Chapter 11 proceedings, a container or equipment lessor can under most circumstances upon default of a customer recover goods leased to the bankrupt provided that a proper petition is filed with the bankruptcy court. Such is not the case in these foreign countries, where when a company declares bankruptcy Flexi-Van is sometimes asked to pay an inordinate redemption fee in order to recover its own property.

Regulatory Standards

Here again, the American service trader's efforts are limited in many countries of the world by the imposition of arbitrary standards for size, technical specifications and safety. In particular, the trailer standards in some countries are so onerous as to force us to confine our business basically to the U.S. and Canada.

But even in Canada, we are forced by regulation to pay different tribute in different provinces. In Quebec, we must appear before a separate licensing board in order to lease chassis and trailers in that province, and risk binding our operations to such arbitrary conditions as, for example, manning requirements established to promote the employment of Canadians.

Mr. Chairman, the examples which I have cited here today are but tremors, hardly discernable on the Richter Scale but perhaps foreshadowing more violent rumblings in the future. Flexi-Van presently enjoys a very strong market position in our three major areas of leasing activity, but as other industrialized nations begin to direct their economies to the establishment of strong market positions in the service industries, you can bet a full scale earthquake will erupt. When that day comes, and it will come soon, we need to be armed with the facts, figures and legislative mandate to take such remedial action as will ensure that the game is played honestly, fairly and in a non-discriminatory fashion. H.R. 794 sets the framework for that preparedness.

I strongly urge you and the members of this subcommittee to give this legislation your highest priority and personal support lest the aftershocks of unfair competition leave our burgeoning service industry with too little too late. Thank you Mr. Chairman.

Mr. FLORIO. Thank you. Mr. Shelp.

TESTIMONY OF RONALD K. SHELP

Mr. SHELP. Thank you, Mr. Chairman. The company I am with, American International Group, is a large, multinational insurance company operating around the world. Needless to say, I concur with most of the comments that have been made by my colleagues in the service industry, since we are also active in most of the trade associations that have spoken today. What I would like to do, therefore, is to make one or two general comments, but then do as I understand you would like me to do, which is address some of the specific problems we have. They are not problems we have abroad; they are problems we have in Washington that can be addressed here.

First, a couple of general comments. We probably have beaten to death this morning the idea that your legislation sends a signal. However, it is a truism. I have been in Europe three times since the GATT ministerial, and a message that I hear constantly from both the public and the private sector is the United States is worn out, especially on the subject of services. After what happened in Geneva, they do not really expect us to be pushing very hard anymore.

The second general comment concerns the data question which your bill tries to do something about. I do not think this can be

underemphasized, and I would like to give you two examples. First at the international level. I think you know when you go to the Bureau of Labor Statistics in the Department of Commerce to get data on trade, there are several thousand categories of data on trade in goods. There are six basic categories of data on trade in services.

Then at the domestic level, especially when you look at wage levels. This is an important question because many people argue that wage levels are less in service economy and that is why a service economy is undesirable. Although 70 percent of Americans work in services, only 30 percent of the firms employing those Americans are surveyed when data is gathered on wages in the economy.

So what you are trying to do is very important and yet, there is a tendency to cut budgets. As you know, we are probably the only industry around, that is, the service industry, who is asking for government to increase its spending and to gather more data instead of less. We do not understand how you can make policy decisions on the economy or how you can address international trade problems and negotiate if you do not have data.

But enough about that. Let me turn to one or two specific instances that I have in mind concerning our problems at home. There has been a lot said about barriers abroad, and I agree. I have testified and others have testified on this almost ad nauseum. As Mr. Feketekuty mentioned earlier, USTR has some 200 computerized pages with some 2,000 restrictions listing the barriers abroad. But I frankly do not think enough attention has been given to what can be done today, instead of years from now after protracted international negotiations. What we need to do is start by putting services on an equal footing at home with goods and commodities in our domestic trade policy.

Most service industries have been excluded from these programs. Let me use insurance as an example—and it is a good example because people tend to see insurance as something that is incidental—almost accidental to the commercial trading transaction. But I hope you will view my using insurance as more of a metaphor of the general problem regarding services and our trade policy. A metaphor demonstrating how services continue to be treated as second class citizens.

Let me start with the Export-Import Bank. As has already been mentioned this morning, the bank does little for services. I think this is especially true for what some call support services such as insurance, which relate to trade. Regarding insurance, we conducted an exhaustive review of the procurement policies of the Export-Import Bank to determine if there were opportunities for insurers to acquire insurance business transactions financed by the bank.

We found there are not any guidelines at all for the placement of insurance. As a result, U.S. insurers never have the ability to compete for business, even though it is generated by tax dollars. There are hundreds of examples I could give you. Let me give you one.

A couple of years ago, Exim financed a $350 million loan to Sonatrach, which is Algeria's oil and gas monopoly. In that country, insurance is nationalized. Because there is not a procurement policy at the Export-Import Bank, the insurance company auto-

matically went to the State insurance program of Algeria. Because of the state insurance company's low capitalization its practices and its cultural linkages to France, ultimately that insurance business was reinsured or spread to the French insurance market and to other European insurors.

Our estimate is that the premiums lost to U.S. insurors on this project alone approximate something like between $4 and $10 million. It happens again and again. I could give you a lot of other examples that are not like Algeria but are free market economies where because of the absence of an Eximbank procurement policy on insurance; that is, Exim has not established rules on competitive bidding for insurance, other counties automatically make sure the insurance ends up in their market.

We have approached Exim on this for about 10 years. Members of Congress in both the Senate and the House have written and spoken to them on the problem again and again. The response we usually get is the following: that by allowing American insurors to compete for sales generated by U.S. tax dollars, these sales might be lost. It is a logic, frankly, we do not understand. We only can conclude that the Export-Import Bank has decided to discriminate against the U.S. insurance industry in its trading transactions.

The American Institute of Marine Underwriters, a trade association, has estimated the lost premium to insurors because of these practices at $100 million. What is most irritating about this is that the other Exims of the world, their counterparts, follow a contrary practice. They not only aggressively seek to secure the insurance on transactions they finance, but many go further. They require the insurance to be placed in their markets. This is something we have never sought, although perhaps we should. We have only asked again and again for a bank procurement policy requiring competitive bidding on insurance to give Americans an opportunity.

A second example that has been in the news a lot lately concerns the Department of Agriculture and the highly publicized deal with the Egyptian Government for the shipment of 150 million metric tons of wheat flour to overcome the commodity subsidization problems from the European Community. As you know, this has been in the news because it has become a contentious diplomatic issue.

It has also been in the news because the administration determined the arrangement to be a concessional sale, thus subject to U.S. cargo preference laws. As a result, shipping costs were substantially increased. What has not made the press are the substantial insurance arrangements associated with these shipments. Our own investigation—and it is quite difficult to obtain the information, I admit—uncovered the basic following facts on the shipment.

When the U.S. Government, through the grain trading companies in this country, arranged this shipment of subsidized grain, the shipment went out C&F, which means cost and freight, and, therefore, left the handling of the insurance to the Egyptians. U.S. insurors never had an opportunity to bid for the business. We estimate on this sale alone, the lost premium was $400,000.

Moreover, our experience suggests that we could not only have competed for the business, but probably at a cheaper rate; $400,000

sounds insignificant, but it happens again and again, and think of all the concessional agricultural deals.

One that did become a major trade dispute a few years ago was the grain purchases by the Soviet Union from the United States. Again, because of absence of a procurement policy, the Soviet Union made sure all the insurance on those sales was handled in the Soviet State insurance company. The point is that there is not, to the best of our knowledge, a procurement policy in the Department of Agriculture to give this particular service industry an opportunity to compete.

The third example,—and I will not go into details because the same principle applies—is in the agency for international development. There has been a GAO study about this that not only talks about insurance but talks in general about the failure of the AID program to try, whenever practical, to assure that U.S. goods, commodities and services are used in programs resulting from foreign assistance.

Once again, there is not a procurement policy to give American insurors the chance to compete, and as a result, there are lost sales.

The final kind of problem I would like to mention is a different kind of problem, but I still think it relates to what you were trying to address, Mr. Chairman. That is the other issue that is in the news a lot today, the DISC, the Domestic International Sales Corporation. As you know, because of a GATT dispute over DISC, the administration is developing an alternative export tax incentive to DISC. The current DISC discriminates against services because only two services are eligible for DISC benefits. It mainly benefits exporters of manufactured goods.

One would have hoped, and we have urged, that the new initiative that has now been unveiled would have corrected this longstanding deficiency and put service exporters on an equal footing with goods exporters. Apparently, it does not. The great majority of service exporters will be continued to be denied the DISC tax incentives.

To sum up, I have given you examples of four different Government agencies which have caused my industry, and I think others, problems. Rather than try to negotiate with each agency, which could take forever, or try to pass legislation to correct these inequities, I would hope the tone that your bill sets would sensitize all these agencies.

We have that under the Department of Commerce leadership's, with the kinds of problems we are talking about and with the pressure of Congress, there situation will to be corrected. If that occurs, I think your bill would accomplish a great objective. It would mean not only that the major contribution that services make to American exports will continue, but that I suspect that with proper policies, it could be increased many times.

Thank you, Mr. Chairman.

[Mr. Shelp's prepared statement follows:]

TESTIMONY

by

RONALD K. SHELP
VICE PRESIDENT
AMERICAN INTERNATIONAL GROUP

I am Ronald K. Shelp, Vice President of American International Group. I welcome the opportunity to appear before this Committee this morning.

Much has been said about the emergence of service industries in the United States economy. Moreover, much has been said about their potential to continue to grow and diversify to meet changing demands and opportunities. Their contribution to our exports in recent years have drawn special attention. We cannot assume, however, that U.S. service industries will simply maintain a competitive advantage in world markets. The increased interest of our major trading partners in recent years in promoting and protecting their service industries is now well documented.

An advertisement that appeared in our national magazines recently accurately depicted how many other nations see the potential for services. The lead - "We're rich in the resource international service companies need most." The answer - "People." The place - "Republic of Ireland - The intelligent location in Europe for International Services." The appeal - "an attractive incentive package especially designed to meet the needs of international services companies; companies where personnel is the key factor."

This and other countries are clearly out to persuade our service industries to relocate and to establish themselves as service industry centers.

Their success can be documented with firm data. In recent years the U.S. share of world trade in invisibles has dropped one-fifth - from 25 to 20 percent.

Competition will undoubtedly be more sophisticated and fierce. If U.S. Service Industries are to continue to move forward and capture appropriate market share in services trade and investment, they must be supported by effective economic and commercial policies. Moreover, we feel that because services have been ignored for so long and are so important to the future growth of the U.S. economy, that separate legislation for services--in the realm of the legislation we are commenting on today--is what is needed to assure their continued success both politically at the negotiating table and commercially in markets throughout the world. Separate services trade legislation - passed by the Congress and signed by the President - will send a strong signal to our trading partners that we are serious about services. This is especially important in today's climate because so many of our allies believe that the U.S. interest in services will wane now that the GATT Ministerial is over. This has been conveyed to me repeatedly in recent trips abroad.

So we support, in principle, the objectives of H.R.794. We praise Congressman Florio and this Committee for their interest and foresight in drafting the Service Industries Commerce Development Act of 1983.

So while agreeing with the general terms of this excellent legislation, let me first explain the one or two concerns we have about it.

We appreciate the significant amount of language in the bill calling for more comprehensive service industry data collection and analysis. This is essential for the development of appropriate policy. Nevertheless, if some of these provisions were implemented, it is our belief that they might well serve

to inhibit service industry progress rather than promote their interests. For example, requiring information on portfolio investments of U.S. institutions abroad--and under the threat of the penalty of the law as well--violates the spirit of cooperation between business and government which is so necessary at this time in developing effective policy. Moreover, the information resulting from these demands might well be an invitation to our trading partners to increase rather than reduce restrictions to service industries operating in their markets.

Having expressed those concerns and stressed our support for the principle elements outlined in the rest of this legislation, I would like to devote the remainder of this statement to a discussion of the kinds of problems we face.

Much has been said about the existing and threatened barriers we confront overseas. They have been well documented in various places and the United States Trade Representative has a list of some 2,000 such restrictions. Further, considerable progress has been made under this Administration's outstanding leadership in beginning the long, painful process towards establishing international rules governing services in GATT.

But not enough attention has been paid to what can be done at home - today, instead of years from now after protracted international negotiations. We can begin at home by putting services on an equal footing with goods in our export efforts. With the Chairman's permission that is what I would like to focus on today.

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We welcome the language in the bills that calls for reviewing service-related trade issues and problems with the intention of improving the competitiveness of U.S. service industries. But to achieve these important objectives, we feel that there should be language in the bill calling for a careful review of all government export promotion and export finance programs, U.S.- aid programs, and government goods and commodity sales programs. This would be for the expressed purpose of identifying opportunities for including services in these programs.

To date, most service industries have been excluded from such programs. This is particularly true for insurance which unfortunately must continue to deal with the traditional preception that it is simply incidental to the commercial transaction. To demonstrate this point, I would like to provide examples of how several government programs whose mandate is to either directly or indirectly increase U.S. exports ignore insurance as a product deserving attention in their policies and operations. I hope you will view these examples as a metaphor of the generic problem regarding services - a metaphor demonstrating how they continue to be treated as second class citizens.

I. EXPORT-IMPORT - Eximbank is a well-known U.S. export promotion facility. Nevertheless, Eximbank does little for services. This is especially true of what some refer to as support services - services inherent to the trading process. Regarding insurance, we conducted an exhaustive review of the procurement policies of the Export-Import Bank to determine if there would be opportunities for insurers to acquire insurance business resulting from Eximbank financial sales or projects. What we have

determined is that there are no meaningful guidelines for the placement of insurance business. As a result, many--if not most--client countries of Eximbank invoke restrictive business practices to force the placement of this significant amount of business in their local markets with national insurers. As a result, U.S. insurers never even have the opportunity to compete for this business even though it is generated by U.S. tax dollars.

For example:

a. Algeria - Several years ago, Eximbank initially approved a $313.5 million loan to Sonatrach--Algeria's oil and gas monopoly--to finance the construction of a large liquified gas plant at Arjew.

In Algeria, however, the insurance industry is nationalized. There are no private sector insurance companies operating in Algeria and by law, all the insurance business on this project, financed by U.S. tax dollars, would have to be purchased from the Algerian state insurance company. This business, however, will not be retained in Algeria, because this state company--like similar companies in many other developing countries-- is minimally capitalized. The national company simply obtains the premium and reinsures most of the business to major European reinsurance centers while collecting substantial commissions for their part of the transaction.

Because of the colonial history of Algeria and the strong cultural ties that remain with the French through language and education,

commercial links have been maintained as well. As a result, much of the reinsurance business would likely be placed in the French reinsurance market. In effect, the eventual recipients of U.S. tax dollars are the Algerians, the French and other European reinsurers. We estimate that the premiums lost to U.S. insurers on this project alone would have been approximately $4-10 million.

But this situation occurs as well in free market economies that do not have the overt restrictive practices encountered in Algeria. Most countries recognize the foreign exchange earning opportunities offered by insurance. So, in the absence of an Export-Import Bank policy encouraging competitive opportunities for U.S. insurers, they quite naturally seek to secure the insurance on EX-IM financed transactions.

We have repeatedly approached Eximbank officials - for over ten years - about this situation and we have received no satisfaction. Numerous members of Congress have written and spoken about this practice and they have received no satisfaction. We are told by the by the bank that allowing American insurers to compete on sales generated by U.S. tax dollars might cost export sales. It is a logic we don't understand. We can only conclude EX-IM has decided to discriminate against the U.S. insurance industry. The American Institute of Marine Underwriters has estimated the lost premium to U.S. insurers because of these practices at $100 million.

What is most perplexing about EX-IM's attitude is that many of its

counterparts - other EX-IM's - follow a contrary practice. They aggressively seek to procure the insurance on transactions they finance for the benefit of their insurance industries. Many go a step further. They require the insurance to be placed in their markets. This is something we have never sought - although perhaps we should. We have only asked again and again for a Bank procurement policy requiring competitive bidding on insurance.

II. U.S. DEPARTMENT OF AGRICULTURE - Several weeks ago, the U.S. Government negotiated a highly publicized deal with the Egyptian government on the shipment of one million metric tons of wheat flour. The clear intention of this sale was to convince the European Community we are serious about responding to its subsidies of agricultural exports. The arrangement continues to be scrutinized in the press for several reasons. For one thing, it has become a contentious diplomatic issue. A complaint has been filed by the European Community in GATT. Secondly, the Administration determined the arrangement to be a concessional sale and thus subject to U.S. cargo preference laws. As a result, shipping costs were doubled.

What has not made the press are the substantial insurance arrangements associated with these shipments. Our own investigation - and it should be noted how difficult it is to obtain this information -- uncovered the following details. After the U.S. negotiated the tonnage and price with the Egyptian authorities, the U.S. Government put out bids to millers to purchase grain at a reduced price from U.S. stockpiles. After purchase the millers process the wheat to flour and sell it to the Egyptian government with a maximum price per ton already determined. The first shipment

of 70,000 tons went out in early February. According to U.S. Department of Agriculture officials, the shipment went C and F which is Cost and Freight -- meaning the insurance was handled by the Egyptians. U.S. insurers never even had an opportunity to bid for the business. We estimate the lost insurance sales at approximately $400,000. Moreover, our experience suggests that the insurance will now cost twice what it would have cost if a U.S. insurer wrote the business.

Perhaps $400,000 sounds insignificant. But think of all the other agricultural export deals. Remember the sales to the Soviet Union where again the insurance was controlled by the Soviets. Over a period of years U.S. insurers have probably been denied millions of dollars of premium income.

Again, as a U.S. insurer, we would not want preferential treatment. We simply want the right to compete for this business. We were denied that right to the best of our knowledge in the Egyptian instance, which however unique, is not unusual when it comes to Agriculture Department insurance practices. To the best of our knowledge the Agriculture Department does not have a clear cut procurement policy when it comes to insurance - a firm policy intended to give American insurers the opportunity to competively bid on exports, especially concessional sales it makes overseas.

III. AGENCY FOR INTERNATIONAL DEVELOPMENT - Although the primary purpose of AID is the provision of economic and management assistance, the Foreign Assistance Act of 1961 as amended states, "AID is requested to ensure

that assistance shall, whenever practicable, be constituted of U.S. commodities and services furnished in a manner consistent with other efforts of the U.S. to improve its balance of payments postion." Nevertheless, it is the conclusion of a GAO study conducted in 1980 on AID administration that the present AID procurement policy is that countries it assists should undertake the implementation of their development assistance programs. AID policy in general is, therefore, one of preferring that the procurement of AID-financed project goods and services required to implement bilateral project agreements be undertaken by the host country rather than by AID--to the extent AID has determined that the country has the capacity to do so.

An assessment of this policy done by the Auditor General of AIG suggested the following. First, this policy had an adverse impact on project implementation. Second, AID missions were not making adequate assessments of the host country's ability to select, award, and administer contracts with local and foreign firms. Third, host countries generally lacked implementation management, technical resources, and plans for support of projects.

As a result of this policy, U.S. insurers confront the same situation in attempting to procure AID business in these markets as they do with Eximbank. Recipient countries simply invoke restrictive legislation and market practices that preclude U.S. insurers from even competing for AID procurement business - even though the business is generated by U.S. tax dollars.

Besides not adhering to what we believe to be the intent of the language in the Foreign Assistance Act of 1961, it is simply ineffective management. U.S. insurers have the capability to insure these projects and they most likely would provide more comprehensive coverage at lower rates.

Countries regularly receiving AID funding while precluding U.S. insurers from competing for AID procurement business include India, Pakistan, and Algeria, among many others.

IV. DISC (Domestic International Sales Corporation) - Permit me to cite one different kind of example that bears on our export promotion efforts. As you know, because of a GATT dispute over DISC, the Administration is developing an alternative export tax incentive to DISC. The current DISC discriminates against services by allowing only two services DISC benefits. One would have hoped the new initiative would have corrected this long standing deficiency and put service exporters on an equal footing with goods exporters. Apparently, it does not. The great majority of service exporters will continue to be denied DISC tax incentives.

V. DATA - H.R.794 makes a number of references to improving data collection on service industries activities. We think this is extremely important and we also feel that a significant amount of work needs to continue in this area.

The government does not have a coordinated, internally consistent system for gathering, processing and publishing international U.S. service

industry data. There is no policy that spells out the use of the international U.S. service industry data that are collected beyond their own use for Balance of Payments measurement purposes and even the Balance of Payments data may be understating the full dimension of U.S. service trade. Such data that are available do not identify sectoral trends on global, regional or bilateral bases so as to facilitate specific analysis of salient issues such as the reason for loss of market to competitors. Further, there is no current requirement for coordination among the different federal government data collecting agencies. There has been no requirement that the information be collected on the same time schedule.

Compare this situation to the data collected on international trade in goods. There are thousands of categories of data by product: there are six categories for services.

We believe that the service trade data collection effort must be improved to ensure that current and future federal government initiatives have sound bases.

Some of this work necessary has been undertaken by the Commerce Department in conjunction with the U.S. Trade Representative and State Department. But recommendations for improving data must be approved by the Office of Management and Budget. And this is a time of budget reductions. We believe it will prove extremely shortsighted to fail to allocate there resources necessary to develop data collection on services, our area of fastest export growth, comparable to that we have

long had for goods and commodities. How can we possibly expect to foster this sector - and to prepare to negotiate away barriers confronting our various service industries--when we lack the most fundamental data on the trade flows of these industries? Yet we hear that this may happen. The very few proposals for improving data that have been suggested to OMB may not be approved for budget our reasons.

CONCLUSION

Once again, Mr. Chairman, we praise your initiative in introducing this important piece of legislation. We hope the kinds of problems I have outlined will give you food for thought on how your bill and other legislation is necesary to enhance the export of American services. They already make a major positive contribution to our balance of payments. The kinds of policies we have suggested will enable U.S. service exports to increase this contribution manyfold.

Mr. FLORIO. Thank you. Mr. McInerney.

STATEMENT OF JOSEPH McINERNEY

Mr. McINERNEY. Thank you, Mr. Chairman. I am here today on behalf of the American Hotel & Motel Association, and I applaud your efforts to address the specific needs of service industries in H.R. 794. From the perspective of the lodging industry, I would like to summarize our comments on two aspects of our concern.

First, there are barriers to operating in certain foreign markets, and second, with regard to the need to develop policies of strengthening the export competitiveness of the U.S. service industries. In discussing barriers to doing business in foreign countries, I have used specific examples in our written statement. As such, these are relative to the Sheraton Corp.

The Sheraton Corp. is a worldwide system of hotels numbering 450 properties in 52 countries around the world. The majority of our properties are in the United States with 350 hotels, and 85,000 hotel rooms. That does, however, leave us 100 properties in 51 countries, other than the United States.

Keeping in mind that certain actions of foreign governments are precipitated by that country's need to maintain a stable currency, on occasion this premise is used to create obstacles for U.S. companies. I have provided examples in the following areas.

Expatriate compensation, import restrictions, insurance coverage, travel allowances, remittance of funds, foreign currency bank accounts, access to local currency credit. I would like to mention that one positive side of doing business in certain foreign countries is the support the government is providing for promoting tourism.

For the lodging industry to survive, hopefully to thrive, it must rely on the business or pleasure traveler.

Sheraton currently spends $40 million annually around the world for advertising and promotion of international travel. These expenditures are spent proportionately to promote our hotels in the United States and other destinations in many countries other than the United States.

Sheraton Hotel's efforts to boost tourism has very healthy support from national government expenditures. In fact, in 20 countries where we do business, the governments give more financial support to attract tourism than this country. And this brings me to the second part of my statement regarding export competitiveness.

The U.S. tourism industry receives much of its export earnings from foreign visitors to the United States.

These domestic tourism services to foreign travelers are a source of revenue that is a major contribution to our balance of payments. In 1981, 23 million foreign visitors to the United States spent $12.2 billion. In the same year, the United States ranked 56th worldwide on a per capita basis in promotional spending. It is obvious that the potential is great while U.S. efforts to tap the potential are meager at best.

The U.S. share of world tourism receipts declined from 13 percent in 1976 to 10.6 percent in 1982. Coincidentally paralleling the downward trend in funding for the U.S. Travel and Tourism Administration. In addition, the U.S. Government is responsible for creating travel trade barriers. No. 1 among these is the antiquated requirement for visas.

We are all familiar with the unemployment issue in the United States. The tourism industry is a large employer of unskilled and semiskilled workers. The industry employs directly or in support jobs, 7 million Americans. The increase in international tourism to the United States could possibly help this problem.

And finally, there are many changes which could come about through education. We will one day greet our foreign visitors with open arms rather than long customs lines. When we reach this level of appreciation of a multibillion-dollar industry the United States will be integrating tourism policy into overall foreign trade policy. This will allow tourism businesses such as the lodging industry to compete with U.S. Government backing for foreign dollars, both at home and abroad. The competition will greatly enhance by arming the United States and its productive of industries with the necessary data base. Not only will this prepare U.S. companies for what they are up against or what they can expect overseas, but will also help us to prepare for foreign visitors to the United States.

I am particularly pleased to see the emphasis on data gathering and analysis in H.R. 794.

Finally, Mr. Chairman, we congratulate you for opening these discussions on service industries development. The introduction of H.R. 794 provides the focus essential to reviewing the needs and concerns of service industries so that the U.S. businesses, and thus, the U.S. economy, can realize the full potential of this growth industry. Thank you.

[Mr. McInerney's prepared statement follows:]

Statement of Joseph McInerney
Senior Vice President of The Sheraton Corporation
on Behalf of the
American Hotel & Motel Association

Mr. Chairman, my name is Joseph McInerney and I am Senior Vice President of The Sheraton Corporation and President of its franchise division. I am here today on behalf of the American Hotel & Motel Association. For background, I should also mention that I serve on the Commerce Department's Industry Sector Advisory Committee on Services (ISAC-13) and as Chairman of ISAC's Tourism Subcommittee.

Mr. Chairman, I applaud your efforts to address the specific needs of service industries in H.R. 794. From the perspective of the lodging industry I would like to comment on two aspects of our concerns. First, there are the barriers to operating in certain foreign markets which are generally similar to those encountered by others in the services sector. Second, with regard to the need to "develop policies to strengthen the export competitiveness of United States service industries"... there are a number of concerns unique to tourism.

I. Barriers to Doing Business in Foreign Nations

In discussing barriers to doing business in foreign countries, I will try to use some specific examples and, as such, these will be relative to The Sheraton Corporation. Sheraton has a worldwide system of hotels, currently numbering 450 hotels and inns in 52 countries. The majority of our properties are located in the United States--350 hotels with 85,000 rooms. That does, however, leave us with 100 properties in 51 countries other than the U.S.

Keeping in mind that certain actions of foreign governments are precipitated by that country's need to maintain a stable currency, on occasion this premise is used to create obstacles for U.S. companies.

Expatriate Compensation

Sheraton is frequently constrained by regulations limiting the ability to compensate expatriate personnel in non-local currency. For example:

--Iraq, where Sheraton operates the Basra Sheraton and the Bagdad Sheraton, had required that thirty (30) percent of an expatriate's compensation be denominated in Iraqi dinars. This proportion was subsequently increased to 50 percent and is now being raised to 60 percent.

--As part of the exchange control regulations implemented in Mexico during the fall of 1982, compensation to personnel in Mexico could only be rendered in Mexican pesos.

Such regulations impair the ability of expatriate personnel to service obligations in their country of origin (mortgages, family maintenance, etc.) and inhibit the willingness of expatriates to assume or continue foreign assignments.

Import Restrictions

Imports of items essential for hotel operation can be banned, subjected to quotas, prior authorization by regulatory authorities, or licenses. Often, in countries having such barriers, an advance deposit scheme is implemented to discourage importations or to increase hard currency available to the government. For example:

--In April 1982, Nigeria introduced an advance deposit system, requiring deposits of 25 to 250 percent on importation of goods. Sheraton has six management contracts signed for hotel operations in Nigeria with advanced negotiations on numerous other opportunities. Several of these properties are under construction and will be severely impacted by these restrictions.

--The Syrian Arab Republic has banned importation of all items considered "luxury", included in the definition being air-conditioning units. Deposit requirements are in force for other importations allowed.

--Italy has imposed temporary advance deposit schemes on payments abroad, requiring 30 percent of the amount be posted in a non-interest bearing account for ninety days. This requirement was lifted in 1982, but illustrates the impact on construction costs and refurbishment on hotels like the Rome Sheraton.

--Importation of automobiles, necessary for transport of guests or operation of the hotel, is restricted or severely limited in many countries were Sheraton operates. The Dominican Republic, Barbados, and numerous other nations have restrictive practices.

Insurance Coverage

Many countries prohibit insuring risks outside the country in which the risk is situated. Coverage from admitted carriers may be more expensive, contain more restrictive conditions, and will provide that payment of claims be made in local currency. For example:

--Mexico prohibits non-admitted insurance. Given seismic conditions, earthquake insurance covering potential loss at the Maria Isabel Sheraton is prudent. Earthquake coverage, available in Mexico, is limited and more expensive than coverage which could be purchased for the risk in the United States on a non-admitted basis.

Travel Allowances

Regulations are often implemented regarding exchange allocations for travel for business and/or tourism purposes. Such limitations may restrict the duration of stay or frequency of travel for a guest booking at hotels or impact the ability of hotel management to attend seminars, conferences, or undertake sales and promotional trips on behalf of the hotel. Sheraton has operations in many countries--for example, Italy, Syria, Jamaica, Guatemala, where such regulations are in place.

Remitabililty of Funds

Franchise Operations

Franchisees in the Dominican Republic and the Republic of South Korea experience long delays in receiving appropriate government approvals to remit any portion of franchise and reservation system fees to Sheraton Headquarters. Delays of six months and more result from onerous bureaucratic regulations and procedures; foreign exchange reserves doled out by the Central Bank are scarce.

Franchisees in Mexico are limited by Central Bank regulation and free market availability of foreign exchange to meet overseas obligations.

No tacit local government recognition nor preference status, re: access to foreign exchange and permission to remit is accorded these properties specifically, or the hospitality/ tourism industry in general, even though hotels and other touristic enterprises are major sources of foreign exchange for the respective governments.

Owned/Leased Operations

Portugal, Turkey and Egypt have labyrinthian systems in effect to govern the flow of foreign currency into and out of the country. We experience delays of up to two years in receiving permits from the Central Bank of Portugal to remit earnings from the Lisbon Sheraton Hotel (1980 earnings may be granted access to foreign exchange reserves and repatriation permits in 1983).

Turkey's Central Bank is two years in arrears on our requests for access to foreign exchange and permission to remit Istanbul Sheraton Hotel earnings. Substantial amounts of Sheraton fee earnings from eight properties managed in Egypt languish in Cairo awaiting permission to remit from the Central Bank.

Foreign Currency Bank Accounts

Many countries prohibit resident and non-resident owned foreign currency denominated bank accounts in local banks and overseas foreign banks. This fact is resulting in an increasingly negative impact on Sheraton's relationships with valued purveyors of goods and services. Permission to retain

some portion of the foreign exchange our hotels generate for the Central Bank coffers in such environments and permission to open U.S. dollar checking accounts in U.S. banks to settle purveyor accounts would improve our vendor relations and perhaps generate more foreign currency revenues for the countries involved. For example, a significant portion of Sheraton's overseas business is booked by U.S. travel agents and airlines. By industry practice, commissions on these reservations are paid in U.S. dollars by check drawn on the bank account of the respective hotel receiving the booking. When the travel agent receives its commission check payable in U.S. dollars drawn on a foreign bank, the check is presented to the agent's local bank for "collection" and deposit. Under international banking protocol, the local bank, for a fee, sends the check under a collection cover letter to the hotel's bank requesting U.S. dollars be returned when and if available for deposit in the travel agent's account. Actual elapsed time from presentation for collection until deposit of dollars in agent's account may be two weeks to four months or more. An example: Boston Travel Agent books a reservation for one night for a client at the Istanbul Sheraton Hotel. The room rate is US$75.00. When the guest departs the hotel, the hotel sends a commission check for US$7.50 drawn on Turkish Bank to the travel agent who presents it to Boston Bank for collection and deposit to agent's account. Boston Bank sends the check to Turkish bank under a collection letter and ten weeks later receives US$5.00 for deposit to travel agent's account (US$2.50 service charge deducted). Boston Bank has already charged Travel Agent's account $8.50 for the collection service fee. Hence, Travel Agent's net

commission is a $3.50 loss. If the Istanbul Hotel could retain two percent of the foreign currency it earns but must sell to the Central Bank, and open a checking account in the U.S. only to be used for travel agent commission checks, the travel agents would book more tourists and business people in Turkey, the hotel would enjoy more business and the government would receive more foreign currency.

Access to Local Currency Credit

In Brazil and other countries, majority foreign owned entities do not have equal access to local credit sources. This impacts operations and more importantly, expansion opportunities, which may generate substantial benefit to the economy.

Specific examples of countries making it hard or impossible for U.S. firms to export to them:

1. Brazil - All private sector imports must be registered with the Bank of Brazil for the purpose of obtaining import permits. An extensive "suspended imports list" is maintained. Import permits are not issued for items on this list. The Brazilian government may control prices of imports to protect a local industry. Decree Law 1427 of March 29, 1977, established an import ban on automobiles, pleasure craft, toys, some perfumeries, luxury foodstuffs, and gifts. Subsidiaries of foreign firms are required to purchase raw materials and components locally. Purchases of foreign currency to pay for imports and import services are subject to a 25 percent tax. Brazil sets high rates on import duties to discourage imports, charges a three percent port tax and a tax equal to 20 percent of ocean charges, and also charges a Value Added Tax on imports

which are also subject to a 14 percent provincial VAT. Financing requirements are also written to discourage imports.

2. Mexico - Mexico requires that permits be obtained for imports, and permits are not granted if locally produced goods can be substituted, even at a price 15 to 20 percent higher. Prohibitive duty rates are often set on importable goods which compete with Mexican-made products.

3. Argentina - Argentina has issued frequent revisions of import and currency control regulations over the last year. Argentina prohibits imports of automobiles, alcoholic beverages, clothing, color televisions, meat, fish and cigarettes. All foreign exchange to pay for imports must come from the Central Bank.

4. Chile - In Chile, an import permit is needed from the Central Bank for all imports valued over $3,000. Most imports are charged a 10 percent duty. All imports are charged a 20 percent VAT, and some imports are charged a 20 percent "additional" tax and a tax on services is also levied.

Throughout Latin America, many restrictions limit the import of clothing, appliances and other consumer items.

I would like to mention one positive side to doing business in certain foreign countries is the support the government's provide in promoting tourism. For the lodging industry to survive, hopefully to thrive, it must rely on the business or pleasure traveler. Sheraton currently spends $40 million annually around the world for advertising and promotion of international travel; these expenditures are spent proportion-

ately to promote our hotels in the U.S. and in other destinations. In many countries, other than the U.S., Sheraton hotels' efforts to boost tourism have very healthy support from national government expenditures. In fact, in 20 countries where we do business, the governments give more financial support to attract tourism than this country.

II. Strengthening Export Competitiveness

This brings me to the second part of my statement regarding "export competitiveness." The U.S. tourism industry receives much of its export earnings from foreign visitors to the United States. These domestic tourism services to foreign travelers are a source of revenue that is a major contribution to our balance of payments. In 1981, 23 million foreign visitors to the U.S. spent $12.2 billion. In this same year the U.S. ranked 56th worldwide, on a per capita basis, in promotional spending. It's obvious that the potential is great while U.S. efforts to tap the potential are meager at best. The U.S. share of world tourism receipts declined from 13 percent in 1976 to 10.6 percent in 1982--"coincidentally" paralleling the downward trend in funding the U.S. Travel & Tourism Administration.

In addition, the U.S. government is responsible for certain travel trade barriers. Number one among these is the antiquated requirement for visas. We strongly urge that the visa requirements be reviewed and a visa waiver program be implemented. Preferably a program that would eliminate this barrier for a number of countries as proposed by the Administration in the 97th Congress; but at a minimum the trial plan which is included in the Immigration Reform and Control Act.

We are all familiar with the unemployment issue in this country. The Tourism Industry is a large employer of unskilled and semi-skilled workers. The industry employs directly or in support jobs 7.0 million Americans. The increase in International tourism to the U.S. could possibly help this problem.

Finally, there are many changes which would come about through education. We view a number of countries around the world as tourism-based economies. We are just beginning to recognize that the U.S. is primarily a services-based economy. Someday we will perhaps acknowledge the importance of tourism as a service industry. What will follow, hopefully, will be such things as better currency acceptance and exchange facilities in this country and more multilingual facilities and capabilities. We will one day greet our foreign visitors with open arms rather than a Customs line.

When we reach this level of appreciation of a multi-billion dollar industry, the U.S. will be integrating tourism policy into overall foreign trade policy. This will allow tourism businesses such as the lodging industry to compete, with U.S. government backing, for foreign dollars both at home and abroad.

The competition will be greatly enhanced by arming the U.S. and its productive industries with the necessary data base. Not only will this prepare U.S. companies for what they are up against, or what they can expect overseas, but also help us to prepare for foreign visitors to the U.S. I am particularly pleased to see the emphasis on data gathering and analysis in H.R. 794.

Finally, Mr. Chairman, we congratulate you for opening these discussions on service industries development. The introduction of H.R. 794 provides the focus essential to reviewing the needs and concerns of service industries so that U.S. businesses, and thus the U.S. economy, can realize the full potential of this growth industry.

Attachments: (1) Selected Impediments to Trade in Services Domestic Analytical Report
(2) Recommendations for Policy Priorities From The Tourism Sub-Committee of the Industry Sector Advisory Committee on Service (ISAC-13)

SELECTED IMPEDIMENTS TO TRADE IN SERVICES
DOMESTIC ANALYTICAL REPORT
REPORT BY ACTION WITHIN INDUSTRY
REVISION 6

INDUSTRY	COUNTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY DETAIL
HOTEL & MOTEL	AFRICA	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY FEES	EXCHANGE CONTROLS OVER THE REMITTANCES OF CURRENT EARNINGS FROM FRANCHISE ROYALTIES OR MANAGEMENT FEES. DELAYS ARE ENCOUNTERED IN OBTAINING GOVERNMENTAL AUTHORIZATION AND FUNDS HAVE BEEN PARTIALLY OR WHOLLY BLOCKED FOR PERIODS OF SEVERAL YEARS. WHEN A FOREIGN GOVERNMENT CENTRAL BANK CONSIDERS ITS CURRENCY RESERVES FALLING BELOW MINIMUM REQUIREMENTS
HOTEL & MOTEL	ARGENTINA	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	
HOTEL & MOTEL	ARGENTINA	PERSONNEL RESTRICTIONS REGARDING DOMESTIC PERSONNEL	WHEN THE NEED TO RELEASE SURPLUS EMPLOYEES ARISES, SEVERANCE AND TERMINATION BENEFITS ARE OFTEN UNREASONABLE AND IN MANY INSTANCES CANNOT BE ACCRUED OR DEDUCTED FOR TAX PURPOSES	
HOTEL & MOTEL	ARGENTINA	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY INTEREST ON LOANS FROM PARENT COMPANY	
HOTEL & MOTEL	ARGENTINA	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE TO REPATRIATE PROFITS	

SELECTED IMPEDIMENTS TO TRADE IN SERVICES
DOMESTIC ANALYTICAL REPORT
REPORT BY ACTION WITHIN INDUSTRY
REVISION 6

INDUSTRY	COUNTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY DETAIL
HOTEL & MOTEL	ARGENTINA	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY FOR TECHNICAL SERVICE AND MANAGEMENT FEES	
HOTEL & MOTEL	ARGENTINA	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	TAXES ON DIVIDENDS, TECHNICAL SERVICE AND MANAGEMENT FEES AND INTEREST PAYMENTS TO PARENT COMPANY THAT ARE OFTEN UNREASONABLY HIGH AND SOMETIMES CONFISCATORY	
HOTEL & MOTEL	BANGLEDESH	DISCRIMINATORY TARIFFS AND CUSTOMS PROCEDURES	RESTRICTION ON IMPORTATION OR ACCESS TO EQUIPMENT NEEDED IN THE OPERATION OF A SERVICE ENTERPRISE	FOREIGN FRANCHISES ENCOUNTER NUMEROUS ADMINISTRATIVE DELAYS ON IMPORTING NEEDED SUPPLIES FOR HOTEL OPERATION WHICH APPEAR DESIGNED TO DISCOURAGE SUCH IMPORTS IN FAVOR OF LOCAL PRODUCTS
HOTEL & MOTEL	BRAZIL	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	
HOTEL & MOTEL	BRAZIL	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY INTEREST ON LOANS FROM PARENT COMPANY	
HOTEL & MOTEL	BRAZIL	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE TO REPATRIATE PROFITS	
HOTEL & MOTEL	BRAZIL	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY FOR TECHNICAL SERVICE AND MANAGEMENT FEES	

INDUSTRY	COUNTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY DETAIL
HOTEL & MOTEL	BRAZIL	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	TAXES ON DIVIDENDS, TECHNICAL SERVICE AND MANAGEMENT FEES AND INTEREST PAYMENTS TO PARENT COMPANY THAT ARE OFTEN UNREASONABLY HIGH AND SOMETIMES CONFISCATORY	
HOTEL & MOTEL	CENTRAL AMERICA	DISCRIMINATORY TARIFFS AND CUSTOMS PROCEDURES	RESTRICTIONS ON IMPORTATION OR ACCESS TO EQUIPMENT NEEDED IN THE OPERATION OF A SERVICE ENTERPRISE	SOME COUNTRIES RECOGNIZE IMPORTANCE OF DEVELOPING HOTEL FACILITIES BY PERMITTING THE IMPORTATION OF NECESSARY FIXTURES, FURNITURE AND EQUIPMENT ON A "SINGLE TIME" BASIS. HOWEVER, EVEN HERE, ADMINISTRATIVE DELAYS ARE OFTEN ENCOUNTERED IN PROVIDING THE NECESSARY EXCHANGE AND IMPORT LICENSE TO THE APPLICANT. THE LIBERAL IMPORT POLICY DOES NOT EXTEND TO REPLACEMENT EQUIPMENT AND REPAIR PARTS.
HOTEL & MOTEL	CENTRAL AMERICA	DISCRIMINATORY TARIFFS AND CUSTOMS PROCEDURES	RESTRICTIONS ON IMPORTATION OR ACCESS TO EQUIPMENT NEEDED IN THE OPERATIONS OF A SERVICE ENTERPRISE	LICENSING AND EXCHANGE CONTROLS OVER IMPORTATIONS EFFECTIVELY PROHIBIT THE ENTRY OF HOTEL MATERIALS SUCH AS ROOM FURNISHINGS, CARPETS, OR FINISHED DRAPERIES. LOCAL MANUFACTURERS INSTEAD ARE REQUIRED TO BE THE SUPPLIERS OF SUCH GOODS EVEN THOUGH THE ARTICLES ARE CONSIDERABLY BELOW THE STANDARDS OF QUALITY UNDERSTOOD TO BE NORMALLY ACCEPTABLE

INDUSTRY	COUNTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY DETAIL
HOTEL & MOTEL	CENTRAL AMERICA	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS		EXCHANGE RESTRICTIONS ON CURRENCY REMITTANCES ARE REPORTED TROUBLESOME IN MANY COUNTRIES
HOTEL & MOTEL	CHILE	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	
HOTEL & MOTEL	CHILE	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY INTEREST ON LOANS FROM PARENT COMPANY	
HOTEL & MOTEL	CHILE	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE TO REPATRIATE PROFITS	
HOTEL & MOTEL	CHILE	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY FOR TECHNICAL SERVICE AND MANAGEMENT FEES	
HOTEL & MOTEL	CHILE	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	TAXES ON DIVIDENDS, TECHNICAL SERVICE AND MANAGEMENT FEES AND INTEREST PAYMENTS TO PARENT COMPANY THAT ARE OFTEN UNREASONABLY HIGH AND SOMETIMES CONFISCATORY	
HOTEL & MOTEL	FRANCE	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	

INDUSTRY	COUNTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY DETAIL
HOTEL & MOTEL	INDIA	DISCRIMINATORY TARIFFS AND CUSTOMS PROCEDURES	RESTRICTION ON IMPORTATION OR ACCESS TO EQUIPMENT NEEDED IN THE OPERATION OF A SERVICE ENTERPRISE	FOREIGN FRANCHISES ENCOUNTER NUMEROUS ADMINISTRATIVE DELAYS ON IMPORTING NEEDED SUPPLIES FOR HOTEL OPERATION WHICH APPEAR DESIGNED TO DISCOURAGE SUCH IMPORTS IN FAVOR OF LOCAL PRODUCTS
HOTEL & MOTEL	KOREA	QUANTITATIVE OR QUALITATIVE RESTRICTIONS ON SERVICE COMPANY OPERATIONS	REQUIREMENTS THAT SPECIAL GOVERNMENT CLEARANCE TO OPERATE BE OBTAINED BY FOREIGN SERVICE FIRMS	IT IS NECESSARY TO OBTAIN THE APPROVAL OF THE ECONOMIC PLANNING BOARD FOR TECHNICAL ASSISTANCE ACTIVITIES - A LENGTHY PROCESS.
HOTEL & MOTEL	MEXICO	QUANTITATIVE OR QUALITATIVE RESTRICTIONS ON SERVICE COMPANY OPERATIONS	LIMITATION ON FOREIGN EQUITY IN A SERVICE FIRM	LAW REQUIRES RESORT DEVELOPMENT COMPANIES TO BE 51% OWNED BY NATIONALS, THOUGH THIS CAN BE WAIVED WHERE LOCAL CAPITAL IS NOT AVAILABLE. PROPERTY RIGHTS IN CERTAIN AREAS CAN ONLY BE OBTAINED BY FOREIGN NATIONALS THROUGH THE MEDIUM OF A 30 YEAR TRUST AGREEMENT, NEGOTIATED THROUGH AN ARRANGEMENT. FOREIGN INVESTORS DO NOT EXERCISE FULL OWNERSHIP RIGHTS BUT INSTEAD *RECEIVE BENEFICIARY* RIGHTS FOR 30 YEARS, ALTHOUGH THEY CAN RETAIN FUTURE PROFITS OR TRANSFER THEIR LAND INTERESTS, AS PROVIDED IN THE TRUST AGREEMENT
HOTEL & MOTEL	MEXICO	DISCRIMINATORY TAXATION	CEILINGS ON PRICES OR *CHARGES FOR SERVICES*	HOTEL RATES ARE SOMETIMES *FIXED BY GOVERNMENT* AGENCIES RESULTING IN UNREALISTIC RATES

INDUSTRY	COUNTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY DETAIL
HOTEL & MOTEL	MEXICO	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	
HOTEL & MOTEL	MEXICO	PERSONNEL RESTRICTIONS REGARDING DOMESTIC PERSONNEL	RESTRICTIONS PREVENTING THE TERMINATING OF SURPLUS OR NON-PRODUCTIVE EMPLOYEES	
HOTEL & MOTEL	MEXICO	PERSONNEL RESTRICTIONS REGARDING FOREIGN PERSONNEL	WORK PERMITS FOR FOREIGN EMPLOYEES ARE DIFFICULT TO OBTAIN, EXTEND OR RENEW.	
HOTEL & MOTEL	MIDDLE EAST	DISCRIMINATORY TAXATION	LACK OF DEFINITIVE LAWS OR TAX RULINGS WHICH MAKE IT DIFFICULT TO DO TAX PLANNING	
HOTEL & MOTEL	MIDDLE EAST	PERSONNEL RESTRICTIONS REGARDING FOREIGN PERSONNEL		IMMIGRATION RESTRICTIONS MAKE IT DIFFICULT OR IMPOSSIBLE TO OBTAIN REQUIRED EXPERTISE AND MANAGEMENT SKILLS NOT AVAILABLE IN FOREIGN COUNTRY.
HOTEL & MOTEL	NETHERLANDS	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	
HOTEL & MOTEL	PAKISTAN	DISCRIMINATORY TARIFFS AND CUSTOMS PROCEDURES	RESTRICTION ON IMPORTATION OR ACCESS TO EQUIPMENT NEEDED IN THE OPERATION OF A SERVICE ENTERPRISE	FOREIGN FRANCHISES ENCOUNTER NUMEROUS ADMINISTRATIVE DELAYS ON IMPORTING NEEDED SUPPLIES FOR HOTEL OPERATION WHICH APPEAR DESIGNED TO DISCOURAGE SUCH IMPORTS IN FAVOR OF LOCAL PRODUCTS

INDUSTRY	COUNTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY DETAIL
HOTEL & MOTEL	PERU	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	
HOTEL & MOTEL	PERU	PERSONNEL RESTRICTIONS REGARDING DOMESTIC PERSONNEL	RESTRICTIONS PREVENTING THE TERMINATING OF SURPLUS OR NON-PRODUCTIVE EMPLOYEES	
HOTEL & MOTEL	PERU	PERSONNEL RESTRICTIONS REGARDING DOMESTIC PERSONNEL	WHEN THE NEED TO RELEASE SURPLUS EMPLOYEES ARISES, SEVERANCE AND TERMINATION BENEFITS ARE OFTEN UNREASONABLE AND IN MANY INSTANCES CANNOT BE ACCRUED OR DEDUCTED FOR TAX PURPOSES	
HOTEL & MOTEL	PERU	PERSONNEL RESTRICTIONS REGARDING FOREIGN PERSONNEL	WORK PERMITS FOR FOREIGN EMPLOYEES ARE DIFFICULT TO OBTAIN, EXTEND OR RENEW.	
HOTEL & MOTEL	PERU	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY INTEREST ON LOANS FROM PARENT COMPANY	
HOTEL & MOTEL	PERU	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE TO REPATRIATE PROFITS	
HOTEL & MOTEL	PERU	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY FOR TECHNICAL SERVICE AND MANAGEMENT FEES	

INDUSTRY	COUNTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY DETAIL
HOTEL & MOTEL	PERU	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	TAXES ON DIVIDENDS, TECHNICAL SERVICE AND MANAGEMENT FEES AND INTEREST PAYMENTS TO PARENT COMPANY THAT ARE OFTEN UNREASONABLY HIGH AND SOMETIMES CONFISCATORY	
HOTEL & MOTEL	PORTUGAL	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	
HOTEL & MOTEL	PORTUGAL	PERSONNEL RESTRICTIONS REGARDING DOMESTIC PERSONNEL	RESTRICTIONS PREVENTING THE TERMINATING OF SURPLUS OR NON-PRODUCTIVE EMPLOYEES	
HOTEL & MOTEL	PORTUGAL	PERSONNEL RESTRICTIONS REGARDING FOREIGN PERSONNEL	WORK PERMITS FOR FOREIGN EMPLOYEES ARE DIFFICULT TO OBTAIN, EXTEND OR RENEW.	
HOTEL & MOTEL	PORTUGAL	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY FEES	EXCHANGE CONTROLS PREVENT ADVERTISING FREELY IN INTERNATIONAL MARKETS
HOTEL & MOTEL	PORTUGAL	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	PROCEDURAL DELAYS IN OBTAINING FOREIGN EXCHANGE NEEDED TO PAY FOR GOODS IMPORTED TO COUNTRY FROM ABROAD	
HOTEL & MOTEL	PUERTO RICO	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	

INDUSTRY	COUNTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY DETAIL
HOTEL & MOTEL	SOUTH AFRICA	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	
HOTEL & MOTEL	SOUTH AMERICA	DISCRIMINATORY TARIFFS AND CUSTOMS PROCEDURES	RESTRICTIONS ON IMPORTATION OR ACCESS TO EQUIPMENT NEEDED IN THE OPERATION OF A SERVICE ENTERPRISE	SOME COUNTRIES RECOGNIZE IMPORTANCE OF DEVELOPING HOTEL FACILITIES BY PERMITTING THE IMPORTATION OF NECESSARY FIXTURES, FURNITURE AND EQUIPMENT ON A "SINGLE TIME" BASIS. HOWEVER, EVEN HERE, ADMINISTRATIVE DELAYS ARE OFTEN ENCOUNTERED IN PROVIDING THE NECESSARY EXCHANGE AND IMPORT LICENSE TO THE APPLICANT. THE LIBERAL IMPORT POLICY DOES NOT EXTEND TO REPLACEMENT EQUIPMENT AND REPAIR PARTS.
HOTEL & MOTEL	SOUTH AMERICA	DISCRIMINATORY TARIFFS AND CUSTOMS PROCEDURES	RESTRICTIONS ON IMPORTATION OR ACCESS TO EQUIPMENT NEEDED IN THE OPERATIONS OF A SERVICE ENTERPRISE	LICENSING AND EXCHANGE CONTROLS OVER IMPORTATIONS EFFECTIVELY PROHIBIT THE ENTRY OF HOTEL MATERIALS SUCH AS ROOM FURNISHINGS, CARPETS, OR FINISHED DRAPERIES. LOCAL MANUFACTURERS INSTEAD ARE REQUIRED TO BE THE SUPPLIERS OF SUCH GOODS EVEN THOUGH THE ARTICLES ARE CONSIDERABLY BELOW THE STANDARDS OF QUALITY UNDERSTOOD TO BE NORMALLY ACCEPTABLE
HOTEL & MOTEL	SOUTH AMERICA	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS		EXCHANGE RESTRICTIONS ON CURRENCY REMITTANCES ARE REPORTED TROUBLESOME IN MANY COUNTRIES

INDUSTRY	COUNTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY DETAIL
HOTEL & MOTEL	SOUTHEAST ASIA	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	RESTRICTIONS UPON ACCESS TO FOREIGN EXCHANGE NEEDED TO REPATRIATE PROFITS	THERE ARE MANY PROBLEMS RELATING TO THE DIFFICULTIES OF REMITTING PROFITS OF FOREIGN FIRMS
HOTEL & MOTEL	SPAIN	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	
HOTEL & MOTEL	SPAIN	PERSONNEL RESTRICTIONS REGARDING DOMESTIC PERSONNEL	WHEN THE NEED TO RELEASE SURPLUS EMPLOYEES ARISES, SEVERANCE AND TERMINATION BENEFITS ARE OFTEN UNREASONABLE AND IN MANY INSTANCES CANNOT BE ACCRUED OR DEDUCTED FOR TAX PURPOSES	
HOTEL & MOTEL	SPAIN	PERSONNEL RESTRICTIONS REGARDING FOREIGN PERSONNEL	WORK PERMITS FOR FOREIGN EMPLOYEES ARE DIFFICULT TO OBTAIN, EXTEND OR RENEW.	
HOTEL & MOTEL	SRI LANKA	DISCRIMINATORY TARIFFS AND CUSTOMS PROCEDURES	RESTRICTION ON IMPORTATION OR ACCESS TO EQUIPMENT NEEDED IN THE OPERATION OF A SERVICE ENTERPRISE	FOREIGN FRANCHISES ENCOUNTER NUMEROUS ADMINISTRATIVE DELAYS ON IMPORTING NEEDED SUPPLIES FOR HOTEL OPERATION WHICH APPEAR DESIGNED TO DISCOURAGE SUCH IMPORTS IN FAVOR OF LOCAL PRODUCTS
HOTEL & MOTEL	ST. CROIX	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	
HOTEL & MOTEL	SWITZERLAND	PERSONNEL RESTRICTIONS REGARDING FOREIGN PERSONNEL	WORK PERMITS FOR FOREIGN EMPLOYEES ARE DIFFICULT TO OBTAIN, EXTEND OR RENEW.	

INDUSTRY	COUNTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY DETAIL
HOTEL & MOTEL	TAIWAN	QUANTITATIVE OR QUALITATIVE RESTRICTIONS ON SERVICE COMPANY OPERATIONS	REQUIREMENTS THAT SPECIAL GOVERNMENT CLEARANCE TO OPERATE BE OBTAINED BY FOREIGN SERVICE FIRMS	ON A PROSPECTIVE FRANCHISE AGREEMENT, APPLICATION FOR TECHNICAL COOPERATION MUST BE SUBMITTED AND APPROVED. TRADEMARK LICENSES REQUIRE GOVERNMENT APPROVAL, ALTHOUGH USUALLY RECEIVED IN CONNECTION WITH APPLICATION FOR TECHNICAL COOPERATION.
HOTEL & MOTEL	TAIWAN	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	PROCEDURAL DELAYS IN OBTAINING FOREIGN EXCHANGE NEEDED TO REPATRIATE PROFITS	REMITTANCES ARE COVERED BY AN APPLICATION FOR TECHNICAL COOPERATION
HOTEL & MOTEL	TRINIDAD	QUANTITATIVE OR QUALITATIVE RESTRICTIONS ON SERVICE COMPANY OPERATIONS	LIMITATIONS ON FOREIGN EQUITY IN A SERVICE FIRM	FOREIGN INVESTMENT CONTROLS LIMITING PERCENTAGE OF LOCAL COMPANY THAT CAN BE OWNED BY FOREIGNERS
HOTEL & MOTEL	TURKEY	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	PROCEDURAL DELAYS IN OBTAINING FOREIGN EXCHANGE NEEDED TO REPATRIATE PROFITS	AN EXTRAORDINARY AMOUNT OF TIME (1-2 YEARS) IS NECESSARY IN ORDER TO REPATRIATE PROFITS
HOTEL & MOTEL	TURKEY	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY FEES	EXCHANGE CONTROLS PREVENT ADVERTISING FREELY IN INTERNATIONAL MARKETS
HOTEL & MOTEL	TURKEY	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	PROCEDURAL DELAYS IN OBTAINING FOREIGN EXCHANGE NEEDED TO PAY FOR GOODS IMPORTED TO COUNTRY FROM ABROAD	
HOTEL & MOTEL	UNITED KINGDOM	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	

SELECTED IMPEDIMENTS TO TRADE IN SERVICES
DOMESTIC ANALYTICAL REPORT
REPORT BY ACTION WITHIN INDUSTRY
REVISION 6

INDUSTRY	COUNTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY DETAIL
HOTEL & MOTEL	UNITED KINGDOM	PERSONNEL RESTRICTIONS REGARDING FOREIGN PERSONNEL	WORK PERMITS FOR FOREIGN EMPLOYEES ARE DIFFICULT TO OBTAIN, EXTEND OR RENEW.	
HOTEL & MOTEL	VENEZUELA	QUANTITATIVE OR QUALITATIVE RESTRICTIONS ON SERVICE COMPANY OPERATIONS	LIMITATIONS ON FOREIGN EQUITY IN A SERVICE FIRM	FOREIGN INVESTMENT CONTROLS LIMITING PERCENTAGE OF LOCAL COMPANY THAT CAN BE OWNED BY FOREIGNERS
HOTEL & MOTEL	VENEZUELA	DISCRIMINATORY TAXATION	EXPENSES SUCH AS HOME OFFICE OVERHEAD AND DIRECT COSTS OF PROVIDING SERVICE ARE OFTEN NOT DEDUCTIBLE EXPENSES FOR FOREIGN TAX PURPOSES	
HOTEL & MOTEL	VENEZUELA	PERSONNEL RESTRICTIONS REGARDING DOMESTIC PERSONNEL	WHEN THE NEED TO RELEASE SURPLUS EMPLOYEES ARISES, SEVERANCE AND TERMINATION BENEFITS ARE OFTEN UNREASONABLE AND IN MANY INSTANCES CANNOT BE ACCRUED OR DEDUCTED FOR TAX PURPOSES	
HOTEL & MOTEL	VENEZUELA	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY INTEREST ON LOANS FROM PARENT COMPANY	
HOTEL & MOTEL	VENEZUELA	DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY FOR TECHNICAL SERVICE AND MANAGEMENT FEES	
HOTEL & MOTEL		DISCRIMINATORY FOREIGN EXCHANGE RESTRICTIONS	EXCHANGE CONTROLS ON ACCESS TO FOREIGN EXCHANGE NEEDED TO PAY FOR GOODS IMPORTED TO COUNTRY FROM ABROAD	

RECOMMENDATIONS FOR POLICY PRIORITIES

FROM

THE TOURISM SUB-COMMITTEE

OF THE

INDUSTRY SECTOR ADVISORY COMMITTEE ON SERVICE (ISAC-13)

I. SYNOPSIS

The United States should incorporate tourism policy more effectively into its overall foreign trade policy.

The Tourism industry is a major force in our economic growth and development. It is the third largest industry in the United States and our fourth largest export industry.

Domestic Tourism services to foreign travelers are viewed as export earnings. In order to effectively increase these export earnings and our market share of international visitors we must increase our effective promotion of tourism to the United States and reduce disincentives and barriers. We must work to:

- Increase funding of the United States Travel and Tourism Administration
- Change visa restrictions
- Refrain from placing disincentives on the Tourism Industry
- Encourage and simplify the acceptance of foreign currencies
- Remove International Reservations barriers
- Integrate Tourism into United States Foreign Trade Policy

The Tourism industry is a large employer of unskilled and semiskilled workers. The industry employs directly or in support jobs 7 million Americans. There are over 30 major industrial components which are beneficiaries of the United States trade and international tourism.

More effective integration of tourism into foreign trade policy will assist in tapping the potential of international travel to the United States from individual democracies and provide a vehicle to assist underdeveloped countries to strengthen their economic stability.

II. PURPOSE

The working Sub-Committee on Tourism was formed by the Industry Sector Advisory Committee on Services (ISAC-13) to advise United States foreign trade policy officials on methods to reduce international trade barriers and domestic disincentives to tourism; and to increase effective promotion of tourism [1] to the United States.

III. SUMMARY

The United States should incorporate tourism policy more effectively into its overall foreign policy as a prerequisite for tapping the enormous remaining potential of international travel to the United States from the industrial democracies. It should also work with the underdeveloped countries to assist them in creating tourism as a vehicle to strengthen their economic stability, especially in areas of the world where the economic and political stability of the region is vital to the welfare and security of the Western Hemisphere.

IV. PRIORITIES

The four major U.S. disincentives to services operating abroad--taxation, the Foreign Corrupt Practices Act, antiboycott legislation, and antitrust practices, are addressed in a proposed paper being prepared by ISAC-13 for consideration by the Executive Branch and apply across the board to the tourism industry.

Domestic Tourism services to foreign travelers are viewed as export earnings. In order to effectively increase these export earnings and our market share of international visitors, we must increase our effective promotion of tourism to the United States and reduce disincentives and barriers. We must work to:

- Increase funding of the United States Travel and Tourism Administration
- Change visa restrictions
- Refrain from placing disincentives on the Tourism Industry
- Encourage and simplify the acceptance of foreign currencies
- Remove International Reservations barriers
- Integrate Tourism into United States Foreign Trade Policy

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[1] A detailed definition of tourism as used in this paper is found on page 8.

United States Travel & Tourism Administration

The National Tourism Policy Act decrees that the Federal government's involvement in tourism be better coordinated. This is a major positive step for a stronger and more comprehensive Domestic Tourism Program. The upgrading of the position to an Under-Secretary of Commerce responsible for the Travel & Tourism Administration with an interagency Tourism Policy Council at his disposal is a more influential position. This is providing tourism with a greater voice in integrating tourism priorities into government policy decisions.

Unfortunately, the anticipated budget cuts will be detrimental to their overall efficiency and effectiveness. In order for the Travel and Tourism Administration to become an effective force, additional funding needs to be appropriated.

Visa Waiver

We must simplify the procedure for obtaining temporary travel permits for persons visiting this country from other countries, to the extent possible and practical.

Under present law, all foreign nationals (except Canadians, Bahamians and British citizens resident in Bermuda, the Cayman Islands and the Turks and Caicos Islands) must obtain a visitor visa in order to enter the United States.

Each potential visitor deterred by existing visa requirements from traveling to the United States represents a loss of more than $650 in U.S. foreign exchange earnings (transportation fares excluded). This is very important in light of the New Orleans Worlds Fair in 1984, the 25th Anniversary Celebration planned by Alaska, and the 1984 Olympics.

Most Western European countries eliminated visa requirements for American and other tourists in the post World War II era. Furthermore, the overwhelming majority of applicants for admission to the United States from Western Europe qualify for entry.

In a number of countries, the volume of visa applications is so large that significant backlogs build up, and there are long delays in processing applications. This creates inconvenience, and, in some cases, undue hardship to the applicant. Too often, the result has been negative publicity for the United States as well as frustration and ill will on the part of the potential visitor. Ill will is especially unfortunate inasmuch as a large number of applicants for U.S. visitor visas are our relatives, our friends, and our business associates.

Refrain from placing disincentives on the Tourism Industry

The following disincentives would be detrimental to tourism.

- The proposed Customs Department cut backs in agents
- The proposed closing of Customs operations at airports on Sundays
- The proposed entry tax
- The placing of restrictions on the deduction of ordinary and necessary business expenses incurred in travel and business promotion. The business meal expense is not only a legitimate and necessary expense of doing business but it also adds to the employment rolls. It is our understanding that this legislation, which was defeated in 1978, will be proposed again during this session of Congress.

Currency Acceptance

We must encourage and simplify the acceptance of foreign currencies by all those providing goods and services to international travelers. Visitors from other countries encounter difficulties in converting foreign currency to United States dollars. Industries such as banks, hotels and other tourist related businesses should be made aware that they are losing business if they do not offer currency exchange facilities.

International Reservations Barriers

Access to international reservation systems is a key element in the competitiveness of U.S. tourism services. In recent years, a number of national reservation systems have favored national service suppliers over foreign suppliers.

For example, denial of access in international air reservation systems is a significant non-tariff barrier which hinders the ability of U.S. carriers to compete with national carriers. With the growing importance of international information flows to the tourism industry, denial of such access poses a significant competitive disadvantage affecting all elements of the tourism industry.

Integrate Tourism Policy into Overall Foreign Trade Policy - The Caribbean and China Examples

The United States needs to incorporate tourism policy more effectively into its overall foreign trade policy. There is much promising evidence of the economic contribution that tourism can make to the economic development and progress of developing countries. The main economic effects of tourism are:

- contribution to balance of payments, particularly to invisible earnings,

- contribution to regional economic development, receipts to grow at a steady rate unlike the wild fluctuations of raw material prices and earnings, and
- employment creation (direct and, particularly indirect).

The Caribbean Basin Initiative illustrates, better than any other single current example, the potential beneficial effects of foreign trade policy on tourism trends. This strategically important foreign trade policy program also illustrates a national propensity to ignore tourism as foreign trade policy.

Tourism is a major industry for most of the Caribbean islands, the major industry of many, and has the greatest immediate expansion potential as an economic engine for the region. One-fifth of the Caribbean tourism economy is American, and rapid development of the entire region is considered to be a priority for national security reasons. Nevertheless, tourism was ignored in the major policy studies leading up to the announcement of a Caribbean Basin Initiative and has been excluded from mention as an important industry sector in the Initiative.

However, Congress inserted tourism into the CBI legislation and has presented an opportunity for the USTTA, in cooperation with the principal agencies on the Caribbean Policy Task Force, to evaluate proposals from industry. Among these, for example, are a common market for tourism to include the United States' territories of Puerto Rico and the Virgin Islands, a Caribbean regional marketing program in which the United States cooperates with its other Caribbean partners to bring more Europeans, Canadians, Latin Americans, Asians, as well as Americans to the area, and bilateral and multi-lateral tourism development assistance programs. A significant step forward would be recognition in public by U.S. policy authorities that the development of tourism is important to the Caribbean Basin Initiative.

U.S.-China tourism relations, in contrast, are a model of effective foreign trade policy. The Shanghai communique of 1972 declared that: "The effort to reduce tensions is served by efforts to improve communications between countries that have different ideologies so as to lessen the risks of confrontation through accident, miscalculation, or misunderstanding." A well-orchestrated succession of consular, civil air, and trade agreements in the last decade launched an American business and pleasure travel boom in China. The question facing foreign policy authorities and industry alike at this time is how to develop a stable tourism infrastructure which can ride out the inevitable fluctuations and political atmospherics between the United States and the Peoples Republic of China. Government and private tourism talks may soon lead to the creation of a bilateral tourism commission on the government level and a

bilateral tourism committee on the commerical level, thus forming a bridge between the centrally planned economy of China and the decentralized market economy of the United States.

The Caribbean and China, as every other international example, illustrates the benefit of viewing the world from a national foreign trade policy perspective in which the tourism industry and government cooperate in formulating and implementing the national interest. This perspective suggests that Federal policy-makers look at tourism in its large sense - conscious of the foreign trade policy value of the American foreign tourism network and American travelers abroad, and the relation of these assets to the huge untapped economic potential of attracting more foreign tourists to the United States.

V. ECONOMIC BENEFIT

The current recession would be far more severe were it not for the persistent growth of service businesses. Less well known is the degree to which trade in services - from international licensing agreements to tourism - is butressing the nation's overall trade position. In 1970, U.S. exports of goods and services exceeded such imports by some $5.6 billion. Last year, early estimates place the comparable surplus at roughly $12 billion. This health picture changes without services. A goods-only surplus of $2.6 billion in 1970 turns into a goods-only deficit of some $27.8 billion in 1981.

According to the Congressional Travel & Tourism Caucus, Travel and Tourism is:

- Forecasted to be the world's largest industry by the year 2000
- Largest private employer in 14 states
- First, second, or third largest private employer in 38 states
- Third largest industry in the U.S.
- Fourth largest export industry in the U.S.

Travel and Tourism in the U.S. generates:

- $35 billion in wages and salaries
- $15.5 billion in federal, state and local tax revenues
- $180 billion in domestic spending, 6% of the gross national product
- $10 billion in receipts from foreign visitors in the U.S.

Employs:

- 4.7 million Americans directly
- 2.3 million more Americans in supporting jobs
- women, youth and minority work forces and offers a large number of entry-level opportunities

Represents:

- one million business establishments directly involved in tourism
- the small business - 99% of all travel-related companies are classified as small businesses
- GROWTH - Receipts from foreign travelers to the U.S. grew more than 270% between 1970 and 1979, while the GNP for the same period was up only 141%

International travel to the United States in 1981:

- accounted for total international arrivals of 23.0 million and receipts of more than $14 billion, both record levels.
- surpassed American travel abroad for the first time.
- (excluding international transportation payments) produced a travel account balance which was in surplus for the first time.
- resulted in federal tax revenues of $700 million.
- directly or indirectly supported/generated over 700,000 jobs.

In 1980, the travel industry contributed 35 percent of the new jobs created; in 1981, it was 16 percent.

In 1979, foreign tourist spending in the U.S. offset the cost of importing 538 million barrels of foreign oil.

The travel and tourism industry provides more jobs in 12 states than any other industry according to a study released by the U.S. Travel Data Center entitled, "The Impact of Travel on State Economics."

International tourism receipts are the personal consumption expenditures of foreign tourists. A study of 1978 foreign visitors' spending in the United States shows that "food takes the largest share of the foreign visitor dollar, with nearly one-fourth of the total". Incidental purchases, including souvenirs, gifts, clothing and other such goods, was the second largest item. Transportation within the United States ranked third; entertainment fourth; and lodging fifth.

The selling of U.S. tourism services to foreign travelers may be viewed as export earnings, comparable to the sale of merchandise abroad. (In 1978, receipts from international tourism equaled about 6 percent of total U.S. merchandise exports and was nearly double the value of such an important export product as wheat [including wheat flour].)

The benefits of international tourism to the nation's economy go far beyond the expenditures registered in the data on U.S. international transactions. The multiplier effect of tourism is generally considered to be in the 3.0 to 3.5 ranges. (I.T.A.) The Greater Boston Convention and Tourist Bureau estimates the convention tourist dollar turns over 6 to 10 times. Table "1" illustrations show how the dollar is spent. Applying the range of multipliers from 3 to 10 to the estimated international travel receipt figure for 1981, $14.0 billion, the total direct and indirect economic impact of foreign tourism spending in the United States approximates $42.0 billion to $140.0 billion - a rough measure of its overall contribution to the U.S. economy.

International tourism--like the much larger domestic tourism (it is estimated that Americans spent $100 billion on domestic trips in 1978 compared to $8.5 billion expenditure of the international tourist in the U.S.)--also has an important impact on U.S. employment.

The tourism industry is a large employer of unskilled and semi-skilled workers. Most of the ones presently unemployed are in these categories. There is also a significant amount of indirect employment generated by the purchase of goods and services by the lodging industry. Based on a special study conducted for the American Hotel and Motel Association in 1978 by Laventhal and Horwath, indirect employment amounts to nearly one person for every three directly employed in the U.S. lodging industry. No similar data is available on an international basis. Indirect employment varies greatly depending upon the capacity of the country to provide the goods and services necessary for developing and operating establishments.

VI. DEFINITION

In the international publications, the terms "tourism" and "tourist" generally cover all temporary visitors staying away from home overnight, regardless of purpose. The segments are identified as "international" and "domestic" tourism. However, in the United States, "tourism" is assumed by many to apply only to pleasure travelers. The economic data provided by the lodging industry, both domestic and international, is for all persons away from home regardless of the purpose of their trip, including persons using the bars, restaurants and other services of an establishment who may return to their homes to sleep. The distinction is important because international travelers worldwide provide less than 25 percent of the occupied room nights in the lodging industry. The ratio varies significantly from one country to another. In the United States in 1981, Laventhol & Horwath estimates that international travelers accounted for approximately 100 thousand of a total of over 580 thousand occupied room nights in commercial accommodations, or less than 20 percent. The balance comes from domestic "tourism."

The Provisional Guidelines on Statistics of International Tourism issued by the United Nations Statistical Commission classify visitors from abroad into two categories: (1) excursionists; and (2) tourists. Tourist is defined as a temporary visitor who stays at least one night in the country visited and the purpose of whose trip is (1) leisure, i.e., recreation, holiday, health, study, religion or sport; or (2) business, family, mission or meeting.

Goods and services purchased by these visitors constitute the principal components of international tourists trade. Table "2" lists these goods and services as defined by the United Nations System of National Accounts.

While the "industry" which produces these goods and services is commonly referred to as the "travel industry", "travel or trade", or "tourism sector", the Standard Industrial Classification System does not contain a "travel industry" classification, inasmuch as establishments which serve visitors also serve residents.

Nevertheless, it is possible to identify 30 major industrial components which are the beneficiaries of the U.S. trade in international tourism, as shown in table "3".

In addition to the problem of definitions, the person attempting to compile economic data on the domestic and international lodging industry faces a difficult task. For example, there is no completely accurate inventory of available capacity of the lodging industry either domestic or international, and the number of room nights spent annually in commercial accommodations can only be estimated using many sources which are also estimates.

VII. SUB-COMMITTEE MEMBERS

Chairman

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Members

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Table "1"

How important to Greater Boston is convention/tourist business?

- Over 5 million visitors annually spend $1 billion in Greater Boston.
- They spend $2 billion in the rest of the Commonwealth.
- Massachusetts gets $120 million from them in tax revenue.
- They are the basis for 100,000 jobs in the Commonwealth.

Everybody profits from visitor business

. . . either directly or indirectly, because visitors bring in new money that stays here. (The convention/tourist dollar turns over to six to ten times.)

How The Visitor Dollar Is Spent

Hotel Rooms	31.7%
Restaurants	24.8%
Retail Stores	14.1%
Entertainment*	12.5%
Miscellaneous	5.3%
Beverages	4.2%
Local Transportation	3.8%
Cars, Gas, Service	3.6%

*Theater, sporting events, bowling

Table "2"

FOREIGN VISITOR SPENDING
IN THE U.S. BY
CATEGORY, 1978
(millions)

	Category	Expenditure
1.	Food	$1,670
2.	Incidentals	1,567
3.	Transportation	1,359
4.	Entertainment	1,180
5.	Lodging	1,112
	Total	$6,894 1/

Source: U.S. Travel Data Center

1/ Exclusive of expenditures in U.S. Territories

Table "3"

30 MAJOR INDUSTRIAL COMPONENTS
WHICH ARE BENEFICIARIES OF
U.S. TRADE IN INTERNATIONAL TOURISM

4011	Railroads
4111	Local and Suburban Transit, including airport transportation and local bus operation
4119	Local passenger transportation not otherwise classified, including sightseeing buses and limousine rental
4121	Taxicabs
4131	Intercity and rural highway passenger transportation
4142	Passenger transportation charter service, except local
4131	Great Lakes-St. Lawrence Seaway transportation
4459	Sightseeing boats, water taxis, swamp buggy rides and excursion boats
4469	Marinas
4511	Air transportation, certified carriers
4521	Air transportation, non-certificated carriers, including sightseeing plane service
4722	Arrangement of passenger transportation, including travel agencies and tour operators
5541	Gasoline service stations
5812-3	Eating and drinking places
5947	Gift, novelty and souvenir shops
5946	Camera and photographic supply stores
6052	Foreign exchange establishments
7011	Hotels, motels and tourist courts
7032	Sporting and recreational camps
7033	Trailer parks and camp sites
7512	Automobile rental without drivers
7922	Theatrical producers
7929	Bands, orchestras and other entertainment groups
7941	Professional sports clubs
7948	Racing, including track operation
7993	Coin-operated amusement devices
7996	Amusement parks
7999	Amusement and recreation services not classified elsewhere
84	Museums, art galleries, botanical and zoological gardens

Mr. FLORIO. Thank you very much. Long before this committee became involved in trade matters, we were involved in tourism matters, which, of course, is very much a part of trade. However, I will echo your concerns about what has happened or, more appropriately, what has not happened over the last 2 years in the area of tourism at the USTTA.

It is of particular disappointment to myself and to most of the members of this committee that the hope that had been set forth in terms of tourism promotion at USTTA, that the development of a tourism promotion plan that we all had thought was going to start has not been developed in the way that it should be in the last 2 years.

So I am hopeful that perhaps as part of the overall aggressive trade promotion policy, there will be an effort to focus in on a very important part of overseas trade opportunities, which is tourism, and perhaps we can go about doing what we tried to do 2 years ago in a direct way by developing a tourism promotion plan, and perhaps in that around-the-corner way of doing it in the context of trade opportunities.

But it is very disappointing that in 2 years we have not seen very much happening at USTTA. Up until approximately a week before the budget proposal was submitted to the Congress, it was anticipated that there would be no money included in the budget for USTTA. It is our understanding that someone, as an afterthought, decided to put $5 million into the USTTA budget provision.

Mr. Sando, I think it is particularly important to emphasize the point that Mr. Rivers made with respect to Mr. Strauss, that progress in promoting overseas service industry opportunities can be directly translated into benefits to our goods sector. That is to say, that service opportunities overseas do inevitably, in some instances, translate into more opportunities to export goods. Can you tell us how your company fits into that development?

Mr. SANDO. Congressman, we are primarily lessors of containers to the industry, to the shipping industry. However, we have found cases whereby some of the regulatory practices in some foreign countries have established situations whereby containers are given preferential use. Containers from the local country is given a preferential use over one of our containers.

Another situation occurs when a foreign container comes into our country, it is allowed, first of all, to rest in this country for many, many days without any sort of import duty or fine, but is also allowed to, while it is in the United States, be used for transporting domestic goods within the country. On the contrary, if one of our containers, lands in France, for instance, or in many cases in the Latin American countries, we are fined if that container is not removed in 90 days. And in some cases, the government can confiscate the container. If that container was damaged, for instance, in an accident and we tried to sell it for scrap, we would have to pay as much as 300 percent of the new value to the foreign government in order to sell it for scrap in that country. Of course, in most cases, if that occurs, we would be forced to take the container out of the country ourselves.

Mr. FLORIO. I just wanted to say that I was particularly im pressed with your examples of how some of our own agencies have not been as helpful in terms of promoting equal access to business in the insurance field, and I am sure there can be other examples provided as to where that has not been the case. And the hope was and the hope is that with a renewed, enhanced and vigorous trade policy, that those types of things would be uncovered for the full disclosure of Congress and the Nation to be aware of, so that we can make some appropriate changes and corrections.

I think any number of witnesses have said this today already, the biggest problem we have is a lack of understanding as to the problems that exist and the opportunities that exist as well. And once that understanding is achieved, then it almost is inevitable that there will be some response to it. Just your reciting these examples to us makes converts of us to the idea that something should be adjusted in those matters, so that these hearings serve that purpose. And I appreciate the testimony from all three witnesses.

The gentleman from Louisiana.

Mr. TAUZIN. I thank the Chair. I only want to echo his appreciation for the testimony, particularly those three illuminating examples. Thank you very much.

Mr. FLORIO. Gentlemen, thank you very much. The last two witnesses I am going to call as a panel. We have Mr. Bruce Malashevich, vice president of Economic Consulting Services, Inc. and Mr. Gordon Cloney, director of the international services policy and programs division of the U.S. Chamber of Commerce.

Gentlemen, we welcome you to the committee.

STATEMENT OF BRUCE MALASHEVICH, VICE PRESIDENT, ECONOMIC CONSULTING SERVICES, INC.; AND GORDON J. CLONEY, DIRECTOR, INTERNATIONAL SERVICES POLICY AND PROGRAMS IN THE INTERNATIONAL DIVISION OF THE CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. MALASHEVICH. Thank you, Mr. Chairman. I very much appreciate the opportunity to appear before you today and offer our views on H.R. 794. I would like to say, I am accompanied by Ms. Diana Hastings, a financial analyst for our firm.

Members of our firm and I have been deeply involved in the analysis of international trade issues related to services for a number of years, with much of our most significant work in this area performed under contract for various U.S. Government agencies.

There is no question that the expansion and liberalization of international trade in services are desirable objectives for the United States. The fact that the United States enjoys a strong international comparative advantage in the production of services is evident from the statistics used to measure our balance of payments. Using standard balance of payments measures, the United States enjoyed net exports of services of $0.5 billion in 1970. This figure rose to $7 billion in 1980, thereby helping to offset our growing deficit in merchandise trade.

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As impressive as these figures are, I believe that the statistical measures commonly used to record the balance of payments for a variety of technical reasons mask the true magnitude of our Nation's stake in services trade. In 1981 our firm completed a study for the U.S. Departments of State and Commerce and the U.S. Trade Representative. The purpose of the study was to examine existing systems of data collection for 16 separate service industries and to evaluate their suitability as a basis for formulating U.S. trade policy in services.

As part of the study—and I have attached a table to my statement with some statistics—we estimated that foreign revenues of U.S. service-producing firms in 1980 totaled approximately $60 billion, roughly twice that of the official balance of payments figure for exports of services, excluding investment income, in that year.

I must say that that $60 billion is a rockbottom conservative estimate of the actual revenues. During this process we found that existing sources of published data provided at least some information on most variables for the designated service industries. However, we also discovered that significant limitations and gaps in these data inhibit their use for purposes of formulating trade policy.

It was our observation in this regard that many of these gaps and limitations result naturally from the difficulty of utilizing existing data systems to further new or modified policymaking purposes that they were never originally designed to serve. Using as a basis our earlier studies of trade and services, let me share with you certain broad conclusions that are relevant to the objectives of section 3(a)(1) of H.R. 794 with respect to most service industries, including information on data processing services.

First, the ability to develop accurate market estimates of U.S. international trade in services varies markedly among the different service industries, particularly in those areas where nonmarket flows of such services between related United States and foreign entities account for a large share of total transactions.

Two, estimates of U.S. imports of services probably cannot be obtained without a survey of foreign suppliers, as it is doubtful that U.S. consumers of services retain records of such purchases by country of origin.

Three, the Government's ability to develop the required data base depends upon the willingness of U.S. firms to provide U.S. statistical data desired. Considerations in this regard include the cost of compilation and the difficulty of generating the relevant data in the required format.

Finally, the Government maximizes the probability of broad participation in its data gathering efforts when confidentiality is protected, the results are shared, and the level of effort required is reasonable. Our research suggests that, while a substantial number of technical issues remain to be resolved, the kind of data gathering program described in section 3 of H.R. 794 would be feasible at least with respect to filling the large gaps that currently exist in our knowledge of trade and those services not distinctly recorded in the balance of payments.

Moreover, I personally believe quite strongly that the overall program described in that section of the bill would considerably improve the factual basis of trade policymaking with respect to virtu-

ally all service sectors by allowing a more accurate detailing of the role played by U.S. service industries internationally. After all, reliable data bases are essential to the formulation of sound policy. This is particularly true as our Government embarks on developing priorities and strategies for international negotiations aimed at insuring the general expansion and liberalization of trade and services.

Thank you, Mr. Chairman.

[Mr. Malashevich's prepared statement follows:]

TESTIMONY OF BRUCE P. MALASHEVICH,
VICE PRESIDENT, ECONOMIC CONSULTING SERVICES INC.,
WASHINGTON, D.C., TO THE HOUSE OF REPRESENTATIVES'
COMMITTEE ON ENERGY AND COMMERCE, SUBCOMMITTEE ON
COMMERCE, TRANSPORTATION, AND TOURISM ON H.R. 794
"SERVICE INDUSTRIES COMMERCE DEVELOPMENT ACT OF 1983"

March 15, 1983

Mr. Chairman, members of the Subcommittee, I very much appreciate the opportunity to appear before you today and offer my views on H.R. 794, the Service Industries Commerce Development Act of 1983. Members of our firm and I have been deeply involved in the analysis of international trade issues relating to services for a number of years, with much of our most significant work in this area performed under contract for various U.S. Government agencies. In fact, ECS prepared two major studies*/ for the U.S. Government which are particularly relevant to the research and analysis called for in Section 3.(a) (1) of the bill now under consideration.

The first study was completed in 1976 and was performed for the U.S. Department of Commerce. It provided an initial compilation of a domestic and international data base for service industries. It also demonstrated the importance of international trade to U.S. services firms and was the first study to identify many of the limitations of U.S. statistics on international trade in services.

*/ Wolf and Company, Economic Consulting Services, Study of Service Industries and Their Relation to Domestic and International Trade, U.S. Department of Commerce, October 1976; Economic Consulting Services Inc., The International Operations of U.S. Service Industries: Current Data Collection and Analysis, U.S. Departments of State and Commerce, and the United States Trade Representative, June 1981.

The second study, completed in 1981, was performed for the U.S. Departments of State and Commerce and the United States Trade Representative. The objectives were to examine the existing systems of data collection related to the operations of 16 separate service industries and to evaluate the quality of data being generated for their potential use in the formulation of U.S. trade policy. The analysis assessed the strengths and limitations of existing official and private sources of international services data in terms of current and potential U.S. policy requirements. The industries studied were: accounting, advertising, banking, business/professional/technical services, construction and engineering, education, employment, franchising, health, information, insurance, leasing, lodging, motion pictures, tourism, and transportation.

Having this background, I believe H.R. 794 represents a significant and timely step forward in support of our Government's efforts to develop a suitable data base to employ in promoting the expansion and liberalization of international trade in services. I will restrict my remarks to the data-gathering provisions of the bill, as it is in this area that I have been most actively involved.

There is no question that the expansion and liberalization of international trade in services are desirable objectives for the United States. In 1947, 57 percent of the work force was employed in the service sector. By 1980,

that figure increased to more than 70 percent. In addition, the output of services as a share of our Gross National Product (GNP) has likewise increased. In 1950, the output of goods was more than 25 percent greater than the output of services. But by 1980, output of services was greater than that of goods by 4 percent.

The fact that the United States enjoys a strong international comparative advantage in the production of services is also evident from the statistics used to measure our balance-of-payments. Using standard balance-of-payments measures, the U.S. enjoyed net "exports" of services totalling $0.5 billion in 1970. This figure subsequently grew to almost $7.0 billion in 1980, thereby helping to offset our growing deficit in merchandise trade.

In spite of this appearance of success, comparative balance-of-payments data show that during the 1970's the United States declined in relative prominence in international services trade. Japan, France and West Germany during the same time frame experienced increases in their shares of receipts from services.

Specifically, the most troublesome change occurred in the U.S. share of world receipts in what is called "Other Private Goods, Services, and Income" in the balance-of-payments. This category includes many of the international transactions of the service industries with which we are concerned. Between 1972 and 1979, the U.S. share dropped

from 16 percent to 8.5 percent. The U.S. market share appeared to be picked up by West Germany, France, Japan, and the non-oil-exporting developing countries.

As impressive as these figures are, I believe that the statistical measures commonly used to record the balance-of-payments, for a variety of technical reasons, mask the true magnitude of our nation's stake in services trade. As mentioned previously, the purpose of our study for the U.S. Departments of State and Commerce and the United States Trade Representative was to examine the existing systems of data collection for 16 separate service industries and to evaluate their suitability as a basis for formulating U.S. trade policy in services. As part of the study (see Table 1), we estimated that the foreign revenues of U.S. service-producing firms in 1980 totalled approximately $60 billion, roughly twice that recorded in the official balance-of-payments for exports of services (excluding investment income) in that year.

During this process we found that existing sources of published data provide at least some information on most variables for the designated service industries. However, we also discovered that significant limitations and gaps in these data inhibited their use for purposes of formulating trade policy. It was our observation in this regard that many of these gaps and limitations result naturally from the difficulty of utilizing existing data systems -- such as

that used to calculate the balance-of-payments -- to further new or modified policy-making purposes which they were never originally designed to serve.

Balance-of-payments accounting, for example, is primarily concerned with recording the international economic transactions of a country, rather than the financial transactions of industries. Therefore, in a balance-of-payments sense, the definition of "services" includes all invisible transactions of a country, whether arising from a service industry or a goods-producing industry.

The major types of balance-of-payments "services" include Government transactions, tourism, passenger fares, transportation, royalties and fees, private miscellaneous services, and income on investment. Tourism, passenger fares, and transportation might be considered service industries. However, the international transactions of most U.S. service industries fall into the categories of royalties and fees, private miscellaneous services, and investment income. Consistent with the balance-of-payments definition of "services," a transaction is recorded in one of these three categories according to its economic nature.

In order to measure the importance of international business to U.S. service industries, data beyond that which is contained in traditional balance-of-payments accounting are necessary. As services are often necessarily produced and consumed at the same location, many service industries

can engage in international business only through some type of foreign presence. Furthermore, certain services, such as telecommunications and data processing, have vague boundaries between the foreign and domestic components involved in their provision.

Therefore, the revenues of the foreign affiliates of U.S. service firms are an important consideration in measuring the U.S. competitive position worldwide, inextricably linking patterns of trade in services to patterns of foreign investment. While these affiliates no doubt do a majority of their business in the currency of the country in which they are located, and therefore such revenue data would not have a direct bearing on the balance-of-payments or the position of the dollar, such revenue data would help to measure the overall penetration of U.S. service industries in the world marketplace.

As trade patterns in services are closely linked to investment patterns, a broader concept of market share than that traditionally used, one which takes into account the operations of foreign affiliates, is necessary. Only on this basis will it be possible to evaluate the relative positions of U.S. and foreign service firms, and of the U.S. service industries among themselves. The ability to make such evaluations is essential to an informed development of U.S. international negotiating priorities and strategy.

Furthermore, collection of services data must be performed by surveys of individual firms, because, unlike goods, services do not pass through clearly specified ports of entry and exit. This necessarily poses a resource problem. In fact, the Bureau of Economic Analysis, in a November 1981 Survey of Current Business article, expressed the belief that the coverage of all services transactions is limited because, among other things, transactions are not covered by the reporting system.

Using as a basis our earlier studies of trade in services, let me share with you certain broad conclusions that are relevant to the objectives of Section 3.(a)(1) in H.R. 794 and which apply to most service industries, including the information and data processing industry.

1. The ability to develop accurate market estimates of U.S. international trade in services varies markedly among the different service industries, particularly in those areas where non-market flows of such services between related U.S. and foreign entities account for a large share of total transactions.

2. Estimates of U.S. imports of certain services probably cannot be obtained without a survey of foreign suppliers, as it is doubtful that U.S. consumers of services retain records of such purchases by country of origin.

3. The Government's ability to develop the required data base depends upon the willingness of U.S. firms to provide the statistical data desired. Considerations in this regard include the cost of compilation and the difficulty of generating the relevant data in the required format.

4. The Government maximizes the probability of broad participation in its data-gathering efforts when confidentiality is protected, the results are shared, and the level of effort required is reasonable.

Our research suggests that, while a substantial number of technical issues remain to be resolved, the kind of data-gathering program described in Section 3.(a)(1) of H.R. 794 would be feasible, at least with respect to filling the large gaps that currently exist in our knowledge of trade in those services not distinctly recorded in the balance-of-payments. Moreover, I personally believe quite strongly that the overall program described in that section of the bill would considerably improve the factual basis of trade policy-making with respect to virtually all service sectors, by allowing a more accurate detailing of the role played by all U.S. service industries internationally. After all, a reliable data base is essential to the formulation of sound policy generally. This is particularly true as our Government embarks on identifying priorities and strategies for international negotiations aimed at ensuring a general expansion and liberalization of trade in services.

Mr. Chairman, I hope that you and other members of this Subcommittee find this information helpful in your deliberations. I would be pleased to answer any questions.

Table 1

ESTIMATED FOREIGN REVENUES OF THE U.S. SERVICES SECTOR, 1980

Service Industry	Foreign Revenues 1/ (billion dollars)
Accounting	2.35
Advertising	2.05
Banking	9.10
Business/Professional/ Technical Services	1.07
Construction and Engineering	5.36
Education	1.27
Employment	0.55
Franchising	1.26
Health	0.27
Information	0.60
Insurance	6.00
Leasing	2.35
Lodging	4.60
Motion Pictures	1.14
Tourism	4.15
Transportation	13.93
Subtotal, 16 service industries	56.05

TOTAL U.S. SERVICES SECTOR 2/..... $60 billion

1/ The following key points should be noted:
- All estimated quantities are essentially gross transactions (receipts, sales, billings, etc.) except for those of the Banking industry;
- Because of the characteristics of international services performed by the Banking industry, the estimated "Foreign Revenues" are net of overseas offices' interest payments (which, if they were included here, would raise total order-of-magnitude for U.S. Services Sector to nearly $100 billion);
- For Franchising industry, estimate has been adjusted to avoid double-counting of certain transactions attributed to the Employment and Leasing industries;
- For Tourism industry, estimate has been adjusted to avoid double-counting of certain transactions attributed to the Education and Lodging industries;
- For Lodging industry, estimate refers to U.S. establishments' revenue from foreigners; industry's overseas receipts are incorporated in estimate for Franchising.

2/ Includes 16 designated service industries plus communications, non-bank financial services, and miscellaneous services.

Source: Economic Consulting Services Inc., The International Operations of U.S. Service Industries: Current Data Collection and Analysis, June 1981, p. 294.

Mr. FLORIO. Thank you.
Mr. Cloney.

STATEMENT OF GORDON J. CLONEY

Mr. CLONEY. Thank you, Mr. Chairman.

I have a written statement which has been submitted, so it will be placed in the record. I would just like to make a couple of points.

First, however, I would like to congratulate you and the cosponsors of H.R. 794 for introducing this bill. We share the general objectives of the bill and we look ahead to its forward and hopefully positive movement in the current Congress.

The U.S. chamber has two general reasons for this interest. One is that about 75 percent of our members, or on the order of 175,000 business enterprises, are service industries. We obviously have an interest in the overall trading situation of that sector.

Second, we believe that legislation to strengthen and clarify the provisions of trade law that relate to international trade in services is needed.

We support the establishment of a service industry program in the Department of Commerce along the lines of that which you have set out in H.R. 794, for several reasons.

One, the Department has an important responsibility to support efforts to bring about negotiations to reduce barriers to trade in services, even though the negotiating responsibility lies with USTR.

Second, the Department has its separate accountabilities with regard to service trade promotion and has made efforts to strengthen this capability and are doing so in a very satisfactory way, I might say.

Finally, Mr. Chairman, the Department has very extensive responsibilities for collecting information necessary to both of these objectives. The Department's present disposition as we see it in all three of these areas is positive, and the level of cooperation between the Department and industry is high.

We have been, however, concerned that the present accountability is set forth by executive order and could be seriously changed or altered by another executive order, perhaps in the future where an administration might be less sympathetic to the problems in the area. Therefore, to cast the Department's service trade accountabilities in legislation would give them permanence. We think this should be done. It is in a sense, the wrench is now ratcheted forward. Your legislation would be the little click that lets us hold and retain the progress to date.

Mr. Chairman, there is one aspect of the bill which we do not support. We are not aware of circumstances that warrant the extensive subpena authority and penalties that are set under sections dealing with the collection of information. We feel that industry, particularly the service industries whose trade interests are most at stake, have indicated a very high degree of willingness to cooperate with the Government in providing and developing information. The process is ongoing at the moment.

Under these circumstances, we question the need for extensive subpena-based information collecting authorities, particularly when the areas to which the power might be addressed are as wide as those set out in section 3(a) of the bill.

This would not, Mr. Chairman, preclude the possible need for more narrowly drawn provisions to improve the ability of the Department of Commerce to collect trade statistics in the service trade area. However, we reserve judgment on that to a future point when provisions of that sort have been put forward and the need clearly set out by the agencies who collect such information.

In conclusion, Mr. Chairman, we support the bill. We think it will formalize the present disposition of the executive branch, and the Commerce Department, which is positive. We see it as a logical strengthening of existing dispositions in that agency, and of course we also see it, as others have mentioned, as being a clear indication that the congressional interest and intent in the matter of service trade and the welfare of our service industries, which goes back to 1974 Mr. Chairman and started in this building, remains firm. And that is an important thing for both the public sector here and the public sector in other countries to be aware of.

Thank you, sir.

[Mr. Cloney's prepared statement follows:]

Chamber of Commerce of the United States of America

Washington

STATEMENT
on
ESTABLISHMENT OF A SERVICES INDUSTRY PROGRAM
and
H.R. 794
before the
SUBCOMMITTEE ON COMMERCE, TRANSPORTATION AND TOURISM
of the
HOUSE COMMITTEE ON ENERGY AND COMMERCE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
Gordon J. Cloney
March 15, 1983

I am Gordon J. Cloney, Director, International Services Policy and Programs in the International Division of the Chamber of Commerce of the United States. I am pleased to represent the Chamber before this Subcommittee's hearing on H.R. 794 which would establish a service industry trade development program in the Department of Commerce and would strengthen Presidential authorities for responding to unfair trade practices impacting on U.S. firms operating in foreign markets.

Of the Chamber's business members, approximately 75 percent, or 175,000 firms are service enterprises. Hence, we have a major interest in legislation affecting trade in services.

The Chamber shares the general objective of H.R. 794. We agree that service sector issues must be a priority for the Department of Commerce and legislation is needed to clarify and strengthen this mandate.

There is one aspect of H.R. 794 which we do not support. We are aware of no circumstances which would warrant the extensive subpoena authority and penalties set out in Sections 3(a)(2), 3(a)(3) and 3(a)(4), particularly in light of the very wide range of information requests set out in Section 3(a)(1) to which these authorities might be applied.

Services are heterogeneous, "invisible" products such as advertising, accounting, architecture, banking, insurance, air transport, lodging, licensing, education, entertainment, leasing, franchising, investment, finance, legal services, construction, communications, data

transmission, information services, shipping, motion pictures, tourism and others.

Legislation which will further strengthen U.S. policy directed to reduce barriers to trade in services and to build our service export position is needed.

Also in our view, it is crucial that our trading partners know that the Congressional intent to assist U.S. service firms competing in world markets, which was first set out in the Trade Act of 1974, remains firm.

American service industries encounter a formidable array of barriers in both developing and industrialized countries. In spite of their diversity, essentially the same obstacles are faced by all service industries. Barriers now loom over some heretofore unrestricted, service activities. These include information transmittal, electronic communication, and transborder data flows. The U.S. still enjoys a competitive advantage in these categories, so it is particularly important that their access to these markets is aggressively promoted by the government. Also, in certain service areas where international arrangements once protected service exporters -- for example, in the commercialization of industry property rights -- traditional protections are eroding.

Apart from the issue of discriminatory unfair trade practices, there is a second issue -- the need to do a better job of promoting and advancing our service trade. Trade in services has traditionally received a lower level of attention within U.S. export promotion programs than its importance to our national economy warrants.

U.S. trade law and practice for addressing such service trade issues is inadequate, but radical reform is not required. For significant improvement, the following basic revisions or clarifications are needed and are feasible:

- o A clear congressional directive to the President to seek agreement in service trade as a principal objective would strengthen our negotiators' positions in any future negotiations.

- Discriminatory practices affecting the branches and subsidiaries of U.S. service enterprises in foreign countries are barriers to international trade. However, as counter arguments have been made that such establishment-related issues involve investment, not trade, legislative clarification is in order.
- Currently, the U.S. Trade Representative (USTR) and the Department of Commerce do a good job of keeping in touch with the private sector. Still, it needs to be confirmed in law that government must consult with industry and, as appropriate, with the state governments before the United States sets negotiating strategies or decides on methods of implementation.
- A process for interagency policy coordination should be clearly set out under which the USTR, through the Trade Policy Committee and its subcommittees, would have (1) the lead trade policy responsibility for services and (2) the authority necessary for involving and coordinating involvement by federal departments and agencies, including independent regulatory agencies, in service trade policy formulation.
- The Secretary of Commerce should be authorized in law to establish a service industries program which promotes U.S. service exports, collects and analyzes information and data, and supports negotiations to reduce barriers.
- Remedies available to U.S. service industries faced with unfair trade discrimination should be strengthened. For example, while we believe that section 301 is intended to address subsidies and unfair pricing in the service sector, in practice questions have been raised about executive branch willingness to apply this authority. Clarification is needed to resolve this uncertainty. Also, consideration of new remedies should be undertaken.

H.R. 794 will formalize, and thus ensure, the continuity of present policy dispositions in the Department of Commerce while giving

emphasis and direction to their service trade orientation. Also, the "service industry development program" that the bill envisions relates logically to steps already taken by the Department to better organize its work in this area.

In sum, H.R. 794 mandates the Department of Commerce to pursue an objective which Congress first expressed in the Trade Act of 1974, and has repeated at various times since, and which the Chamber fully shares -- the executive branch must give a policy priority to the trade needs of our service firms. We support the current efforts by this subcommittee to achieve this objective.

Mr. FLORIO. Thank you very much.

I would like to ask if either of you have any thoughts on the effect of the change in the benchmark survey criteria that we heard suggested this morning. That is to say, rather than surveying companies that earn $500,000 a year, the new surveying criteria is going to be $3 million. Do you share the thought of the representative from the Commerce Department here this morning that you can still obtain adequate information as a result of a sampling that strikes the level of $3 million as opposed to $500,000?

Mr. MALASHEVICH. If I may answer that first, Mr. Chairman, I think the Bureau of Economic Analysis of the Commerce Department is in the best position to evaluate the effects of the changing threshold on the quality of the information they receive, as they have access to the raw data and we do not.

I would say, however, in the course of our studies that we came across a number of service industries for which the foreign investment benchmark survey does not at the present level of threshold provide any level of detail whatsoever due to problems caused by limitations on disclosure. That would suggest that to the extent the current threshold is increased the problems of public disclosure might increase as well, as fewer firms are brought into the net with respect to certain individual industries. That may not be true for the quality of the foreign benchmark survey as a whole, but only with respect to certain service industries where the services are primarily produced by small or medium-sized business.

To give you an example, with respect to engineering, architectural and surveying services, U.S. firms with less than $1 million in receipts accounted for 40 percent of the total industry's receipts, and those firms with less than $5 million in revenue accounted for almost 60 percent. In the computer and data processing industries, firms with less than $1 million in receipts were responsible for 20 percent of the industry total and firms with less than $5 million accounted for 40 percent.

To the extent the same pattern of concentration or, better yet, lack thereof prevails overseas, it could be that much of U.S. services exports would not be captured with a substantially increased threshold in the selected service industry samples, and to the extent that more information is not disclosed to the public, that certainly reduces the incentive of firms to incur the costs in report-

ing these statistics to the Government without resort to any type of forceable reporting procedures.

Mr. FLORIO. Our concern, of course, is that the threshold is being increased not so much for accuracy purposes, but because of fiscal constraints, and someone has determined that they are going to save some money by reviewing fewer companies, and this is clearly perceived as being perhaps a false economy.

I appreciate what the representative from the Commerce Department said today, that he thinks this new threshold would still provide them with the opportunity for accurate sampling so as to disclose the same type of information. I think we will be looking at that to see if that is the case.

Mr. Cloney, I was interested in your observations about the deficiencies, as you see it, in the subpena power. Do you have any suggestions as to what a moderate approach might be so as to assure that we have cooperation? Now, in a sense you have said you anticipate that everyone will cooperate. I suppose you could take that argument and say there is no harm done by having the subpena power. If everyone is going to cooperate, it will never be used.

Have you got some suggestions, or if, perhaps not now, could we look forward to receiving from your organization statutory language, proposed statutory language that might provide us with enforcement capability that you would not regard as overreaching?

Mr. CLONEY. Mr. Chairman, there are actually several questions there. We have a committee that is looking into these questions now and I will be pleased to bring this to their attention with regard to forming some opinion about what, if anything, might be needed.

I would also suggest the important reason for increasing or broadening the statutory authorities here would be to fill gaps in the basic data that may exist. And these gaps have to be identified by the people who collect that information, and indicate that they need additional authority to provide the kind of information that the Congress or the trade negotiating people feel they might need for specific objectives. That is a consideration I would also address to the consideration of the subcommittee.

There are other points I had noted, but I skipped over them in my brief statement before. With regard to any authority, that is put in place we suggest certain constraints would be germane. One would be that the Secretary of Commerce, together with other interested agencies of the Government, should clearly set out the need for which the information—the trade policy need for which the information is intended, because encyclopedic approaches to information are not in our judgment needed, or at least they are terribly costly and burdensome for companies.

Second, I think there should be a determination made that the information being sought cannot be obtained through a cooperative arrangement with industry or with industry trade associations, and thus there is a need to collect it through governmental channels.

And finally, in the instances where that determination is made, there should be some system through which survey form or format, if it is a more broadly gaged type of exercise, is developed in consultation with industry to assure that the burden of the process is a reasonable one, that questions are cast in language to which in-

dustry can respond, that accounting concepts are consistent with normal industry practice, and so on.

So those would be three areas of constraint, as it were, perhaps you might all them steps, that might be applied to any subpena based authority to obtain information. As I pointed out also in my opening statement, I think if you look at the subpena authorities and then relate them to all of the areas that are outlined for action, and appropriately so, by the Department in the program that is set forth in section 3(a), I think the collection authority should be targeted on the question of statistics, and trade data.

For example, there are concepts such as industrial strategy in 3(a). And I am not sure what the meaning of a broadly gaged subpena authority with civil penalties is in regard to collecting information on competitive strategy which is also mentioned in 3(a). I do not think it essential to meeting the other more basic needs that I think you would like to meet.

Thank you.

Mr. FLORIO. Thank you very much. That is very helpful.

We appreciate your patience through the course of the morning and into the afternoon. Thank you very much for your participation.

Mr. CLONEY. Thank you.

Mr. FLORIO. If there is no further business, the committee stands adjourned.

[Whereupon, at 1 p.m., the subcommittee was adjourned.]

GENERAL TRADE POLICY

Trade Policy Overview

TUESDAY, APRIL 5, 1983.

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE,
TRANSPORTATION, AND TOURISM,
Washington, D.C.

The subcommittee met, pursuant to call, at 9:35 a.m., in room 2123, Rayburn House Office Building, Hon. James J. Florio (chairman) presiding.

Mr. FLORIO. The subcommittee will come to order.

We welcome all in attendance to what is a start of a series of hearings this committee will be conducting. A good number of the members of the committee are off investigating trade possibilities, as you may know, in various segments around the world.

Mr. Broyhill, ranking minority member on the full committee, will be here shortly.

I would like to welcome everyone to this, the first in a series of hearings during which the subcommittee will examine proposals to strengthen U.S. trade policy.

Last year, the United States trade deficit was higher than at any other point in our Nation's history—nearly $43 billion. Furthermore, this year's trade deficit is projected to be even higher than last year's.

Both American business and American workers have suffered greatly as the United States has lost its market position in the wake of intense foreign competition both at home and abroad. In some cases, the losses have occurred in declining U.S. industries which no longer can compete in the world market. In some other cases, U.S. businesses have lost market share as a result of unfair trade practices and direct subsidies of foreign governments.

In more and more cases, however, the United States is losing market share as a result of aggressive trade policies which foreign governments have implemented with the close cooperation and support of their private sectors. These policies are designed to heighten the international competitiveness of foreign business and industry and include the targeting of certain industries for export promotion, the sharing of information on world market trends and opportunities, the promotion of research and development and the creation of special financing programs.

It is time that the United States also began to think coherently about our trade objectives and goals. As the rate of growth in world trade continues to fall, competition from our trading partners will only grow stronger. We must begin now to define what our national interest in trade is and how best to achieve it.

These hearings are designed to begin that process. I personally believe there are many opportunities for greater cooperation between Government and the private sector. We must now seize these opportunities if the United States is to retain its position of leadership in world trade. I look forward to hearing the views of each of the witnesses this morning on these matters.

[Testimony resumes on p. 234.]

[The text of H.R. 2203 follows:]

98TH CONGRESS
1ST SESSION

H. R. 2203

To improve the competitiveness of the United States in domestic and foreign markets, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

MARCH 21, 1983

Mr. FLORIO introduced the following bill; which was referred jointly to the Committees on Foreign Affairs, Ways and Means, and Energy and Commerce

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A BILL

To improve the competitiveness of the United States in domestic and foreign markets, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Competitiveness in International Trade Act of 1983".

SEC. 2. FINDINGS AND PURPOSES.

(a) FINDINGS.—The Congress finds that—

(1) it is increasingly difficult for United States providers of goods and services to compete in foreign markets, as well as in domestic markets, given the

1 many revolutionary aspects of current world economic
2 conditions;
3 (2) to ensure that United States industries are
4 competitive both at home and abroad, the economic re-
5 sources of all sectors of the United States must be
6 marshaled in order to strengthen or expand United
7 States productive capacities in existing markets, as
8 well as to seek out and pursue aggressively new na-
9 tional and international market opportunities; and
10 (3) the present problems facing United States in-
11 dustries cannot be solved solely through fiscal and
12 monetary policies, but require that new policies provid-
13 ing for the development and implementation of effec-
14 tive integrated economic policy and trade strategies be
15 devised.
16 (b) PURPOSE.—It is the purpose of this Act to give the
17 Secretary of the Department of Domestic and Foreign Com-
18 merce as redesignated by this Act responsibility for establish-
19 ing and implementing a comprehensive system, based on the
20 cooperation of the public and private sectors, for identifying
21 and evaluating the strengths and weaknesses in the competi-
22 tive capabilities of United States providers of goods and serv-
23 ices, and for appropriately developing and marshaling the
24 human and material resources of this Nation in order to revi-
25 talize its position in both foreign and domestic commerce.

1 **SEC. 3. DEPARTMENT OF DOMESTIC AND FOREIGN COM-**
2 **MERCE.**

3 The Department of Commerce is hereby redesignated as
4 the Department of Domestic and Foreign Commerce. The
5 chief executive officer of the Department of Domestic and
6 Foreign Commerce shall be known as the Secretary of Do-
7 mestic and Foreign Commerce. Any reference in any law,
8 regulation, document, or paper of the United States to the
9 Department of Commerce or to the Secretary of Commerce
10 shall be treated as a reference to the Department of Domes-
11 tic and Foreign Commerce (hereinafter referred to in this Act
12 as the "Department") and the Secretary of Domestic and
13 Foreign Commerce (hereinafter in this Act referred to as the
14 "Secretary"), respectively.

15 **SEC. 4. PROGRAM TO ASSIST UNITED STATES INDUSTRIES TO**
16 **MAINTAIN AND EXPAND COMPETITIVENESS IN**
17 **FOREIGN AND DOMESTIC MARKETS.**

18 (a) IN GENERAL.—The Secretary shall carry out a pro-
19 gram, designed to assist United States industries to maintain
20 or expand their ability to compete in foreign and domestic
21 markets, that consists of the following actions:

22 (1) EVALUATION OF UNITED STATES COMPETI-
23 TIVENESS IN FOREIGN MARKETS.—The Secretary
24 shall undertake a comprehensive and continuing evalu-
25 ation of the export potential of United States goods
26 and services, based upon, but not limited to—

1 (A) an inventory, on a country-by-country
2 basis, of foreign market conditions, opportunities,
3 structures, and factors which offer potential for
4 the export of United States goods or services, or
5 for foreign direct investment by United States
6 persons which is necessary for the export of goods
7 or services;
8 (B) an analysis of the factors which signifi-
9 cantly affect competitiveness of those United
10 States industries that have a high potential for
11 export sales growth, including applicable United
12 States and foreign governmental policies and
13 practices (particularly macroeconomic, regulatory,
14 and sectoral policies) and the conditions in, and
15 structure of, the markets that supply, or distribute
16 the products and services of, such industries;
17 (C) an evaluation, on a country-by-country
18 basis, of foreign subsidy programs and policies (in-
19 cluding, but not limited to, financing) that affect
20 the competitiveness of United States goods and
21 services abroad, including, but not limited to—
22 (i) an inventory of the methods used by
23 foreign countries to subsidize exports in for-
24 eign markets, and

1 (ii) a qualitative and quantitative assess-
2 ment of the effect that such subsidy pro-
3 grams and policies have on the competitive-
4 ness of United States goods and services in
5 foreign markets; and
6 (D) specification of the aspects of each major
7 United States industry in which improvement
8 must be made in order that the international com-
9 petitiveness of the industry can be maintained or
10 expanded, including, but not limited to, aspects
11 such as investment, research and development, in-
12 frastructure, labor and management training, plant
13 and equipment, organization, market structure,
14 and relevant government policies.
15 (2) EVALUATION OF UNITED STATES COMPETI-
16 TIVENESS IN DOMESTIC MARKETS.—The Secretary
17 shall undertake a comprehensive and continuing evalu-
18 ation of the potential competitiveness of United States
19 goods and services in markets within the United States
20 (hereinafter referred to as the "domestic markets"),
21 based upon, but not limited to—
22 (A) an inventory of those domestic market
23 conditions, opportunities, structures and factors
24 which offer potential for growth and development;

1 (B) an analysis of those factors which signifi-
2 cantly affect the competitiveness of those domestic
3 industries that have a high potential for growth,
4 including applicable Federal and State policies
5 and practices (particularly macroeconomic, regula-
6 tory, and sectoral policies) and the conditions in,
7 and the structure of, the markets that supply, or
8 distribute the products or services of, such indus-
9 tries;
10 (C) an evaluation, on a country-by-country
11 basis, of foreign subsidy programs and policies (in-
12 cluding, but not limited to, financing) that affect
13 the competitiveness of United States goods and
14 services in the domestic markets, including, but
15 not limited to—
16 (i) an inventory of the methods used by
17 foreign countries to subsidize exports for the
18 domestic markets, and
19 (ii) a qualitative and quantitative assess-
20 ment of the effect that foreign subsidy pro-
21 grams and policies have on the competitive-
22 ness of United States goods and services in
23 the domestic markets;

1 (D) an evaluation, on a country-by-country
2 basis, of foreign plans for the penetration of do-
3 mestic markets, including, but not limited to—
4 (i) an inventory of those foreign indus-
5 tries that will likely participate in such pene-
6 tration during the next five, ten, and twenty
7 years,
8 (ii) a description of efforts, policies, and
9 programs which foreign countries are utiliz-
10 ing, or are planning to utilize, for purposes
11 of achieving such penetration, and
12 (iii) a quantitative or qualitative assess-
13 ment, whichever is appropriate, of the ef-
14 forts, policies, and programs referred to in
15 clause (ii) that have been implemented;
16 (E) specification of the aspects of each major
17 United States industry in which improvement
18 must be made in order that the domestic competi-
19 tiveness of the industry can be maintained or ex-
20 panded, including but not limited to, aspects such
21 as investment, research and development, infra-
22 structure, labor and management training, plant
23 and equipment, organization, market structure,
24 and relevant government policies.

1 (3) RECOMMENDED TRADE STRATEGIES.—(A)
2 On the basis of the comprehensive evaluations under-
3 taken in accordance with paragraphs (1) and (2) and
4 other relevant information, the Secretary shall formu-
5 late and update recommended strategies for—
6 (i) promoting foreign market opportunities for
7 all United States industries and particularly for
8 those United States industries with high foreign
9 market potential; and
10 (ii) increasing the competitiveness of United
11 States industries in domestic markets.
12 (B) In addition to formulating the trade strategies
13 described in subparagraph (A), the Secretary shall de-
14 velop—
15 (i) such recommended Federal legislation as
16 may be appropriate to implement such strategies,
17 including, but not limited to, proposed statutory
18 authority (I) to enable the United States to offer
19 terms and rates for export financing sufficient to
20 make United States goods competitive in foreign
21 markets, and (II) to stimulate action to address
22 the needs identified under sections 5, 6, and 7;
23 and
24 (ii) recommendations for the appropriate Fed-
25 eral agencies regarding actions which may be

1 taken by them under existing statutory authority
2 to implement such strategies.
3 (C) The Secretary shall consult with the heads of
4 the appropriate Federal and State agencies, as well as
5 with private persons, before formulating the strategies
6 and recommendations referred to in paragraphs (A) and
7 (B).
8 (b) INFORMATION AND SUPPORT SERVICES.—(1) The
9 head of each department or agency of the executive branch of
10 the Federal Government, including any independent
11 agency—
12 (A) shall furnish to the Secretary, upon request,
13 such data, reports, and other information as is neces-
14 sary for the Secretary to carry out his functions under
15 subsection (a); and
16 (B) may detail such personnel and may furnish
17 such services, with or without reimbursement, as the
18 Secretary may request to assist in carrying out such
19 functions.
20 (2)(A) The Secretary shall seek to establish arrange-
21 ments with the private sector regarding the access by the
22 Secretary to private sector information that is necessary for
23 the Secretary to carry out his functions under subsection (a).
24 (B) The Secretary may request persons to submit to him
25 any information referred to in subparagraph (A) that the Sec-

1 retary considers to be critical for the carrying out of such
2 functions.

3 (C) All information to which the Secretary is given
4 access under subparagraph (A), is submitted to the Secretary
5 under subparagraph (B), or produced under subparagraph (D)
6 shall be confidential and shall not be disclosed; except (i) the
7 Secretary may disclose the information if the provider of the
8 information in writing waives confidentiality, or (ii) when re-
9 quired under court order. The Secretary shall, by regulation,
10 prescribe such procedures as may be necessary to preserve
11 such confidentiality, except that—

12 (i) the Secretary shall release upon request any
13 such information to the Congress or any committee
14 thereof; and

15 (ii) the Secretary may release or make public any
16 such information, excluding investment and income
17 data, in any aggregate or summary statistical form
18 which does not directly or indirectly disclose the identi-
19 ty or business operations of the person who submitted
20 the information.

21 (D)(i) The Secretary may issue subpenas requiring the
22 production of any information requested by him under subpar-
23 agraph (B). Such production of information may be required
24 from any place within the United States.

1 (ii) If a person issued a subpena under clause (i) refuses
2 to obey such subpena or is guilty of contumacy, any court of
3 the United States within the judicial district within which
4 such person is found or resides or transacts business may
5 (upon application by the Secretary) order such person to
6 appear before the Secretary to produce the information. Any
7 failure to obey such order of the court may be punished by
8 such court as a contempt thereof.

9 (iii) The subpenas of the Secretary shall be served in the
10 manner provided for in subpenas issued by a United States
11 district court under the Federal Rules of Civil Procedure for
12 the United States district courts.

13 (iv) All process of any court to which application may be
14 made under this subparagraph may be served in the judicial
15 district wherein the person required to be served resides or
16 may be found.

17 (E)(i) It is unlawful for any person to refuse willfully to
18 obey a request by the Secretary for information issued under
19 subparagraph (B).

20 (ii) Any person who is found by the Secretary, after
21 notice and an opportunity for a hearing in accordance with
22 section 554 of title 5, United States Code, to have violated
23 clause (i) shall be liable to the United States for a civil penal-
24 ty. The amount of the civil penalty for each such violation
25 shall not exceed $10,000. The amount of such civil penalty

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1 shall be assessed by the Secretary, or his designee, by writ-
2 ten notice.

3 (iii) Any person against whom a civil penalty is assessed
4 under clause (ii) may obtain review thereof in the appropriate
5 court of the United States by filing a notice of appeal in such
6 court within thirty days from the date of such order and by
7 simultaneously sending a copy of such notice by certified mail
8 to the Secretary. The Secretary shall promptly file in such
9 court a certified copy of the record upon which such violation
10 was found or such penalty imposed, as provided in section
11 2112 of title 28, United States Code. The findings and order
12 of the Secretary shall be subject to judicial review in accord-
13 ance with section 706 of title 5, United States Code.

14 (iv) If any person fails to pay an assessment of a civil
15 penalty after it has become a final and unappealable order, or
16 after the appropriate court has entered final judgment in
17 favor of the Secretary, the Secretary shall refer the matter to
18 the Attorney General of the United States, who shall recover
19 the amount assessed in any appropriate district court of the
20 United States. In such action, the validity and appropriate-
21 ness of the final order imposing civil penalty shall not be
22 subject to review.

23 (v) The Secretary may compromise, modify, or remit,
24 with or without conditions, any civil penalty which is subject

1 to imposition or which has been imposed under this subpara-
2 graph.

3 (3) Nothing in this section shall authorize the release of
4 information to, or the use of information by, the Secretary in
5 a manner inconsistent with law or any procedure established
6 pursuant thereto.

7 **SEC. 5. RELATED INITIATIVES TO SUPPORT THE PROGRAM OF**
8 **ENHANCED COMPETITIVENESS.**

9 In connection with the functions specified in section 4,
10 the Secretary shall carry out the following actions in order to
11 achieve the purposes of this Act:

12 (1) ASSISTANCE REGARDING RESEARCH AND DE-
13 VELOPMENT.—After taking into account all relevant
14 information obtained in carrying out section 4(a) (1)
15 and (2), and other available appropriate data, regarding
16 the research and development needs (including but not
17 limited to, commercialization of research and develop-
18 ment) of United States industries, the Secretary shall
19 prepare, and thereafter periodically revise—

20 (A) an inventory of the research and develop-
21 ment that (i) is relevant to the maintenance or ex-
22 pansion of the competitiveness of United States
23 industry, and (ii) is being, or is planned to be, un-
24 dertaken by United States producers; and

1 (B) a listing of those new areas of research
2 and development not covered under subparagraph
3 (A) that should be engaged in if such competitive-
4 ness is to be maintained or expanded.
5 (2) IMPROVEMENTS IN TRAINING AND EDUCA-
6 TION.—On the basis of the most recent information de-
7 rived under section 4, and from other available appro-
8 priate data regarding the labor needs of United States
9 industries, the Secretary shall periodically consult with
10 the Secretary of Labor, the Secretary of Education,
11 and the heads of appropriate State agencies regarding
12 actions that may be taken within their respective juris-
13 dictions to improve the quality and availability of labor
14 market information, training (including teacher train-
15 ing), retraining , and education, in those skills and dis-
16 ciplines which will be required by United States indus-
17 tries for purposes of maintaining or expanding their
18 competitiveness.
19 (3) REDUCTION AND ELIMINATION OF REGULA-
20 TORY AND BUREAUCRATIC OBSTACLES.—The Secre-
21 tary shall undertake periodic consultation with appro-
22 priate Federal and State officials and representatives of
23 United States industry and business for purposes of
24 identifying those regulations, policies, and procedures
25 that inhibit or delay the development, commercializa-

1 tion, or marketing of goods or services and shall,
2 giving due consideration to the various purposes of
3 such regulations, policies and procedures, make recom-
4 mendations to the Congress, and to the appropriate
5 Federal and State agencies, regarding those statutory
6 and administrative changes that would, if implemented,
7 eliminate or reduce such obstacles.

8 (4) COMPETITION.—The Secretary shall consult
9 with the Department of Justice and the Federal Trade
10 Commission for purposes of—

11 (A) ensuring appropriate emphasis in anti-
12 trust enforcement to encourage the development
13 through market forces of those industries consid-
14 ered by the Secretary to be important to the
15 maintenance or expansion of United States com-
16 petitiveness; and

17 (B) considering means by which the Depart-
18 ment of Justice and the Federal Trade Commis-
19 sion could expedite current procedures under
20 which the Department of Justice and the Federal
21 Trade Commission provide advice as to whether
22 business proposals regarding goods, services, proj-
23 ects (including, but not limited to, joint research
24 and development ventures), or practices, that are
25 considered by the Secretary to be important to

1 the maintenance or expansion of United States
2 competitiveness, comply with the laws relating to
3 antitrust and consumer protection that are admin-
4 istered by the Department of Justice and the Fed-
5 eral Trade Commission. The Secretary shall de-
6 velop, in consultation with these and other Feder-
7 al agencies concerned with consumer protection,
8 programs to enhance the confidence of United
9 States consumers in domestically-produced prod-
10 ucts and the competitive position of such products
11 in world markets.
12 (5) FEDERAL PROCUREMENT.—The Secretary
13 shall periodically review Federal procurement policies
14 and practices and make recommendations for such
15 changes in those policies and practices as may be ap-
16 propriate for purposes of assisting in the maintenance
17 and expansion of United States competitiveness.
18 **SEC. 6. OFFICE FOR THE STUDY OF PRODUCTIVITY AND MAN-**
19 **AGEMENT.**
20 The Secretary shall establish in the Department an
21 Office for the Study of Productivity and Management. The
22 functions of the Office shall be—
23 (1) to collect and evaluate information regarding
24 current developments (both theoretical and applied) in
25 the areas of business management, productivity, and

1 governmental policies to assist industries in improving
2 management and productivity;
3 (2) to develop, using the information obtained
4 under this Act, proposed remedial actions to be taken
5 by business regarding problems being experienced by
6 various sectors of United States industry in maintain-
7 ing or expanding their competitiveness in foreign and
8 domestic markets; and
9 (3) to disseminate the applicable information and
10 recommendations derived incident to the carrying out
11 of paragraphs (1) and (2) through appropriate channels
12 such as the applicable State agencies, business and
13 labor organizations, and educational institutions.

14 **SEC. 7. IMPLEMENTATION OF PROGRAM AND BIENNIAL**
15 **REPORT.**

16 (a) SECRETARIAL ACTIONS.—The Secretary shall take
17 such action as may be necessary or appropriate, consistent
18 with such powers as are granted to him under law, to imple-
19 ment the trade strategies and other recommendations devel-
20 oped under sections 4, 5, and 6.
21 (b) BIENNIAL REPORT.—Before the close of (1) the
22 twelve-month period beginning on the date of the enactment
23 of this Act and (2) each two-year period thereafter, the Sec-
24 retary shall prepare, and submit to Congress and to the

President, a report containing, with respect to the period covered by the report—

(A) the evaluations and other actions required to be undertaken, and the recommended trade strategies required to be formulated, by the Secretary under section 4, together with an analysis of the extent to which such trade strategies and other recommendations have been implemented by United States industries and the agencies concerned;

(B) a summary of the consultations carried out under sections 4, 5, and 6 and the extent to which the resulting recommendations and actions have been implemented by the agencies concerned; and

(C) all legislative recommendations developed under section 4(a)(3)(B) together with any other suggested legislation that the Secretary considers necessary for carrying out the purposes of this Act.

SEC. 8. ADVISORY COUNCIL ON INTERNATIONAL TRADE COMPETITIVENESS.

(a) ESTABLISHMENT AND OPERATION.—(1) The Secretary shall establish an Advisory Council on International Trade Competitiveness (hereinafter in this section referred to as the "Council") which shall consist of eighteen members appointed by the Secretary as follows:

1 (A) 9 members shall represent United States in-
2 dustries facing international competition.
3 (B) 3 members shall represent labor employed in
4 industries of a kind referred to in subparagraph (A).
5 (C) 3 members shall represent consumer interests.
6 (D) 3 members from the academic community who
7 specialize in disciplines related to international trade.
8 (2) Members of the Council shall serve without pay, al-
9 lowances, or benefits; but shall be reimbursed for actual ex-
10 penses, including travel expenses, incurred by them while
11 performing functions vested in the Board.
12 (3) The Secretary shall provide from the Department
13 such administrative and technical support services as the
14 Council may require.
15 (4) The Council shall meet at least twice each year at
16 the call of the Secretary or a majority of its members.
17 (b) FUNCTIONS.—The Council shall—
18 (1) provide a forum for the identification and dis-
19 cussion of, and the proposing of solutions to, problems
20 and disputes that arise from time-to-time regarding the
21 competitiveness of United States industry;
22 (2) assist the Secretary in such manner, and at
23 such time, as he may require for purposes of preparing
24 the report, and the revisions thereto, required by sec-

1 tion 7(b) and carrying out the actions referred to in
2 section 5; and
3 (3) undertake studies to achieve the purposes of
4 this Act.
5 (c) PANELS.—The Council may appoint such voluntary
6 advisory panels, consisting of individuals in the public and
7 private sectors having knowledge or experience in various
8 aspects of international trade, as may be appropriate to assist
9 the Council in carrying out its functions.

10 **SEC. 9. PRESIDENTIAL ACTION TO ENSURE FAIR TRADE IN**
11 **SERVICES.**

12 (a) DEFINITIONS.—For purposes of this section—
13 (1) The term "designated major trading country"
14 means any major trading country which the Secretary,
15 after consultation with the Committee on Finance and
16 the Committee on Commerce, Science, and Transpor-
17 tation of the Senate and the Committee on Ways and
18 Means and the Committee on Energy and Commerce
19 of the House of Representatives, designates as a coun-
20 try with respect to which the study and analysis under
21 subsection (b)(4) is necessary and appropriate.
22 (2) The term "foreign supplier" means a supplier
23 whose corporate headquarters is located in a foreign
24 country.

1 (3) The term "major trading country" means
2 Canada, the European Economic Community, the indi-
3 vidual member countries of such community, Japan,
4 and any other foreign country or instrumentality desig-
5 nated by the Secretary for consideration for designation
6 under paragraph (1).
7 (4) The term "services" means economic outputs
8 which are not tangible goods or structures, including,
9 but not limited to, transportation, communications,
10 retail and wholesale trade, advertising, construction,
11 design and engineering, utilities, insurance, real estate,
12 professional services, entertainment, and tourism, and
13 overseas investments which are necessary for the
14 export and sale of such services.
15 (5) The term "supplier" means any person who is
16 engaged in the business of providing services for ulti-
17 mate sale in the United States and includes as one
18 entity all persons who control, are controlled by, or are
19 in common control with, such person. Such term also
20 includes any predecessor or successor of such a
21 supplier.
22 (b) REPORT.—On not less than a biennial basis com-
23 mencing with 1985, the Secretary shall prepare a report
24 (which shall be submitted to the Congress and the President

1 not later than fifteen days after the close of the period cov-
2 ered by the report) containing—
3 (1) an analysis of the activities during the period
4 covered by the report of foreign suppliers within the
5 various service industries in the United States market;
6 (2) an analysis of Federal, State, and local regula-
7 tion during such period of such foreign suppliers and
8 the potential effect of such regulation on trade relation-
9 ships and negotiations;
10 (3) an analysis of the activities during such period
11 of United States suppliers of services in foreign coun-
12 tries, including the types of services provided, the
13 value of investment made in such services, and the
14 income resulting from their provision; and
15 (4) a study and an analysis of the impact during
16 such period of any act, policy, or practice of each des-
17 ignated major trading country that limits the access of
18 United States suppliers of services to markets in that
19 country in a manner that is unjustifiable, unreasonable,
20 or discriminatory and burdens or restricts United
21 States commerce.
22 (c) PRESIDENTIAL ACTION.—(1) Notwithstanding any
23 other provision of law, the President may impose, in accord-
24 ance with paragraphs (2) and (3), such terms, conditions, or
25 limitations, as he deems appropriate, under which foreign

1 suppliers shall be eligible to engage in interstate commerce in
2 the United States.
3 (2) Within one hundred and twenty days after receiving
4 a report under subsection (b), the President shall—
5 (A) review all acts, policies, and practices ana-
6 lyzed in the report as required by subsection (b)(4);
7 (B) determine whether limitations should be im-
8 posed under paragraph (1); and
9 (C) publish notice in the Federal Register—
10 (i) of each determination made under subpar-
11 agraph (B) together with a description of the limi-
12 tations which the President proposes to implement
13 under subsection (b) as a result of that determina-
14 tion, and
15 (ii) that written comment of interested per-
16 sons regarding such determination and the pro-
17 posed limitations may be submitted to the Secre-
18 tary during the one hundred and fifty-day period
19 beginning on the date of publication of the notice.
20 (3) The President may not impose any limitation under
21 subsection (b) until he has taken into account all comments
22 that are timely submitted in accordance with paragraph
23 (2)(C)(ii) with respect to the determination and proposed limi-
24 tations concerned.

Mr. FLORIO. We are very pleased to have Ambassador Brock as our first witness. I would like to call on our colleague from Mississippi, Mr. Dowdy.

Mr. DOWDY. Mr. Chairman, I have no comments to make at this time. I welcome the Trade Representative.

Mr. FLORIO. Welcome to the committee, Ambassador Brock. As with all witnesses, your testimony will be made a part of the record in its entirety.

STATEMENT OF WILLIAM E. BROCK, AMBASSADOR, U.S. TRADE REPRESENTATIVE, EXECUTIVE OFFICE OF THE PRESIDENT

Ambassador BROCK. Thank you. Let me congratulate you for your interest in and leadership in this particular subject.

Almost no subject considered in the 98th Congress can be discussed without first determining how it will help create permanent productive American jobs.

Trade is not a threat to employment, rather it is the opportunity. A steady increase in the volume of exports and imports lays a foundation for the creation of new, more stable jobs, higher real income, and a healthy economy. In short, effective trade policies will put more Americans back to work.

A look backward shows that 35 years of world leadership in pursuit of free trade policies have made us stronger economically. In recent years, four out of five of the new U.S. jobs in manufacturing have been created by international trade. One out of every three acres planted by American farmers is producing crops for export.

As we look beyond our own borders to meet the trade challenge of the 1980's, we see that potential for growth is enormous. A $2 trillion international market in goods and services gives us an opportunity to create millions of jobs and more income security for our people.

As President Reagan recently stated, this administration has a positive plan to meet this trade challenge on three key fronts:

First, and most importantly, I think we must lay a firm foundation for noninflationary growth based on enduring economic principles of fiscal and monetary discipline, competition, incentives, thrift, and reward.

Second, we need to enhance the ability of U.S. producers and industries to compete on a fair and equitable basis in the international marketplace. In this regard, we must continue to work with our trading partners to resolve outstanding problems of market access, and to chart new directions for free and fair trade in the products of the future.

Third, we have to take the lead in assisting international financial and trade institutions to strengthen world growth and bolster the forces of freedom and democracy. Other steps are required, education, training, and retraining are as fundamental to our success as our research, development, and productivity. Labor, management, and government at all levels can and must participate in improving these tools of growth.

Tax policy and regulatory practices, all need constant reevaluation in terms of our maintaining competitive opportunity. In

the final analysis, every American has a role, and a stake, in international trade.

Internationally, the United States will continue its vigorous efforts to strengthen international agreements. Our leadership is essential. We must stop the drift toward short-term inward looking policies that would cause the nations of the international trading system to repeat the disastrous history of the 1930's, when protectionism and trade wars contributed to unprecedented suffering. As a leader of the free world, the United States cannot and will not accept this result. We will provide this leadership by act, and by example.

To achieve open and fair competition for U.S. industries we must vigorously enforce United States and international trade codes. This administration has been aggressive in pursuing unfair trade practice complaints against our trading partners for their violations under the GATT. We will continue to be vigilant and forceful in defending U.S. workers against unfair predatory practices by enforcing vigorously the trade laws that are already on the books.

Since August 1981, USTR has initiated 17 section 301 investigations. Thus, more than 40 percent of all investigations initiated under section 301 of the Trade Act of 1974 have been initiated in the last 18 months.

Last week, the President imposed a duty increase and tariff rate quota on heavyweight motorcycles imported into the United States. Resolution of this section 201 case, the first import relief petition filed with this administration, is designed to reduce the threat of injury from excessive imports during the period our domestic industry is undertaking adjustments designed to improve its international competitiveness.

In addition, we currently have 49 countervailing actions in effect and an additional 44 pending. This is an increase of 22 cases over 1980 and 37 over 1981. We have 87 antidumping actions in effect and 20 actions pending, more than at any previous time.

While we are prepared to take action to enforce our international rights whenever necessary, we must also make certain that our own laws operate fairly and efficiently. The administration is committed to work with Congress in examining the adequacy of our trade laws and methods to strengthen them as required.

If I can talk to the opportunity for growth, the key to our success or policies that allow our economy adapt to technology-intensive industries and toward services that support a technologically advanced society. With a highly skilled labor force, abundant capital for investment, technological know-how and experience and a huge internal and world market, the United States is uniquely positioned to lead the way in high technology trade. This opportunity for growth will require and generate new kinds of jobs.

A recent study found that 9 of 10 of the fastest growing industries in the United States in the 1980's will come in the high tech area. By the year 2020 as many as half of the U.S. workers could be employed at jobs that do not exist at all today.

However, these future opportunities could be denied if we do not address today's potentially serious trade problems. Since virtually all nations view high technology industries as critical to their eco-

nomic growth, some have designed national industrial policies complemented by a broad range of interventionist policy instruments.

Some countries have identified and targeted priority industries for special treatment, including low interest loans, tax subsidies, and direct grants.

There are serious problems we intend to address multilaterally in the GATT and bilaterally with our principal trading partners.

Unilaterally, an interagency task force has been established to examine the issue of targeting and industrial policies and to determine the effect these practices have on a free and open trading system.

In the trade in services area, the U.S. service sector, like high technology, has become a central element in the U.S. economy and the current account balance. Services account for over 65 percent of our GNP and services industries employ 7 out of 10 workers.

Unfortunately, trade in services has increasingly been distorted by a growing number of nontariff barriers and restrictions. Though often invisible these trade barriers exert a major impact on world trade, U.S. jobs and earnings.

I want to commend you, Mr. Chairman, for your personal efforts in the past year to stress the importance of services trade in our economy and to recommend courses of policy action that have been a major contribution to the issue.

We testified fully on your bill, H.R. 794, last month so I will only touch briefly on aspects of the measure.

I continue to fully support the intent of the services industries development program, which was a feature of your services bill in the last Congress. It is an important first step toward developing a more comprehensive analysis of our competitiveness in services at home and abroad.

I also endorse the provision calling for the improvement in services data. We are already at work on this by chairing an interagency task force aimed at improving our data collection methods so that services trade can be more accurately reflected in official U.S. Government statistics.

Multilaterally, we have made significant progress in bringing trade in services issues to the attention of contracting parties under the framework of GATT. We expect to present a comprehensive national study on the issue this fall and have initiated a series of informal talks on services with interested GATT members. It is only a beginning, but the basic principles of trade liberalization and dispute settlement procedures make the GATT the best international forum for understanding on this issue.

As we push ahead, urging our trading partners to do more to strengthen the GATT and encourage freer trade policies, we do expect to meet reluctance and some opposition. There may be and are those, who in the fact of difficult decisions advocate retrenchment and retreat.

Nevertheless, the United States has been successful in the trade field because of its bipartisan adherence to free trade principles. Ironically, however, we face the opponents here at home who advocate less free trade, not more. Many wish to put off the tough decisions of adjustment which face all major trading nations and desire instead to return to a world of protective barriers.

As we have done internationally, this administration will continue to vigorously oppose protectionism at home that would damage our productive future and distort world and American adjustment prospects.

Finally, I want to address briefly the Fair Practices in Automotive Products Act, H.R.1234.

As I understand this subcommittee will be holding hearings on this bill next week, I want to reiterate this administration's strong opposition to this proposal. This bill would raise the price of every car, cost jobs, and start a trade war. It is the worst piece of economic legislation in a decade.

H.R. 1234 has been proposed to this Congress to deal with the unemployment problems of more than a quarter of a million U.S. automobile workers and another 750,000 in automotive supply industries. However, this bill does not address the fundamental problem of the U.S. auto industry and, in my opinion, can only worsen the industry's situation and cause enormous harm to other U.S. workers and the world trading system.

This administration is concerned about the very real problems faced by the U.S. automotive industry, its workers and suppliers. The economic difficulties of this industry have been coming for some time and are the result of oil supply problems, Government over regulation, and the manufacturers' failure to quickly respond to consumer demand for smaller fuel-efficient cars.

However, let me emphasize the view that it is not correct to blame the present condition of the U.S. automotive industry substantially on imports. While we are aware that the average import penetration through 1982 was 27.9 percent, in absolute terms, import sales are running only 200,000 units more this year than 5 years ago when the import penetration was 18.4 percent. In other words, the problem has been decline in the U.S. market, not an increase in absolute volume of imports.

Even so, the voluntary restraints on auto exports were implemented by the Japanese Government in 1981. In February of this year, Japan stated its intention to continue these restraints through March 1984 at the previous level of 1.68 million passenger vehicles.

The continuation of Japan's unilateral restraints on automotive exports into 1984 assures that virtually every additional car that is to be sold in the United States during this period will be manufactured in North America. I particularly believe that the Japanese action is effectively meeting the import issue without permanently damaging the trading system, U.S. exports and jobs as would domestic content legislation.

Should our foreign trading partners respond to the illegal U.S. trade actions mandated by this bill by retaliating against our leading exports, our vitally important industries such as computers, aircraft, and agricultural products would be seriously threatened.

The possible impact of retaliation and emulation far exceeds this bill's potential benefits to the automotive industry. An analysis by your own Congressional Budget Office estimates that although 38,000 auto jobs would be created by H.R. 1234, the new jobs are more than offset by 104,000 jobs eliminated in factories that make goods for exports.

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We must put an end to protectionism and the place to begin is with the defeat of H.R. 1234. We have a choice to either trade more and create more employment or trade less and create more unemployment.

Only through the expansion of trade can we hope to create more long-term job opportunities in growing, flexible industries and sectors. Our current employment problems demand that we compete successfully in the rest of the world. Achievement of this goal will not be a victory for one party or one side, it will be a victory for our Nation.

Thank you, Mr. Chairman.

[Testimony resumes on p. 253.]

[Mr. Brock's prepared statement follows:]

STATEMENT

BY

AMBASSADOR WILLIAM E. BROCK

Mr. Chairman, I am pleased to have the opportunity to come before this subcommittee to discuss U.S. trade policy and its importance to employment, an issue that is on the minds of all Americans and all Members of Congress. Almost no subject considered during the 98th Congress can be discussed without first determining how it will help create permanent, productive American jobs.

Trade is not a threat to employment, rather it is the opportunity. A steady increase in the volume of exports and imports lays a foundation for the creation of new, more stable jobs, higher real income, and a healthy economy. In short, effective trade policies will put more Americans back to work.

A look backward shows that thirty-five years of world leadership in pursuit of free trade policies have made us stronger economically. In recent years, 4 out of 5 of the new U.S. jobs in manufacturing have been created by international trade. One out of every three acres planted by American farmers is producing crops for export.

As we look beyond our own borders to meet the trade challenge of the 80's, we see that potential for growth is enormous. A $2 trillion dollar international market in goods and services gives us an opportunity to create millions of jobs and more income security for our people.

As President Reagan recently stated, the Administration has a positive plan to meet this trade challenge on three key fronts:

- First, we must lay a firm foundation for non-inflationary growth based on enduring economic principles of fiscal and monetary discipline, competition, incentives, thrift and reward.

- Second, we need to enhance the ability of U.S. producers and industries to compete on a fair and equitable basis in the international marketplace. In this regard, we must continue to work with our trading partners to resolve outstanding problems of market access, and to chart new directions for free and fair trade in the products of the future.

- Third, we have to take the lead in assisting international financial and trade institutions to strengthen world growth and bolster the forces of freedom and democracy. Taken together, these actions give the United States a positive framework for leading our producers and trading partners toward more open markets, greater freedom and human progress.

Domestically, the challenge is to fashion economic policies that will generate sufficient growth to allow the nation's economy to adjust to rapidly changing technological and competitive conditions. As economic recovery proceeds, American industries will emerge leaner, more efficient and better able to compete at home and abroad.

Other steps are also required. Education, training, and retraining are as fundamental to our success as are research, development, and productivity. Labor, management, and government at all levels can and must participate in improving these tools of growth. Tax policy and regulatory practices, all need constant reevaluation in terms of our maintaining competitive opportunity. In the final analysis, every American has a role, and a stake, in international trade.

Our success will be measured not in laws or lofty statements -- but in jobs, growth, and real income. We can compete with anyone, and our potential is almost limitless.

Internationally, the United States will continue its vigorous efforts to strengthen international agreements. Our leadership is essential. We must stop the drift toward short-term inward looking policies that would cause the nations of the international trading system to repeat the disastrous history of the 1930s, when protectionism and trade wars contributed to unprecedented suffering. As a leader of the free world, the United States cannot and will not accept this result. We will provide this leadership by act, and by example.

To achieve open and fair competition for U.S. industries we must vigorously enforce U.S. and international trade codes. This Administration has been aggressive in pursuing unfair trade practice complaints against our trading partners for their violations under the GATT. We will continue to be vigilant and forceful in defending U.S. workers against unfair predatory practices by enforcing vigorously the trade laws that are already on the books.

When faced with policies and practices of foreign governments that are either inconsistent with their obligations under trade agreements or deemed to be unreasonable, unjustifiable or discriminatory and a burden on U.S. commerce, this Administration has not hesitated to challenge those practices.

Since August of 1981, USTR has initiated 17 Section 301 investigations. Thus, more than 40% of all investigations initiated under Section 301 of the Trade Act of 1974 have been initiated in the last 18 months.

Last week, the President imposed a duty increase and tariff rate quota on heavyweight motorcycles imported into the United States. Resolution of this Section 201 case, the first import relief petition filed with this Administration, is designed to reduce the threat of injury from excessive imports during the period our domestic industry is undertaking adjustments designed to improve its international competitiveness.

In addition, we currently have 49 countervailing actions in effect and an additional 18 pending. We also have 85 antidumping actions in effect and 30 actions pending - more than at any previous time.

While we are prepared to take action to enforce our international rights whenever necessary, we must also make certain that our own laws operate fairly and efficiently. This Administration has committed to work with Congress in examining the adequacy of our trade laws and methods to strengthen them if required.

Let me note a specific piece of legislation that will be of great assistance in our efforts to strengthen the international codes of conduct. Bills designed to address trade problems in the areas of services, investments and high technology goods have been introduced in the House and Senate. The Administration supported similar legislation last year in an effort to overcome some of the more restrictive practices in these emerging areas within the realm of GATT rules. The Administration has endorsed the Senate bill, S. 144 this year, and we look foward to working with the House and Senate on reciprocity bills again this year.

Where there are gaps or a lack of clarity in international rules of competition, the United States will utilize bilateral negotiations to achieve its goals. To that end, we engaged in detailed

discussions with the Japanese on import testing procedures and standards. I am optimistic that the Japanese Government's recently announced intention to seek parliamentary action to amend a number of its import testing procedures will result in greater access for U.S. suppliers to the Japanese market.

In addition, intensive bilateral discussion on agricultural trade issues with the European Community and Japan are aimed achieving for our farmers an equitable share of the world market.

However, multilateralism still provides the central framework for the pursuit of U.S. trade goals, and the institutions and rules of the GATT are essential to the achievement of global, non-inflationary economic growth. It was for this reason that the United States took the lead at the GATT Ministerial meeting last year to attempt to persuade the major trading nations that emerging issues such as in the areas of technology and services should be placed on the agenda for future research and ultimately incorporated in the rules of international trading.

Opportunities for Growth

The key to our continued leadership and success are policies that allow our economy to adapt to technology intensive industries and toward the services that support a technologically advanced society.

We must build on our strengths, particularly in the areas where the United States has already established a strong competitive record and where even greater opportunities lie in the future.

With a highly skilled labor force, abundant capital for investment, technological know-how and experience and a huge internal and worldwide market, the United States in uniquely positioned to lead the way in high technology trade. This opportunity for growth will require and generate new kinds of jobs. A recent study found that 9 out of 10 fastest growing industries in the United States in the 1980's will come from the high technology area. By the year 2020, as many as one-half of the U.S. workers could be employed at jobs that do not exist today.

However, these future opportunities could be denied if we do not address today's potentially serious trade problems. Since virtually all nations view high technology industries as critical to their economic growth, some have designed national industrial policies complimented by a broad range of interventionist policy instruments.

Some countries have identified and targeted priority industries for special treatment, including low interest loans, tax subsidies and direct grants.

There are serious problems we intend to address multilaterally in the GATT and bilaterally with our principal trading partners.

Unilaterally, an interagency task force has been established to examine the issue of targeting and industrial policies and to determine the effect these practices have on a free and open trading system.

Trade in Services

The U.S. service sector, like high technology, has become a central element in the U.S. economy and the current account balance. Services account for over 65 percent of our GNP and services industries employ 7 out of 10 workers.

Unfortunately, trade in services has increasingly been distorted by a growing number of nontariff barriers and restrictions. Though often "invisible" these trade barriers exert a major impact on world trade, U.S. jobs and earnings.

I want to commend you, Mr. Chairman, for your personal efforts in the past year to stress the importance of services trade in our economy and to recommend courses of policy action that have been a major contribution to the issue.

USTR testified on your bill, H.R. 794, last month so I will only touch briefly on aspects of the measure.

I continue to fully support the intent of the Services Industries Development Program, which was a feature of your services bill in the last Congress. It is an important first step toward developing a more comprehensive analysis of our competitiveness in services at home and abroad.

I also endorse the provision calling for the improvement in services data. USTR is already at work on this by chairing an interagency task force aimed at improving our data collection methods so that services trade can be more accurately reflected in official U.S. Government statistics.

I support the principle of having the legal tools for dealing with unfair trade problems facing U.S. service industries, especially in the absence of international rules. However, I have a reservation about the provision of H.R. 794 that calls for the President to act against foreign practices that discriminate against U.S. service exports. Such authority is quite similar to existing authority under Section 301 of the Trade Act.

In all, however, I think you have introduced a useful piece of legislation and we look forward to working with you on mutually acceptable language.

Multilaterally, we have made significant progress in bringing trade in services issues to the attention of contracting parties under the framework of GATT. We expect to present a comprehensive national study on the issue this Fall and have initiated a series of informal talks on services with interested GATT members. It is only a beginning, but the basic principles of trade liberalization and dispute settlement procedures make the GATT the best international forum for understanding on this issue.

As we push ahead, urging our trading partners to do more to strengthen the GATT and encourage freer trade policies, we expect to meet reluctance and some opposition. There may be those, who in the fact of difficult decisions advocate retrenchment and retreat.

Nonetheless, the United States has been successful in the trade field because of its bipartisan adherence to free trade principles. Ironically, however, we face the opponents here at home who advocate less free trade, not more. They wish to put off the tough decisions of adjustment which face all major trading nations and desire instead to return to a world of protective barriers.

As we have done internationally, this Administration will continue to vigorously oppose protectionism at home that would damage our productive future and distort world and American adjustment prospects.

Finally, I want to address H.R. 1234, the Fair Practices in Automotive Products Act.

As I understand this subcommittee will be holding hearings on this bill next week, I want to reiterate this Administration's strong opposition to this proposal. This bill would raise the price of every car, cost jobs and start a trade war. It is the worst piece of economic legislation in a decade.

H.R. 1234 has been proposed to this Congress to deal with the unemployment problems of more than a quarter of a million U.S. automobile workers and another 750,000 in automotive supply

industries. However, this bill does not address the fundamental problem of the U.S. auto industry and, in my opinion, can only worsen the industry's situation and cause enormous harm to other U.S. workers and the world trading system.

This Administration is concerned about the very real problems faced by the U.S. automotive industry, its workers and suppliers. The economic difficulties of this industry have been coming for sometime and are the result of oil supply problem, government over-regulation, and the manufacturers' failure to quickly respond to consumer demand for smaller fuel-efficient cars.

However, let me emphasize the view that it is not correct to blame the present condition of the U.S. automotive industry substantially on imports. While we are aware that the average import penetration through 1982 was 27.9 percent, in absolute terms, import sales are running only 200,000 units more this year than five years ago when the import penetration was 18.4 percent.

Even so, the voluntary restraints on auto exports were implemented by the Japanese Government in 1981. In February of this year, Japan stated its intention to continue these restraints through March 1984 at the previous level of 1.68 million passenger vehicles.

The continuation of Japan's unilateral restraints on automotive exports into 1984 assures that virtually every additional car that is to be sold in the United States during this period will be manufactured in North America. I particularly believe that the Japanese action is effectively meetin the import issue without permanently damaging the trading syste U.S. exports and jobs as would domestic content legislation.

The consequences of this legislation are serious and far reaching. The bill is directly contrary to the principles of the GATT and would very likely meet a very negative international response.

Should our foreign trading partners respond to the illegal U.S. trade actions mandated by this bill by retaliating against our leading exports, our vitally important industries such as computers, aircraft and agricultural products would be seriously threatened.

The possible impact of retaliation and emulation far exceeds this bill's potential benefits to the automotive industry. An analysis by the Congressional Budget Office estimates that although 38,000 auto jobs would be created by H.R. 1234, the new jobs are more than offset by 104,000 jobs eliminated in factories that make goods for exports.

We must put an end to protectionism and the place to begin is with the defeat of H.R. 1234. We have a choice to either trade more and create more employment or trade less and create more unemployment.

Only through the expansion of trade can we hope to create more long-term job opportunities in growing, flexible industries and sectors. Our current employment problems demand that we compete successfully in the rest of the world. Achievement of this goal will not be a victory for one party or one side, it will be a victory for our nation.

Mr. FLORIO. Thank you very much, Mr. Ambassador.

Mr. Ambassador, in your recent report issued by your office, you were quoted as saying that the lack of institutional capability for analysis of economic issues in the U.S. Government is a significant weakness in the formulation of a cohesive U.S. trade policy.

I am wondering if your office or anybody in the administration is making any suggestions, be they legislative or just policy pronouncements as to how to overcome that deficiency, that is the lack of some structural means for institutionalizing a capability of having overall economic analysis take place so as to facilitate a healthier trade policy.

Ambassador BROCK. We have a number of programs underway. I think I mentioned in my testimony the interagency process that we are presently chairing to improve services data, for example, the collection and dissemination of that information. But I think perhaps it would be better to refer that question to the Commerce Department which has the fundamental responsibility.

I think they are doing an excellent job. The problem is that this economy has changed so much as it moved from an agricultural to an industrial to what is now called an information society that the data as we found even in monetary control is extremely difficult to maintain at a high quality level.

A lot of work is being done, a lot more needs to be done, to be sure of the adequacy of that information.

Mr. FLORIO. The President in the State of the Union message alluded to reorganizational efforts to try to facilitate a more aggressive trade policy. Of course you and the Secretary of Commerce are kind of the lead governmental participants in formulating and carrying out trade policy.

Are you aware of specific reorganizational proposals that are going to be coming down before too very long?

Ambassador BROCK. Well, no, in the sense of something that may be coming to the Congress. We have had 2 or 3 months worth of very intensive discussions on the possibility of improving the process. Some have—some of the suggestions have been incorporated in changes substantive sufficiently to require legislation.

Other changes can be made internally by addressing the complexities or overlaps within the executive management process.

No final decision has been made on this particular question so I don't know how to answer the question about something that might be forthcoming. I think we basically looked at two or three different bills in Congress, Senator Moynihan's bill, Senator Roth's bill, and at the possibility of simply by changing the Cabinet Council management structure itself to see which combination may be more effective.

But no final decision has been made at this time.

Mr. FLORIO. It has been represented, there has been discussion on the Hill which I assume has some basis in fact, that the administration is somewhat reluctant to become involved in comprehensive trade legislation this year for concerns that you have expressed, that that legislation may very well end up being a vehicle for protectionist legislation in the form of domestic content or other clearly protectionist type legislation.

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An opposite argument can be raised that if you want to defuse the economic pressure that builds support for this type legislation you will have to address these problems in a much more comprehensive way.

Can you share with us your thoughts as to which of these two approaches makes more economic sense and trade sense?

Ambassador BROCK. I frankly agree with both. I do worry, Mr. Chairman, and I won't speak for the administration but simply for myself in this regard, I do worry that reorganization plans could become a vehicle for a new agency with a highly protectionist mandate. I don't think that is in the interest of the country. You would have to be awfully careful in describing the basic premise of that project, what you intended the agency to do, to be sure that we didn't lay down a predicate that could do a lot of damage in the future.

With that, I do think that there is obviously a need for clarification in some areas.

Let me caution you just a bit though, Mr. Chairman, on that issue. One of the reasons the Congress set up my office, I think first in 1962, and if I recall Christian Herter was the first head of the U.S. Trade Office, at that time the special Trade Representative, was because we saw in the Congress this constant conflict between the various agencies that had some responsibility in the trade area, State, Commerce, Treasury, Agriculture, and others.

We felt that it was important to put into the Executive Office of the President a mechanism, very small, to coordinate trade policy and to pull together the development of that policy leaving to the regular departments the implementation of the policy.

But the establishment of the policy and the negotiations were to be done directly under the auspices of the President in order to pull together these conflicting elements.

I don't believe that it is possible to write a new department, a new piece of legislation that would ever eliminate that kind of conflict. I cannot foresee a time in our lifetime when the State Department doesn't have a legitimate interest in what is going on in trade, when the Defense Department doesn't have a legitimate interest, when the Treasury doesn't have a legitimate interest.

So at some point there has to be in the executive branch a coordinating role whether it is done with a new department or not, and you still have to have in the Presidency, that final responsibility and that is the real conflict or question we have been wrestling with internally, how do we manage the process so as to be sure that the real coordination is maintained and that we have trade policies established with one voice.

Mr. FLORIO. Have you found there to be any conflict, or do you anticipate any conflict within your own office if you were to be designated as the overall agency for formulating new and enhanced aggressive capabilities in our trade policies, while at the same time you are called upon to be the negotiator with respect to trading partners and trying to come to accommodations?

Is there an internal conflict in being the aggressive advocate, and at the same time, you are designated as the negotiator with our trade policy questions?

Ambassador BROCK. Someone in the conversation in the last 30 days described my office as one of being the honest broker within these various departments, all of whom have an interest in order to pull together one viewpoint and present that as a national viewpoint to our trading partners. I think that is a pretty fair description.

I would see some possible conflict if we had to get into direct implementation of every nuance of all trade actions, particularly if we were to be required to get into industrial policy or targeting actions. I think that that would pose some inherent conflict internally that would make life much more difficult in terms of international negotiations.

Mr. FLORIO. For example, the concept of reciprocity, if you were to be the lead agency in determining whether one of our trading partners was erecting nontariff barriers or conducting themselves in such a way that powers under a reciprocity concept would result in actions taken against that trade partner.

I suspect that might inhibit your ability to continue negotiating with that trade partner in the context of GATT or whatever.

Do you foresee any difficulties there?

Ambassador BROCK. No; I don't see that as a problem, Mr. Chairman.

As a matter of fact, we are the lead agency in 301 actions. We make the final recommendation to the President. If the ITC makes a decision under a 201 proceeding, that comes to us to make the recommendation as to whether to approve, disapprove, or modify to the President.

I don't see that as a conflict. As a matter of fact, I think those are just additional arrows in the quiver. I think that helps with negotiations.

If foreign governments that are engaging in some outrageous practice know the person they are negotiating with can step on their toes, it might help to negotiate a little more seriously than they might otherwise do.

What happens is foreign governments do what we might do in the same circumstances. We will try to play one agency off against another. That is where you get into some problems. If they don't know who the responsibility lies with, then you do have the potential for running around the barn a few times.

Mr. FLORIO. Let me ask two more questions. A recent Commerce Department study on the competitiveness of U.S. high-tech industries found that foreign governments are targeting some of their high-technology industries. The suggestion has been made in a lot of circles that we should undertake the same type of activity.

Do you believe this concept of targeting is capable of being used within our traditions of economic activity, that our system can be adapted to become involved in this type of economic competition?

Ambassador BROCK. Mr. Chairman, I would be very uncomfortable if either the executive branch or the executive branch in combination with the Congress were to try to engage in what is called picking winners and losers. That is really what targeting is.

If you are going to target an industry for particular help because it is the leading-edge technology, a sunrise industry, you have to take resources from others. The money has to come from some-

where, and you then deprive consumers or taxpayers or other industries and workers of the same opportunity.

I am not sure that I think this government ever can be wise enough to do that. I frankly believe that the open market that we have, while it is difficult in the face of targeting practices on the part of others, is in the long-term much healthier.

I think they face a greater risk. Japan has not been uniformly successful. They have selected some winners but they have also selected a lot of losers. I am not sure we want to follow that route.

Mr. FLORIO. Is that really the choice we are faced with, the status quo which has caused difficulties in our economic posture, or getting into what some—I don't say that you are positing as an extreme position—of centralized planning.

We have substantial governmental involvement, but the point is that it doesn't appear to be orchestrated in a coherent way to achieve certain policy goals.

I bring your attention, as I have earlier, to the new initiative apparently being launched by the Defense Department. An article appeared last week saying the Department intends to undertake research and development on the next generation of supercomputers.

The stated purpose is to insure U.S. supremacy over the Japanese in this technology in the 1990's. That seems to me to be this concept of targeting being undertaken by the Defense Department.

Whether that is wise or unwise, when we cross that threshold of getting involved in targeting in one area, it seems it should not be that difficult to bridge our ideological gap that prevents us from talking about it, saying that it gets into picking winners and losers.

First of all, I would like to ask your thought as to whether the Defense Department's activities don't constitute targeting of sorts. And if it does, should the Defense Department be out on their own with respect to a very important part of our overall economy, the computer industry?

What control or what sense of organization should we bring to this type of thing to go beyond just the scope of the Defense Department making these foreign policy and trade decisions rather than making them through your office?

Ambassador BROCK. That is an eminently thoughtful and fair question.

Yes; I think you could classify that sort of a Defense Department action as a form of targeting. Does it cross the line? I don't know.

I wonder if the line should be drawn at the defense area in the sense that we do have as a Federal Government, as our most fundamental responsibility the security of the Nation. If that is involved in something as extremely technical as the computer area, perhaps that is a legitimate exercise.

Let me be more specific in saying that we are hardly pure in saying we have no industrial or targeting policy. We have had targeting policy for 200 years. We have been targeting farms for support as long as I have been around and probably will for a long time into the future.

We have enormous Government support programs in the section of agriculture. We have in the aircraft area through our defense programs, too. We have in a number of computer areas through defense support.

Mr. FLORIO. Therefore, doesn't the point go to whether we should attempt to make this coherent and shouldn't we be determining some goals as a Nation and then trying to put all these pieces of governmental intervention, if we call it that, that have existed into a meaningful pattern so we achieve the goals in an organized way?

Ambassador BROCK. I guess it may be that we are arguing semantics rather than substance. I want to be careful in how I say this, but I guess the best example I can give you is that I think it is a national tragedy of enormous proportion that we have done almost nothing to deal with the 20-year decline in our high school, primary, and secondary education performance in this country.

Twenty consecutive years, until this year, the trend didn't stop. Every year reading skills declined, math skills declined, communication skills declined.

I think that is inexcusable for this country not to deal with that. I think it is dangerous for us not to understand that the most important single tool we have as human beings is our mind.

If we can't offer our children a better education and a better opportunity for continuing education throughout adult life, we are not going to be competitive 20 years from now, not just with Japan, but Brazil and half a dozen others.

So, that is a fundamental area of government that I think we at the local, Federal, and State level, business, labor all have to get our act together, and do it quickly.

I would call that targeting in a sense because it is targeting resources to people so that we can be competitive in an information age.

I do not believe that we should pick the textile industry to the disadvantage of the automobile industry. That is something that I think government can't do.

I don't think we are wise enough in government to know what the new industries are going to be. I think we have to establish the predicate, which means training, education, capital formation, motivation—those are the essentials to a competitive society. If you do that, this vibrant free-enterprise system will respond to markets far faster than government can.

Mr. FLORIO. I don't want to engage you in a particularly political area. I would just observe that the members here would probably agree with you wholeheartedly about the need for greater educational opportunities, and therefore would point out that the 30-percent cut in Federal aid to education in the past 2 years may not be in the right direction if we are going to enhance the capability of our development of a highly trained work force.

The only other point I would ask is, this Defense Department initiative in terms of targeting supercomputers, was this run by the interagency task force that you maintain exists in the administration to talk about trade policies? If so, was it approved?

Ambassador BROCK. Not to my knowledge.

Mr. FLORIO. Mr. Dowdy.

Mr. DOWDY. Mr. Ambassador, in your statement you comment on H.R. 1234 and the impending hearings before this subcommittee on the domestic content legislation.

In summarizing your opposition to that legislation, which I supported last year and am inclined to support this year, you state on

page 13 of your statement that this bill does not address the fundamental problem of the U.S. auto industry. You do not elaborate as to what the fundamental problem of the auto industry is.

Could you give us your thoughts on that?

Ambassador BROCK. We began to get the best evidence of that fundamental problem in 1979 when the second oil crisis occurred and we switched from high priced but short and adequate supply of gasoline, to very short supply.

We had 300,000 Japanese automobiles on the docks unsold. They couldn't sell them because people in this country didn't want a small car. All of a sudden, the gasoline lines formed and everybody scrambled to buy the smallest, most fuel-efficient car available.

That was an international circumstance that simply nobody could have predicted. The Japanese didn't; neither did we. It just happened that their market circumstance led them to produce a small car. We were not prepared because our consumers wanted a large car—still do, by the way.

But that broke the camel's back, and the ensuing losses that we suffered put us in a position of being capital shy. We lost over $30 billion in cash flow in the industry in the last 2 or 3 years. And our ability to retool, we have been extremely hampered.

When you compound that with changing government policy—and I mean daily changing in some cases—over the last decade, as we told automobile manufacturers to worry about safety, then fuel, then pollution, and then do all three at the same time, some of which were directly competitive with each other, we simply made life almost impossible.

At the same time that that was happening and we had the Government interference, our work rules, our wage rates, and our management practices were getting out of competitive whack.

Those are fundamentals that are internal and have nothing to do with imports.

Perhaps the latest and most important fundamental again has nothing to do with imports. It is the extremely strong position of the U.S. dollar in relationship to other currencies, particularly the yen. We have had serious and sustained efforts by labor and management in this industry to effectuate productivity improvements, cost savings, real economies, and they have done a heck of a good job in the last 2 or 3 years.

All the savings they have made in the last 2 years have been wiped out, and more by the shift in the relationship of the dollar. Our higher interest rates, primarily as a consequence of the level of deficits that this Congress and this administration have to deal with, are keeping the dollar at an exorbitant price. That wipes out the savings efforts of labor and management.

Those are fundamentals that have nothing to do with imports and exports.

Mr. DOWDY. My point was, in your statement you seemed to say that there was one fundamental problem, and you have mentioned several problems.

Ambassador BROCK. I should have said "fundamentals," and put a plural on it.

I don't know how to quantify. I guess we could mathematically do it for you, the yen-dollar relationship; noncompetitive work and

wage practices; noncompetitive management practices. But they are being addressed. It takes time.

You don't do those things overnight. But this domestic content bill will do nothing to contribute to that progress—nothing at all. It will simply make matters worse.

You have already got cars priced too high in this country. People can't afford the monthly payment now.

The biggest cost of that payment has been interest rates. That has nothing to do with imports, has nothing to do with UAW or automotive management. That has to do with whether or not we in this Government—you and this administration, collectively—can get these deficits down and take the burden of that pressure off the money markets of this country.

Mr. DOWDY. That is all I have, Mr. Chairman. Thank you.

Mr. FLORIO. Since I was going to ask a question with regard to the voluntary restraint agreement, I thought I heard you say it would be extended?

We understand it was in the third year, and there was no statement yet as to the extention of it.

Ambassador BROCK. I didn't say that. It has been extended this past February for the third year.

Mr. FLORIO. For the third year, yes.

Ambassador BROCK. Through March 1984.

Mr. FLORIO. The rationale for that was, at the outset, to assist the United States in perhaps correcting the differential that existed between the sales price of Japanese cars and American cars.

As you say, that differential has extended. It has gone beyond what it was.

You attribute that in large measure to the monetary questions, the strength of the dollar?

Ambassador BROCK. The strength of the dollar and the decline of the value of the yen have more than offset the cost savings and productivity improvements incorporated by management and labor, yes, that is correct.

Mr. FLORIO. Is there an alternative import relief program that you would suggest be considered other than what it is that we have now?

The end of the voluntary agreement period, if in fact the agreement is not extended by the Japanese, and we have the price differential for whatever reason greater than it is now, one could say that if we are going to deal with just the international marketplace forces, one can conceive of the American automobile industry virtually going out of existence. I don't think that is tolerable.

What would be the suggestion as to how we should deal with that situation?

Ambassador BROCK. It is a little early to be sure what course of action might be taken on that hypothetical situation.

We are making a lot of progress in producing a much higher quality product. American cars today are quality competitive. They are certainly safer than imports.

We are getting our prices more in line. I don't know how fast that will continue to occur, but if it continues at the pace of the last year, we should have a competitive product certainly within the next 2 or 3 years.

But I grant you that the problem will be potentially serious in 1984 and 1985. If the Japanese do not see fit to extend a voluntary restraint, the legal route of the industry will be to pursue a 201 process, such as they tried 3 years ago.

The problem that they had then, if you will recall, on the split vote in the ITC, was that the ITC found that the primary cause was the recession and not imports. I guess the numbers are about 10 percent worse in terms of imports than they were then.

If I recall, import levels were between 15 and 20 percent; they are about 28 percent now.

Mr. FLORIO. Should the test there for cyclical industries such as automobiles be modified?

It is my recollection that the substantial cause is imports. Could it be modified to indicate that it is a relevant cause rather than the substantial cause of the problem that might provide 201 relief?

Ambassador BROCK. We are looking at that question very carefully to be sure that the present law is in fact adequate to deal with this problem. So I will reserve a final answer for you.

Basically I tend to think we need a fairly tough standard on imports because there would be a temptation to use imports to deal with the problem that is fundamentally caused by domestic economic situations, recession.

If we do that, we will have no trade policy at all. We would become simply a protected country and follow the route of some of our friends who have gone that path and are suffering greatly as a consequence.

One of the reasons that I think this country proposed to take advantage of the 1980,s in international terms than any other country in the world, including Japan, is because we have not followed that path.

We have had a very tough time with this recession. We are going to come out of it better, tougher, more competitive, and better positioned to compete than any other country in the world.

If we make the mistake of putting up barriers that are fundamentally trying to deal with the recession rather than the unfair imports, I think we would make a tragic mistake.

Mr. FLORIO. In your opening presentation, you touched on a lot of considerations that describe influences on the competitive positions of nations vis-a-vis each other.

One that you touched on was tax policies. I wonder what your thoughts on that are as to what degree the reliance, as I understand it, that most of our trading partners put on the value-added tax as a means of generating a substantial portion of their revenues.

To what degree is reliance on that form of taxation, versus the type we have, an asset in their trading postures—that is to say, that tax system—does that enhance their competitive position?

Ambassador BROCK. Yes. In international terms it does, yes.

Basically tax policy comes down to a societal question. A value-added tax is a consumer tax. We have relied almost entirely at the national level on the income tax, feeling it is a fairer tax. So for that equity reason we have chosen our route.

But in international trade terms, Japan's 20-percent excise tax effectively—or value-added tax on an automobile that is rebated at

the border gives them a very solid competitive opportunity overseas that is not beneficial to their consumers, frankly, but it is beneficial to their exporters.

Mr. FLORIO. Perhaps just an observation, I don't know of any new initiatives coming out of the administration to impose a value-added tax, but there has been the observation that what is taking place is effectively the same type of redistribution of tax burdens, in the sense that the income tax has been reduced rather substantially with the administration's tax policies, the corporate tax is reduced again rather substantially, to the point that some observe that it would not be in existence in the near future.

There has been a reevaluation and shifting toward reliance upon excise taxes. In Congress in the last 2 years we increased cigarette, telephone, gasoline and so on, taxes. Is there an approach being pursued by the administration in a conscious way to try to emulate the imposition of consumer taxes in a way that is shy of advocating a VAT or to shift off one form of taxation and shift on to consumer taxes in the way that other nations have relied upon consumer taxes, Mr. Ambassador?

Ambassador BROCK. No, I don't see any inclination to pursue that objective. We do believe that income taxes, because of the combination of the progressive system and inflation which throws people annually into a higher tax bracket, we are creating a digressive situation that was very damaging to incentives to saving and investment.

We felt that—we felt cutting the rate of taxes and indexing would restore the ability of Americans to maintain that which they have earned. When we suggested the gasoline tax we did so on the premise that it was a user tax, that it in effect went to benefit the people that were using the highways that the tax was going to support.

That is different than a value-added tax which goes against all consumers across the board. Fundamentally, most Americans agree with that as a premise. The user tax is a fairly well accepted tax in this country. But consumer taxes in most States have reached a point of some substantial resistance now.

Mr. FLORIO. Mr. Ambassador, we appreciate your participation today. It was very helpful. Thank you.

Ambassador BROCK. Thank you very much.

Mr. FLORIO. The next witness—and we are adjusting the witness list to accommodate travel requirements—we will ask Professor George Lodge of the Harvard Business School to come forward.

STATEMENT OF GEORGE C. LODGE, PROFESSOR, HARVARD BUSINESS SCHOOL

Mr. LODGE. Thank you, Mr. Chairman.

As you suggested at the beginning, America's $60 billion trade deficit and much of our unemployment is evidence that our economy is in many ways no longer competitive.

Japan and other Asian countries in particular, have found ways to produce and distribute products of better quality at lower prices than ours. The causes of our deterioration have varied, but overall, the competitiveness of the East Asian countries is based on a will-

ingness and an ability to save, to invest, and to design a strategy through which government, business, and labor work in consort to abandon old industries and create new ones which are aimed at the growing markets of the world.

We complain that our competitors violate the rules of free trade which in many instances is true, but the question comes by whose rules is the world going to play? If not ours, then we had better learn how to adjust to the new reality.

The first step is to make an accurate and comprehensive description and diagnosis of the competitive problems of the United States. In which categories of manufacturing and servicing are we winning and losing? What are the reasons?

This requires examining over time what has been happening in these categories in terms of investment, profits, wage rates, research and development, and so on. What have been the trends and what is likely to happen next? With this data in hand we can examine the causes and then seek remedies. My colleague, Professor Bruce Scott and I, together with others at Harvard are now engaged in this effort and we hope to have some significant results in 6 months or so.

It seems to me that such continuing description and diagnosis is in part the intent of several bills before this committee, H.R. 794, H.R. 1571, and H.R. 2203.

From a clear diagnosis, we can proceed intelligently to remedies. It is I think already clear that ad hoc protection of the status quo is no solution. It is also clear that since we are being defeated by more effective systems our response must be systematic. U.S. competitiveness is affected by a wide range of Government policies; fiscal, monetary, trade, investment, and more. It is aided or handicapped by innumerable regulations, subsidies, incentives, and disincentives. It is helped or hindered by relationships between managers and those whom they manage. The task is to make the system competitive, the approach must be holistic.

Under the pressure of competition, management and labor and several industries are introducing imaginative changes in their relationships. Managers are learning to manage better, and trade union leaders are being reminded that without competitive companies there are no jobs. It would be poor policy to discourage the innovation which is underway. What is essential is to help it along, to ease the transition, and to insure that the burden of change is fairly shared.

H.R. 1234, Domestic Content, seems to me to be premature. There may be justification for this form of protection, but as yet we do not know. It does not come without a sacrifice on the part of consumers and employees of industries which will be hurt by the predictable retaliation such a law would provoke.

Without an overall strategy, we cannot know whether this price is worth paying. It can be argued that without this legislation, the U.S. automobile industry will decline until it becomes competitive with others in the world. Is this desirable? It may be if there is work for those laid off, training to equip them to do it, and if that work is in higher value added industries which will sustain our standard of living in the future the way the auto industry has in the past.

It is undesirable if such work and training does not exist. Thus comes the necessity of a strategy, a consistent set of priorities about what we want to achieve as a Nation and coherent policies to get there as provided for in H.R. 2203. Presumably, we do not want to be a service island in a manufacturing archipelago.

But we have not completely decided. Without a strategy we are in danger of resorting to a variety of uncoordinated remedies, responding to the pressure of first one and then another set of interest groups, the overall effect being to prolong uncompetitiveness and diminish America's capacity to maintain or to raise its standard of living.

Regarding the location in Government of such a strategy-making capability, H.R. 2203 proposes a new Department of Domestic and Foreign Commerce.

My own preference is to expand and strengthen the office of the U.S. Trade Representative for the reasons and in the fashion set forth in my prepared statement.

H.R. 1571 on reciprocity is fully consistent with my view of the U.S. Trade Respresentative's role and perhaps the bill is necessary in order to emphasize the importance which Congress attaches to the U.S. Trade Respresentative's and to its advisory committee apparatus.

In particular, I would like to call the committee's attention to pages 10 to 13 of my prepared testimony where I set forth the five criteria which an effective strategy making apparatus should meet.

Briefly, Mr. Chairman, if I may, the first is it should be able to formulate a single Government position reflecting the views of the executive branch. For this reason it should not be a part of any department but it should be above them all.

Second, it must be able to secure congressional endorsement of a definition of national priorities. Therefore, it needs to have special continuing, stable and relatively formal relationships with the Congress in the manner that the U.S. Trade Representative has.

Three, the apparatus must be able to work cooperatively, indeed intimately with the companies and the labor unions, who are on the front lines. The Government needs their competence just as business and labor need the authority of Government.

Four, the apparatus should be able to force those groups to balance and manage their competing demands with a view to the general long-term needs of the Nation. It should therefore be the single focus for the negotiation of trade agreements and other policies having to do with competitiveness.

Five, the apparatus should be staffed by the highest quality personnel who are encouraged to remain at their work over a long period of time relatively free of political patronage and other distractions. The staff need not be large but it must be authoritative.

Many of the activities of the apparatus will impinge upon domestic policies. Therefore, there should be the closest working relationship between it and the Office of Management and Budget which office over the years has gained authority for coordinating all domestic regulation and programs.

Thank you, Mr. Chairman.

[Testimony resumes on p. 279.]

[Mr. Lodge's prepared statement follows:]

Testimony of
George C. Lodge
Before the House Subcommittee on Commerce, Transportation and Tourism of the Committee on Energy and Commerce

The time is at hand when leaders of business and labor recognize that the federal government of the United States must have a coherent strategy for dealing with both domestic and foreign ramifications of international trade and competition. Priorities need to be set and realistic government and business policies determined to achieve the priorities. The pretense of free trade and laissez-faire obscures the fact that all nations of the world, including the United States, have and will continue to have a host of policies which affect the behavior of business: subsidies, tax incentives, accounting conventions, credit allocation, trade laws, monetary policy, foreign and defense policy, environmental policy, energy policy and more. Either these policies are designed coherently, their overall effects calculated and balanced, or they are the casual result of disparate interests seeking a variety of incompatible goals. Until fairly recently the United States could afford incoherence; today the costs are too great.

There is a mechanism in the Federal government today which with increased support from government, business and labor could become an effective instrument for the formulation of a national strategy to recover lost ground in the international arena. It is the White House Office of the United States Trade Representative (USTR), currently led by Ambassador William Brock with a staff of 100 career officers. A number of other worthwhile suggestions have been made to undertake this task; including, for

Acknowledging the traditional aversion of business to the definition of the national interest by a coherent government, Irving Shapiro, retired chairman of DuPont and former head of the Roundtable, said, "I don't think it's controversial to say that the role of government is to define the national interest. We don't have the mechanism to do it and we keep proving it year in and year out, but if government isn't going to define the national interest, who is?"

Charles Brown, chairman of AT&T,[2] Fletcher Byrom, retired chairman of Koppers and head of the Committee for Economic Development,[3] Frank T. Cary, chairman of IBM,[4] Howard Love, chairman of National Steel,[5] William Norris, chairman of Control Data,[6] Henry Schacht, chairman of Cummins Engine,[7] and many other business leaders share these views.

They derive from a realistic assessment of the growing interdependence of the United States on the rest of the world. We are irrevocably enmeshed in world competition and in many areas we are losing. Our trade deficit in 1982 is likely to be more than $40 billion, about half of which is with Japan. Some 20% of U.S. industrial production is now exported, and farm produce from two out of five acres is sold abroad. One out of every six jobs in U.S. manufacturing comes from exports. Almost one third of U.S. corporate profits derives from international trade and foreign investment of U.S. firms. The share of trade in the gross national product has doubled in the past decade. Considering potential exposure to import penetration, more than 70% of U.S. goods are now effectively in international competition. And more than half of the nation's supplies of 24 important raw materials, ranging from petroleum to cobalt, are obtained from foreign sources.[8]

can do this are moving ahead of those which cannot. It is folly to pretend that we can live in a world which is so interlocked by trade patterns and rely on a free market system when that system is regularly deformed and distorted by others. If we continue, we will be allowing other nations to dictate our national policies and direction. Some industries undoubtedly will have to contract. There must therefore, be national support structures to phase them out--job retraining, development of other industries in a parallel time frame and ways of matching workers to new industrial needs."[11]

Before considering where and how the formulation of national strategy could best be institutionalized in the federal government, let us consider the plight of the steel industry as an example of a situation which requires strategic attention.

THE U.S. STEEL INDUSTRY

The condition of the American steel industry in the winter of 1983 demonstrated dramatically the need for continuing, coherent thought and action by companies, government, and labor. Each group was pursuing its own objectives and the resultant policies were whipsawing the industry, leaving it unable to meet any goals at all. It was becoming clear that we can't have everything: achievement of social goals costs money that must be diverted from pursuit of economic efficiency, competitive supremacy, and/or financial return. It was also clear that we had no mechanism to set priorities among our objectives. Some policies shaped the environment so that the steel industry achieved social ends, some encouraged financial return, others competitive improvement. The strength of each set of policies varied over time and the steel industry, in responding to first one set of government policies and then another had over the long run dissatisfied everybody. The industry

To conduct international trade negotiations successfully requires either an implicit or explicit definition of the nation's interest regarding domestic steel manufacturing. This in turn requires a mechanism for the purpose which could consult relevant groups and establish a consensus on goals and policies, which would be reliable over time. The alternative is continued vacillation, dissatisfaction with steel industry performance, and waste.

An analysis of statistics on the industry provided by the American Iron and Steel Institute for the years 1972-1981 shows that industry managers have sought high financial return under current accounting conventions. Taking four possible goals for the industry--economic efficiency, financial return, competitive supremacy, and social/political contribution--the industry has pursued financial returns essentially through improvements in economic efficiency. This has required sacrificing competitive position and employment.

The effort to improve financial returns has been made by industry management despite government policy. Most such policy, notably depreciation rates and environmental control laws, sacrificed financial return in favor of other goals. Management sought to improve productivity by closing plants at the same time that government was requiring increased expenditures on plant and equipment. Pollution control laws, with their effluent rather than financial standards, directly contradicted efforts to improve productivity by shrinking the asset base. During the 1972-81 period, the steel industry was forced to spend $6 billion on air and water quality control while the

If we wanted to encourage mini-mills, that policy should be inspected. The question comes what does the president mean by a "world-class" industry? And what is "the threshold" to which Dr. Mettler refers? World steelmaking capacity exceeding demand, who do we expect will cut back?

Government policy to deal with international competition has been consistent but ineffective. In general, whether under the guise of anti-dumping and countervailing duty laws or trigger-price mechanisms, the U.S. has tried to force other countries to accept our underlying steel policy of seeking high financial returns and high wages without government subsidies. Subsidization, for whatever reason, has been deemed "wrong" and the U.S. government has attempted to get other governments to stop it and behave "fairly," i.e., pursue the goals we do. Our consistent attempts have been consistently unsuccessful. The result has been a decline in market share. As the American steel industry has gone for high return, markets have gone to those willing to take lower returns. Failing to get other countries to require a higher return in their steel industries, we must either reduce labor costs and profit expectations, continue to lose market share, or seek some form of protection.

In 1982 the U.S. government found itself once again obliged by law and a fervent belief in free trade principles to seek to prevent foreign governments--this time our European allies--from subsidizing their steel industries. Under the threat of countervailing duties imposed by the U.S.

AN APPARATUS FOR STRATEGY FORMULATION: CRITERIA

If management and unions in the major lines of American industry today were to design a governmental apparatus capable of formulating a reliab and effective strategy for the United States in the world economy, they would we think, want it to have the following capabilities:

1) It should be able to formulate a single government position, reflecting the views of the executive branch. Recognizing the very different interests and responsibilities of the several government departments--Agriculture, Commerce, Defense, Treasury, State--the ideal apparatus should collect, balance, and compose those several interests into a coherent U.S. position. This is plainly not easy. If we impose strict restraints on European steel exports, the Europeans are likely to retaliate against U.S. farm products, offending agriculture. U.S. exports become prohibitively expensive as the value of the dollar rises in response to the Fed's tight money policies and high interest rates which attract foreigners to invest in dollars making them scarce and more valuable. State and Defense are loath t anger European governments at a time when we are seeking greater commitments to NATO. But nevertheless trade negotiations are inevitable and they requir that the U.S. knows its own mind. These criteria would naturally suggest that the apparatus should not be a part of any department, but above them al

2) It must be able to secure congressional endorsement of a definition of national priorities. This virtually requires congressional participation in the formulation process. It means that the constitutional separation of powers between Congress and the executive must be bridged in matters concerning trade and international competition. No trade policy can effective without the support of Congress and the actions of Congress affect

focus for negotiation of trade agreements between the United States and foreign nations. Plainly it is senseless to have such negotiations taking place at many different points in Washington; this encourages foreign interests to look for the weakest point where our armor is thinnest. The negotiation of tariff and nontariff barriers with other countries reaches into all aspects of the U.S. government and relevant businesses and unions. Nontariff barriers, for example, include subsidies to encourage exports. But when is a subsidy a subsidy, and when is its purpose export rather than domestic justice? Europeans complain that U.S. natural gas price controls have kept costs of our chemical industry unfairly low. Is that a subsidy? The leasing provisions of the Tax Act of 1981 was a way to funnel money into the profitless industries of America including Big Steel. A subsidy? The free market enthusiasts in Washington decry credit allocation by foreign government as being unfair. And yet the Council of Economic Advisers reported that in 1981 the U.S. government allocated a whopping $86.5 billion to private industry and agriculture in direct loans, guaranteed loans or government-sponsored loans.[15] If credit allocation is to be a matter of negotiation abroad our ideal apparatus has to have some role in it at home. These are the kinds of uncertainties which make countervailing duty and antidumping statutes so difficult to apply and enforce. They were written in a different age for a different time. It is why inevitably their application becomes only a part of a larger negotiation.

5) Since negotiating with foreigners is a skill increased by experience, which requires language ability and cultural adaptability, the apparatus should be staffed by the highest quality personnel who are encouraged to remain at their work over a long period of time, relatively free of

The critical issue is presidential will. For the USTR to do what needs to be done requires that the President want it to. So far presidents have been uncertain. Both Carter and Reagan did their best to move the office out of the White House. Unable to do so because of Congress they became increasingly aware of its importance located right where it is. But still the office needs great strengthening if it is to even approach its awesome task.

Here is where business leadership is essential. Ideology and politics make it improbable that President Reagan will take the necessary initiative. He is much more likely to continue doing as he has done: let nature take its course with authority and responsibility scattered among an incoherent number of individuals, groups, and departments.

If business wants a strategy, it must take the leadership in forcing the conversion of the USTR into the apparatus here outlined. If it does not, business will continue to work around the edges of government, probing and pushing where it may, seeking targets of opportunity and short-term gains as they crop up. Although some individual companies might benefit from such a tactic, it will not serve the best interests of either the country or business as a whole.

The Evolution of the USTR

The idea for the current USTR emerged in Congress in the early 1970s frustration grew with the old procedures for trade negotiation. There were two problems: First of all, the United States, the leading proponent of free trade in the world, was, Congress felt, being increasingly taken by other countries who would not play by the rules of the game. The "cheaters," such as Japan and France, were continually confronting us with sophisticated and

Second, the White House Office of the Special Trade Representative (STR) was greatly strengthened, and given cabinet rank. Congress expected it to be a single strong focal point within the executive for determining trade policy and making trade-offs between the positions held by various departments and agencies. The STR chaired a series of intergovernmental coordinating committees which thrashed out final American positions. Location in the White House and dual responsibility to both Congress and the executive branch, gave the office authority, as well as the capacity to fuse the gap between the two branches of government.

The third innovation of the Trade Act of 1974 was the creation of an extensive set of advisory committees, composed of members from the private sector, to consult with and advise the American negotiators. As Congress had insulated itself from the special pleading of interest groups, so it mandated the executive branch to listen to them and to incorporate their recommendations into American trade policy. In this way, the diverse interests of Americans could be taken into account before and during the formulation process rather than after agreements had been reached. Congress maintained its oversight responsibility by requiring each committee to submit a final report to it. According to Geza Feketekuty of the USTR Office staff: "The idea was that the negotiators should get as many of these groups as possible on board with what they were doing. At the end of the negotiations, each of the committees was required to report to the Congress on the extent to which the executive branch took their advice into account, and the extent to which they were satisfied with the outcome. If they said they were unhappy, the Congress wasn't going

president when he became STR and used this combination to build a broad consensus for the agreements coming out of the Tokyo Round. Trade-offs both large and small had to be made. The Italians complained about almonds and eyeglasses. Opposition to removal of a nontariff barrier on whiskey imports from the bourbon industry was neutralized by gaining concessions on tobacco. Steel was less than satisfied with the trade agreements but could be mollified by adjustments in the wording of domestic legislation. Above all, GATT and free trade had to be preserved which could only be done by building a broad consensus for multilateral negotiations in the U.S. through a combination of domestic and international deal-making.

Strauss was able to use the central position of the Office combined with strong presidential support, to become in effect a broker, building consensus between the U.S. and foreign governments, between agencies and departments of the executive branch, between Congress and the executive, and between the government and the private sector. He was able to use his cabinet rank, the consensus-building resources of the Office, its close White House ties, its special relationship to both Congress and the executive, and particularly its institutionalized ties to the private sector, to achieve broad agreement on the Tokyo Round conclusions. One measure of his success was the near-unanimous passage by Congress of the domestic legislation implementing the Tokyo Round agreements, a far cry from the outcome of previous multinational negotiations.

Analysis

The kind of consensus building engaged in by the USTR during the Tokyo Round is an unusual activity for the American government. There are many examples of *ad hoc* coalitions being formed under strong leadership or in

The reaffirmation by the '79 Act of the changes made in 1974 reflected the belief in the efficacy of this new system as well as in the results it produced. The expedited congressional procedures for considering trade legislation were maintained. The Office of the USTR was made permanent. The private advisory committee system was reauthorized and its mandate expanded from provision of advice on negotiations to implementation of the agreements and ongoing consultation on trade policy. According to the report of the House Ways and Means Committee on the '79 Trade Act,

> The continuation of this type of mechanism will be of critical importance in ensuring effective implementation of the MTN agreements, evaluating and refining those agreements, managing problems in key trading sectors, and shaping overall U.S. trade policy objectives and priorities.

Although many countries have close ties between their governments and their private sectors, particularly when considering international issues, such is not the case in the United States. As Phyllis Bonanno, director of the Office of Private Sector Liaison at USTR put it, "You have a private sector in the United States unlike any other in a developed country in the world. Our private sector and our government do not walk hand in hand the way the Japanese, Germans, and French do." Americans are much more comfortable with adversarial rather than consensual procedures. Based on the belief that the common good emerges from the competition of each group pursuing its own particular interests, they look askance on efforts to combine those interest groups to work out and articulate common goals.

The USTR and its consensus-making activities during the Tokyo Round did not escape this criticism. The initial ambivalence on the part of the private sector members of the advisory committees reflected this view. Over

Eads suggests that there is some absolute definition of the national interest which presumably governmental experts should be able to divine free from "political brokering." But is that true? May not in fact the national interest emerge from exactly the kind of pulling and hauling which the USTR apparatus is set up to manage?

What seems essential is that business, government, and labor understand their roles and responsibilities clearly. Here again the thoughts of Shapiro and Mettler are particularly relevant.[16] Said Shapiro:

> If we want better government, business had better help develop the alterntive policy choices and lay them out so that people who have the political power can make wiser choices.
>
> Policy choices must be made through the political system. The role of the private sector is to help the political system do the job better.
>
> The concept of adversary relationships has to be abandoned. You have to create a climate in which business, government, and labor can sit down together and try to fashion remedies that work. Business and labor must always recognize that the final decision will be government's but it can't make a good decision unless it has decent inputs.

And Mettler:

> There is no question that the United States has to become more competitive. We have neglected the health of our economic system. But there is no remedy which can be put into place outside of the political process. It is all very well for private groups of academics, business people or whoever to meet and talk and recommend, but when the chips are down it is through the political process that national policy changes are made in the United States.[17]

Eads' comments and those of Bradford Stroup of Data General raise the problem of representation on the committees of the USTR. Stroup is concerned about the big, well-established computer companies who built plants in Europe,

conveniently fit the advisory committee titles. Some industries have virtually no unions at all. The problem has to some extent been avoided by the USTR practice of placing industry and labor on separate committees. But labor representation will be a continuing difficulty unless traditional union organization is extended to unorganized industries or some form of company union system is established as in Japan. It is significant that on the new Services Policy Advisory Committee, dealing with banking, insurance, shipping, and other services, industry and labor representatives are for the first time meeting together. The union representatives include the presidents of the Communications Workers of America, the International Brotherhood of Electrical Workers, the Pilot's union, hotel and restaurant employees and the Seafarers union.

If labor organization makes tripartite arrangements difficult so does industry organization. Unlike in Europe or Japan, much of American industry is not well organized. "Banks, for example, are a very heterogeneous lot," said Feketekuty. "It is difficult for the American Bankers Association to represent effectively the full diversity. In fact, service industries generally are not well organized at all politically."

The Mandate

The USTR apparatus represents a radical--if pragmatic--departure from several components of traditional American ideology. It would have failed if the basis for its authority and legitimacy had not been carefully laid. Its consensus-building activities diminish the separation of the Congress from the executive and are protected from publicity. The USTR seeks to organize and reduce if not to restrict interest group activity; it recognizes that the marketplace is not free and open and that therefore

governments from subsidizing their steel producers in Europe, Brazil, South Africa and South Korea,* brought steel also under the jurisdiction of the Commerce Department which is charged with enforcing antidumping laws. But as law enforcement turns inevitably into negotiations, the steel matter needs the coordinating capabilities of the USTR. The U.S. cannot have a sensible steel policy without, for example, taking into account the interests of U.S. banks. The big steel producers of the 1990s will certainly include Brazil and Mexico; each plans to double or triple its capacity. Each also owes from $60 to $80 billion to mostly American foreign banks.

The Reagan administration has urged the IMF to force debtor countries to tighten their belts and pay their debts. To pay their debts they must export steel. The rich world's banks have cheered this notion. The virtuous circle which the administration is urging upon the poor is as follows: Consume less, save and invest more, and liberate your entrepreneurs. They, with the additional investment funds made available, will make goods (i.e. steel) and services for export to the U.S. and elsewhere which will earn the foreign exchange which will enable the debtors to pay their debts. Thus trade policy is only one part of a total economic policy which in turn is inseparable from foreign political and military policies and from domestic policies as well.

Enlargements of the responsibilities of the Office can be expected to cause confrontations with the old line cabinet departments such as Commerce, Agriculture, Labor, and Treasury upon whose staffs the Office relies to do its work. Although there is good reason to locate the apparatus at the highest and most central level, namely the White House, the interfaces

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*South Korea, with labor costs of about $1.80 an hour and the world's most modern mills, is now the fifth largest supplier of steel mill products in the U.S.[19]

in an increasingly competitive world. The voice of business is particularly important because its influence in this administration is presumably greater than normal and it has much of the knowledge and competence necessary to make the choice wisely.

Business executives can contribute to the weakening of the USTR apparatus by exploiting the natural propensity of the federal government toward fragmentation and incoherence. That is certainly the easy way, and might yield some short-term benefit for those companies which have special clout. But over-all the results would not be good: increased crisis, pressure for protection against mounting imports, confusion among our trading partners and expense for the nation.

On the other hand, business can use its influence to help build a national capacity for coherent strategy formulation; it can help to create a procedure through which goals and policies can be set and a consensus behind them developed. In my judgment business can do this best by strengthening the USTR apparatus, encouraging strong support for it from the President and his staff, enhancing the role of the advisory committee structure by using it and protecting it from misuse, and in general realizing that the success of business is linked to the ability of the nation as a whole to prosper.

Mr. FLORIO. Thank you very much, Professor.

Let me express my frustration at trying to deal with many of these suggestions that you have put forth which I think really are in essence in the same direction that the legislation that this committee is introducing. We heard a bit of this from the Trade Representative and we have heard it in the past; we have heard that somehow it is un-American to try to put together a coherent overall policy, that it runs counter to our traditions of domestic catch-as-catch-can that everything should happen by the mysterious hand of the marketplace.

Particularly over the last 2 years when the administration admittedly starts from the premise that Government somehow is the problem and, therefore, to start talking about a greater governmental presence in trying to formulate a coherent trade policy would appear to be running counter to what this approach is.

Have you any suggestions as to how almost as a political approach one can start to lift the level of consciousness of the American people to the need for going in the same direction that just about every other industrialized nation in the world has gone in, and that is a cooperative effort to mobilize the national resources and it is not going to take place without some public sector presence in our economy.

Mr. LODGE. We pay a big price for the myths of the traditional American ideology. The myth of the limited state is becoming more and more costly. We would prefer, I think as a Nation, to have a smaller, less interventionary, less expensive Government.

The problem is that the reality of the world requires increasingly coherent Government policy. It doesn't make any difference what administration. It requires Government to make choices about what the national interest is, about what the community needs. Some 20 percent of all of the credit in the United States is allocated by Government through loans, subsidies, loan guarantees, one thing and another.

We pretend, however, that we don't have credit allocation. Of course we do, but it is credit allocation according to the pulling and hauling of an infinite variety of interest groups which is incoherent.

We are paying a big price for this traditional conception of ours. Take the question of the decline of the automobile industry that Ambassador Brock described. If we had had some kind of capacity to think coherently and strategically in 1973 or 1974, perhaps the automobile industry and the Government would have sat down and said to themselves, is the price of oil going to go up or is it not? If it is going to go up, does it make any sense to pursue a Government policy of keeping the price artificially low so that American consumers will continue to want big cars and we can't change to manufacturing small cars?

If we had done that in 1974, the automobile industry today would be in much better shape. And ironically this incoherence makes Government larger, more interventionary and more expensive than it otherwise might be.

We did not do that. Our oil pricing policy is a very good example of incoherence.

Mr. FLORIO. Let me play devil's advocate, how then does one protect—if one moved in the direction you advocate—how does one protect against an overextension of authority on the part of the public sector participants in this new sense of coherence to the point that we are talking then about the potential for centralized control, inefficient Government allocation of capital, the picking of the winners and losers in a nonmarketplace context; and I think most agree that the marketplace, when it operates, is a more effective allocator of resources.

How does one build into the institutional structure that one might talk about sufficient safeguards that we don't go to the stream, that we have some sense of economic democracy and free marketplace forces still operating so as to avoid the scary scenario that some say inevitably will result from any attempt to have a public sector presence in the operation of our marketplace? Do you have any suggestions?

Mr. LODGE. I think the first prerequisite is for us to know what we are doing. That is, if we consciously understand and agree that the role of Government in 1983 includes thinking strategically about the place of the United States in the world economy, if we recognized that, at the same time we would recognize the hazards and they could be guarded against; but the problem with proceeding the way we are is that in response to crisis and catastrophies of one sort or another, the Government wields a big club which is a very blunt instrument, and frequently takes actions which are more interventionary and less efficient than they might be.

For example, over the years there have been forms of protection of the steel industry with no quid pro quo being demanded of the steel industry in terms of modernization or consolidation or increased competitiveness.

Mr. FLORIO. Doesn't that go to the concerns that some have, if the Government has the ability to demand the quid pro quo and says that you shall do this, this, and this; doesn't that reason force the concerns that some have that governmental managers would be making those types of managerial prerogative decisions, that they are not particularly capable of making?

Mr. LODGE. If we look at the Chrysler example, there was a Government bailout, if you like, but it came with a quid pro quo and I think it has worked better than many of its detractors expected it would.

One of the appealing features to me with respect to this last point of yours that is very important, one of the appealing features to me of the U.S. Trade Representative's Office is the potential of the advisory structure that is built around it: representatives of industry and labor who meet regularly, year in and year out, with administration after administration, one after the other, and they report both to Congress as well as to the Executive.

I think that insures that there is a pluralism in the formulation of policy. That would be an important safeguard. So that is one reason I think that that particular office has many desirable features which the Congress obviously built into it knowingly, because when the Congress delegated much of its authority in the trade field to the Office of the U.S. Trade Representative, I am sure it was mindful of just the hazards that you emphasize.

Mr. FLORIO. If I can provide you with one more example of that concept of governmental intervention that worked, I think fairly well, that came out of this committee was the whole question of Conrail, trying to wean Conrail off the public dole through this legislation, establishing productivity milestones that had to be achieved before the next installment of assistance over a period of time was allowed to go forward and we have a situation now that even in difficult economic times, Conrail is on the verge of becoming—if it is not already—off of the public dole and is a much more efficient and lean operation. That is the type of approach you are succeeding.

Let me ask one last question, you heard my point I raised to the Trade Representative with respect to the Defense Department's latest action in the sense in targeting computers. Are you aware of this and could I ask what your thoughts are as to the concept of that sort as conduct by the Defense Department in particular and one branch of Government in general?

Mr. LODGE. I am no more aware of it than I am of what is in the papers. I think the idea that we don't target is a myth. We subsidize the tobacco industry; we subsidize peanuts; we subsidize sugar; we subsidize all over the place. So we target.

The question is, what are the criteria. I see nothing inherently wrong. In fact, I see it as a good idea to encourage the high-tech industries of this country, semiconductors, computers, and the rest.

I can see nothing wrong with this being done in collaboration with the Department of Defense. What I do think is crucial, however, is that that be part of an overall strategy. The Department of Defense, like every other department, needs to be coordinated so that it by itself is not making national strategy in the competitive field.

Mr. FLORIO. Mr. Dowdy.

Mr. DOWDY. Thank you.

Professor Lodge, I want to thank you. Your written statement was furnished beforehand by the members of the committee and it was very helpful.

I wanted to ask you briefly about your comments in your oral testimony regarding the domestic content legislation. You state that it is now premature.

What changes would be needed before you would change your attitude and that it is no longer premature but would be needed? What changes would have to occur?

Mr. LODGE. The justification for the act would be the maintenance or the creation of an automobile industry in the United States of a certain configuration with a certain cost structure. When I say "premature," what I mean is you can't decide whether that is how we want to spend our resources or whether we want to spend our resources in high tech or in some other way. I don't know how a decision to protect the status quo in the automobile industry—which this legislation represents—can be made without looking at the larger scene. That is one problem.

The other problem is—and here I agree with Ambassador Brock—that there is a great deal going on in that industry which is long overdue. The problem is, of course, that it is unfairly painful to the unemployed workers that are paying the price. But I think

better policy would be to find some way to assist them, retrain them, relocate them, rather than to perpetuate a costly and inefficient and uncompetitive industry.

That is the objective of a national strategy which I think the chairman referred to. If one looks at Japan, which has had a very successful national strategy, the one thing the Japanese have never done is to protect uncompetitiveness. I think if there is one lesson to be learned from them, it is that.

Mr. DOWDY. That is all I have. Thank you.

Mr. FLORIO. Professor, just one last point. Part of what you said today is I think reinforcing the points that some of us have made in the past about the need for greater linkage between trade policy and domestic policies.

I just wonder, the emphasis that you and the Trade Representative said in suggesting that the Trade Representative be the lead agency, if an alternative would be the Commerce Department. Wouldn't there be greater opportunity to facilitate that linkage inasmuch as the Commerce Department is obviously already involved in domestic policy?

If in fact the Trade Representative, who has very little to do with domestic policy, were to be the lead agency, would that facilitate the linkage question?

Mr. LODGE. As I suggested in my testimony, to my mind the proper locus for the policymaking and for overall supervision of these questions having to do with trade and competitiveness seems to me to be the U.S. Trade Representative Office plus the OMB. The problem with Commerce is that there are other departments which also have a very important domestic interest and which have to be taken into account—Labor, Agriculture, Treasury, EPA.

And by locating it in one of these places I think you would be handicapping the President in his capacity to be coherent. In a way, in our setup the only place where you can have a coherent capability, it seems to me, is in the office of the President.

Now, that doesn't mean that the work, the implementation, the research, all of that can't be farmed out. I think it can be as it is now indeed being done. Much of the U.S. Trade Representative's work is done now in Commerce. I think that that is appropriate.

Mr. FLORIO. Professor, thank you very much.

Mr. LODGE. Thank you.

Mr. FLORIO. We are pleased to have the Honorable Olin Wethington, Deputy Under Secretary for International Trade of the U.S. Department of Commerce.

Mr. Secretary, welcome to our committee.

STATEMENT OF OLIN L. WETHINGTON, DEPUTY UNDER SECRETARY FOR INTERNATIONAL TRADE, DEPARTMENT OF COMMERCE, ACCOMPANIED BY MICHAEL DRIGGS, DEPUTY ASSISTANT SECRETARY FOR AUTOMOTIVE INDUSTRY AFFAIRS

Mr. WETHINGTON. Thank you, Mr. Chairman.

Mr. FLORIO. We appreciate your willingness to accommodate the previous witness' time schedule.

Your statement will be entered in the record.

Mr. WETHINGTON. Thank you, Mr. Chairman.

I am pleased to appear today before the committee to discuss the overall U.S. trade policy, domestic content legislation, and trade organization. I am accompanied by Michael Driggs, Deputy Assistant Secretary for Automotive Industry Affairs, who is prepared to answer any questions you may have on auto industry issues or on the administration's position on domestic content legislation.

Today, the United States and many of our trading partners are poised at a delicate juncture. Economic recovery is beginning—certainly in this country; but forces pushing the world toward protectionism still threaten. In this posture, where many of our trading partners would like to believe that an upturn in global economic performance will ease their domestic pressure for import restraints. How we manage trade issues at home is certain to have an important bearing on whether we can convince our trading partners to avoid further protectionist moves.

We will require a strong united voice for free trade and an assertive trade policy which seeks to pursue our legitimate trading rights. We are likely to need these more in the future than we have in the past because even with economic recovery and even if protectionist pressures abroad ease somewhat, the need for greater market access overseas and enhancement of our competitiveness will not quickly subside. Prominent factors on the landscape pointing to continuing major trade problems will still persist.

As we are all aware, trade is an increasingly large part of the domestic economies of our major trading partners, as it is in our own case. In recent years in the United States, four out of every five new jobs in the manufacturing sector have been export created. Most major industrialized countries face the need for significant structural adjustment in basic industries.

Unemployment, though it may decline, will continue at relatively high levels. The debt burden faced by many developing countries will persist, as some will still find themselves using more than half of their export earnings just to pay the interest on their debt. Moreover, foreign governments, including some of our major trading partners, will continue to assemble advantages for their businesses in the form of industrial targeting practices, while raising obstacles to market access by ours.

In this context, the main lines of our trade policy are as follows:

The first step to maintaining and enhancing our place in world markets is to create conditions conducive to a sound domestic economy. The administration's economic recovery program has sought to accomplish this through the pursuit of steady noninflationary economic growth; and the signs of recovery are at hand.

Second, we will seek to maintain an open trading system that will enable U.S. business to compete, and to compete on fair terms. We do not seek trade liberalization purely for its own sake, but rather our persistence is based on historical experience and on our hardnosed assessment that a free and open system is in the long-term best interests of U.S. firms.

As we pursue open markets as the best means for maximizing our economic welfare, we must at the same time be realistic about what we can achieve—lest in our frustration we throw away the gains we have achieved to date for something even less satisfactory.

There is broad skepticism in many quarters as to our ability to persuade our trading partners to liberalize their markets. And I would agree that in some instances we can no longer accept protestations of good intent. But multilaterally, we should continue to do what we can to bolster the GATT. While at the same time being careful not to claim more for the multilateral GATT process than it can deliver.

In many instances we may find that more can be accomplished through nondiscriminatory bilateral efforts than through broad multilateral negotiations. But if we wish to maintain the basic framework of an open trading system, there can be no substitute for forceful, yet patient, negotiation.

Some may feel that our economy is so large and diverse that we could survive as a less open market. But we have achieved our economic strength largely because we have been able to sell abroad and because we had to face competition with foreign advances to spur our own innovation.

The administration strongly opposes local content legislation. It will only insulate the auto industry from foreign competition. Tinkering with the mechanics of H.R. 1234 will not make it acceptable. Local content legislation will not lead to significant job creation; it could even lead to job destruction. The exclusion of some foreign autos may, if other foreign manufacturers do not take the slack, temporarily create some additional U.S. jobs. But the employment gain would be small and none of these jobs would be available this year or next.

The consumer will also suffer under a local content law. Imports will decline, car prices will go up, and fewer models will be available.

We believe that the problems of the industry will not be solved by erecting trade barriers. They will be solved by providing an economic environment in which the U.S. auto companies become more productive and more competitive, domestically and worldwide.

Furthermore, we must use our trade laws to insure against unfair practices in our marketplace. Our adherence to free trade policy requires us to do not less, even where our response to unfair practices may result in remedial actions on our side.

The question of the adequacy of our trade laws to protecting our interest has become a subject of the day. There is a widespread perception that our trade laws as now written and administered do not provide effective and timely import relief. This perception may in part stem from misplaced expectations that seek to accomplish through litigation what are more fundamental problems of competitiveness. Our laws must be evenhanded; not creating or permitting an artificial competitive environment for either domestic or foreign business and they must be consistent with our international obligations.

Although I think our laws in general measure up well and do not need a fundamental overhaul, there may be some administrative changes in how effective our trade laws are. As to our antidumping and countervailing duty laws which the Department of Commerce administers, we have been looking at a number of possible areas of improvement and look forward to working with the Congress and

the private sector in the coming months on how our trade laws might work more effectively.

Finally, because of the competitive challenges facing us in the future, we have concluded, as Secretary Baldrige stated in his testimony before Senator Roth on March 17, that it is worthwhile to address whether the U.S. Government may need improvements in its trade process and structure.

Over the last two decades, the United States has gradually strengthened institutionally the role of trade in the executive branch. This has been natural as the importance of trade to our domestic economy and to our position in the world has grown. And so, we may have again arrived at the point where we need to ask whether we are organizationally equipped to provide in the decade ahead the kind of leadership necessary to give assertive direction to the development and implementation of trade policy.

We all recognize that there are organizational complexities and overlap that now exist in the trade area. We face global markets and intense foreign competition; and it is clear that authority must be effectively linked either by process or structure to institutional resources.

Within the administration we have been looking at these questions. The administration has not yet arrived at a decision whether to support a major reorganization but all options are open. No decision has been made. Chairman Florio has introduced a reorganization bill, H.R. 2203. While we do not at this time support any particular approach, we believe H.R. 2203 makes a contribution to the debate and we look forward to discussions on this particular bill and others.

Thank you.

Mr. FLORIO. Thank you very much.

Mr. Secretary, one of the points specifically that has been brought to our attention is the proposal, the inadequacies, I am not sure if you were here during Ambassador Brock's testimony. One of the points I raised to him was the question of the injury test in the 201 program, particularly as it impacts cyclical industries such as automobiles.

I wonder if the administration is proposing any specific legislative changes other than a more comprehensive reorganization and you are indicating you are evaluating comprehensive proposals. But are there specific proposals to deal with the deficiencies that may exist in our import programs, relief programs, that is?

Mr. WETHINGTON. The specific reference to 201 that you mentioned, I think we must be very careful in terms of quick changes to that provision. That is an escape clause provision; relief is granted in that situation apart from any evidence of unfair practices.

As Ambassador Brock indicated, we will be studying that issue. I think it is our view that we should proceed cautiously before we make any changes in that area. As to antidumping and countervailing duty laws which are administered by Commerce, there may be, in fact, some significant ways in which those two import relief statutes can be improved.

As you are aware, there are a broad array of adjustments that are taken into considering in assessing whether or not foreign imports are dumping. It may be the case—this is one thing we are

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looking into and we have not arrived at a conclusion—but we will have something to say on this before too very long but that we can simplify that process, simplify that in a way which makes that import relief law more accessible technically to small businesses as well as to other U.S. industries.

Another area that deserves attention might be the area of the compliance approach the Department goes through in assessing whether or not under an existing dumping order the duties should to an extent be modified. That process is cumbersome, maybe too complicated than it need be.

That is another area we are currently looking at and maybe one area where we will have changes shortly.

Mr. FLORIO. One of the things that a number of witnesses have made reference to today, though it is not the major subject of our hearing, was, of course, the domestic content legislation.

I recall one of the more persuasive points that was made in the legislative debate by the proponents of that legislation, it was that on the basis of equity, fairness, even happiness of relationships, that the concept of domestic content was not that radical and that, in fact, the Japanese have from time to time become involved in prescribing domestic content themselves and specific reference was made to purchase of airplanes, I believe from Boeing, whereby in the Japanese purchase orders specified the degree of domestic content that incorporated the same concept as in the bill that was under consideration.

Might I ask—please feel free to refer to your colleague—as to whether that is a fact and over and above that, doesn't that undermine the fundamental opposition to the concept of domestic content if, in fact, it is being used as a trade and negotiation device already by some of our trading partners?

Mr. DRIGGS. Mr. Chairman, I do remember the debate and the point you made. One of the things overlooked by some of the people, however, in their arguments for local content is that this particular arrangement for the Boeing 767, I believe, was an arrangement between two corporations.

The Japanese Government did not by legislation require local content but this was part of a normal contract negotiation, if you will.

The problems that arise when a government enters and by law imposes local content, not only come from violating the GATT and violating policies and principles which affect all commodities which are traded, but it also when this is used as an example for the automobile industry I think overlooks the point that even though we may be concerned about very valid trade problems with Japan in many, many commodities, hurting our own automobile industry to make a point for other commodities against us very little perhaps for the other commodities and hurts us a great deal in one of our most important industries.

Mr. FLORIO. Your initial response to the question was, well, that was a private sector decision by the Japanese, but isn't the point of all these hearings as well as the discussion taking place that our trading partners really don't operate in the same way that we do; that their private sector companies are not totally private sector and to the degree that there is governmental involvement, whether

it be in targeting, picking winners or losers, there is a degree of governmental involvement that is far beyond what we have in this Nation, and that you can't separate what is allegedly a private sector decision on the part of the airline industry in Japan from essential governmental policy?

Rarely do you find private sector decisions in the Japanese economy that are totally removed from an overall sense of governmental policy, for example?

Mr. DRIGGS. Mr. Chairman——

Mr. FLORIO. My point is, such that alleged private sector decisions, the proponents of domestic content legislation, would say, it is not a private sector decision. In fact, if it is not, how was it inequitable for our governmental-private sector relationship to be prescribing the same concept?

Mr. DRIGGS. The point I come back to, first of all I don't think any of us are that conversant with the details of the negotiation that occurred between the two companies. The key factor is that the Japanese Diet, their congress, did not pass a law which required this to be the case. International corporations must by nature of doing business take into account the policies of the governments of the countries in which they deal, the mood of the people, the popular sentiment, if you will, it is as valid in this country as in any other.

I am not sure any of us will be able to weigh just how much of a factor that may have been in this particular decision.

Mr. FLORIO. Of course, the workers at Boeing probably don't care too terribly much about the niceties of who made the decision in Japan and I suppose their objection would be that action wherever it came from is insuring that those airplanes at some degree will be made in Japan or something will be done in Japan that will detract from their ability to make what they would regard as an American product in America, generating jobs here.

As I say, the legal niceties are something we all have to be concerned about but I don't think there is any secret that part, if not a great majority, of the momentum for this type of legislation comes from our concern about the job creating opportunities that it has if in fact it has—obviously, there is dispute as to whether this type of legislation results in job making opportunities, which leads me to another question—did you want to comment first?

Mr. WETHINGTON. Yes, Mr. Chairman.

It is true, as I think you indicated in your question, that many other countries have some form or another of domestic content legislation whether it is in autos or some other industry.

This is a question I feel of, particularly at this stage anyway, where the actions that other countries take will be influenced to some perhaps significant extent by how we manage our domestic economy, it is a question of leadership and whether the United States is going to continue to assert leadership in the area of free trade or whether it is going to provide in a sense some kind of cover, perhaps, for other countries that may seek to move in the direction of certain import restraints particularly whereas we think is the case in the auto industry, that the impact on jobs simply is not to be found, that in the long run the open markets, in the long run the willingness of U.S. industry to go up against for-

eign competition, is what is going to make us more competitive rather than this kind of legislation.

Mr. FLORIO. Let's shift then from talking about the industries in our Nation that are described as less competitive than they used to be; auto, steel, textiles, and talk about the industries that are competitive and extremely productive and yet have difficulty penetrating overseas markets because of activities that are being conducted by our trading partners.

Many of those industries, by the way, are the major job creating industries of the future, whether it be communications, pharmaceuticals, service industries, and so on. The suggestion has been made and I think it is embodied in some of these legislative proposals that in order to maximize the export potential that we have in these admittedly productive, competitive industries, that is somehow being stifled now, we have to have the coordinated trade policy approach that the previous witness, Professor Lodge, advocated.

Do you in any way see the preservation of the status quo being able to cope with what appears to be the erection of barriers to our growth industries expanding overseas? I recently came back from Europe and was at a trade conference in Athens and almost to a nation, all of the participants in that conference said they wanted to develop their high technology industries; they wanted to develop the service industries; and in order to do that they had to protect their industries against our extremely productive industries that if the free market operated, if free trade operated the way that it should, that their growth industries wouldn't have the time, that is their productive industries; their service industries; wouldn't have time and protection to develop into what they wanted to have them develop into.

I suppose my point is that without some coordination that the inevitable policies of these nations are going to be designed to provide their developing industries, that happens to be our productive industries, the time to develop to the detriment of our ability to promote exports in those industries.

Can I ask what your thoughts are as to what will happen if we don't do anything to insure the export potential for our already productive, competitive industries?

Mr. WETHINGTON. Mr. Chairman, the status quo as we find it certainly as we face increasing targeting practices on the part of our major trading partners is not satisfactory.

At the same time, I think there is in place a coherent, and if you will, comprehensive strategy for dealing with that situation. The real question is what are the specific tools that the Government should bring to bear to deal with these problems?

There is, I feel, a coherent strategy in place which is to provide basic conditions conducive to economic growth, which is to make structural improvements in the ability of U.S. firms to compete which is to pursue through negotiation the tearing down of foreign market barriers, which is to rely on our trade laws and maybe they need in some areas to be strengthened, to rely on our trade laws, to offset unfair practices.

But the question is, what beyond that should the Government do? I think we could quickly, at least I would hope we could, agree

that the picking of winners and losers and allocation of capital, the direction of resources toward particular markets, are simply not conducive to our way of doing business.

Mr. FLORIO. Is it really productive to be talking in those terms? I don't know anyone really who is talking about the allocation of capital by the Government.

The picking of winners and losers keeps recurring. I don't know anyone who is saying that the Nation should be picking winners and losers. You have acknowledged and I think appropriately so, that the status quo is not acceptable. If the only alternative to the status quo is picking losers and winners, then there is no room for movement to some position other than the status quo. Is there not something we can do in between?

Mr. WETHINGTON. Certainly, we need greater understanding, more information, more analysis of the competitive threats that face us. Certainly, more industry-government discussion is needed, discussion of the competitive situation we now face.

I think to some extent gradually, maybe not fast enough, we have been moving in that direction. You made reference, also, to the study that we have just produced that was directed by the Cabinet Council on Commerce on Trade, an overall study assessing the competitiveness of our U.S. high technology industries.

The information, the analysis that we have on foreign threats is not adequate. We are moving gradually in the direction of beefing up our capability. We have recently begun the creation of a data base, for example, on foreign industrial targeting programs that will encompass somewhere between 12 and 15 major high technology sectors and will include the policies of at least that many countries.

We need to understand more than we now do with more precision the kind of competitive threats we face.

At the Department we, Secretary Baldrige, created about a year and 1½ years ago an Office of Competitive Assessment for the purpose of undertaking medium/long-term studies of the ability of particular U.S. sectors to compete both domestically and in foreign markets.

There are things that are in that intermediate area of the field that can be done and some things of a nature I just described will make a contribution to our understanding of the problem in any case.

Mr. FLORIO. How about export financing? The Eximbank has a specific proposal to assist overseas opportunities, that has been cut in the last 2 fiscal years. This year the budget submission is in real purchasing power less than the amount for fiscal year 1980.

Is it thought by the Commerce Department or the administration that export financing is something that should be a major tool in promoting exports? The Japanese as I understand it finance exports for 43 percent of all exports. Is it the thought that this should be a greater or lesser tool of assistance to American businesses in promoting exports than it has been in the past?

Mr. WETHINGTON. Certainly U.S. business needs adequate financing and perhaps there is no more—from a business point of view—no more important need than competitive export financing.

More importantly, however, than the extent of Eximbank funding is our ability I feel to persuade our major trading partners to eliminate their subsidized export credits.

Mr. FLORIO. But that is not going to happen. We have been talking about that for a long period of time?

Mr. WETHINGTON. No, we have in place a consensus arrangement within OECD which has set a floor on export financing. There are negotations now underway and will be underway this spring to strengthen that kind of arrangement. But we are opposed to subsidized credits on our part and we will seek to provide adequate financing, we think the amounts requested meet the demand, and at the same time we will continue to pursue through negotiation the elimination of foreign export subsidies.

Mr. FLORIO. You heard my reference with previous witnesses about the Defense Department's recent announcement that it is intending to, in a sense target computer operations so as to insure, I assume, the Defense Department's access to what they hope will be superior computer technology from the United States through the course of the 1990's.

To what degree was the Commerce Department involved in that decision by the Defense Department, and could I ask what your observations are as to whether it is appropriate for one department other than Commerce—which one presumes is in charge of Commerce—to become involved in decisions of that sort?

Mr. WETHINGTON. Mr. Chairman, to my knowledge the Commerce Department was not involved in that decision. As I understand it, the decision was made not for commercial reasons but primarily for reasons of national security.

Mr. FLORIO. At the same time, yes, we appreciate that the computer business is certainly a sum part of national security considerations but it is a very important part, certainly, of our overall economic well-being which really folds in some of the thoughts that Professor Lodge talked about and that Congress is talking about, the need to address the totality of the considerations, not only defense-wise but international trade considerations and domestic implications of these decisions which argues for the proposition that it should be some overall coordinating entity that makes some of these decisions and here we have a fairly substantial—I forget what the number is—but the Defense Department was looking for $40 million or $50 million for this particular project.

Yet it appears to be conducted, initiated and conducted in a vacuum out by itself without the Trade Representative's input and from your testimony, apparently without the Commerce Department having very much input. It is really going in the opposite direction of what it is everyone seems to be advocating.

Mr. WETHINGTON. The question you pose is certainly deserving of serious consideration, and consideration—discussion is taking place on the kind of situation you pose. We find, I guess woefully so, that there is not at this time a central repository of information, comprehensively gathered, on all federally sponsored R&D. The National Technical Information Service—this is part of the Department of Commerce—now has an effort underway to at least as a matter of information, to bring together in some kind of compre-

hensive and easily accesible way, information on federally sponsored R&D efforts.

We have not reached the stage of decision on the kind of question you proposed. Maybe in fact we do need more scrutiny on a Government-wide basis for federally sponsored R&D.

Mr. FLORIO. Over and above R&D, I assume that that was the purpose of the task force that was referred to, through the course of the morning anyway, that the interagency task force dealing with trade matters, and to have it in place and to have two participants on the task force, in a sense, acknowledge the fact that some of this research, a major innovation, that is the Department of Defense's proposal, is done without awareness of two major participants in trade on that task force which almost puts in question what the task force is doing, and if, in fact, it really is fulfilling the purpose of just sharing information, much less formulating coordinated policies?

Mr. WETHINGTON. Well, the task force is a serious effort to try to get our hands around the problem of foreign industrial targeting. I don't think necessarily that this one decision by the Department of Defense which they undertook, as I understand it, for national security reasons cuts against the ability, necessarily, of the group to complete its task.

Mr. FLORIO. Let me express my appreciation to you for your participation and thank you very much for your help.

Mr. WETHINGTON. Thank you, Mr. Chairman.

Mr. FLORIO. We are now pleased to have a panel comprised of Mr. Alan Wolff, representing the Semiconductor Industry Association; and Mr. George Scalise, senior vice president, Advanced Micro Devices, Inc.

Welcome to the committee, gentlemen.

Your statements will be entered in the record, and you may proceed in a summary fashion, or however you wish.

Mr. Wolff.

Mr. WOLFF. Mr. Chairman, if we might, Mr. Alex Lidow, vice president, research and development, Semiconductor Division, of International Rectifier Corp., is here in place of Mr. Scalise, and would go first.

STATEMENTS OF ALEX LIDOW, ON BEHALF OF SEMICONDUCTOR INDUSTRY ASSOCIATION; AND ALAN WILLIAM WOLFF, COUNSEL (SIA)

Mr. LIDOW. I am Alex Lidow, vice president of the research and development of the Semiconductor Division of International Rectifier Corp.

I am standing in for Mr. George Scalise today, representing the Semiconductor Industry Association.

As you are aware, our industry is a leader in America's international competitiveness. We are responsible for what we call the microelectronics revolution which is affecting virtually everybody's lives over the decades.

The cost of our products have consistently declined as have our prices, and we have invested heavily in new automatic equipment

to the tune of 28 percent of total revenues, to the tune of 110 percent of our profits.

The competitiveness of our firms in the world is very well known. I don't believe that is in dispute. It is not an exaggeration for me to say that the extent, to the extent the United States is an efficient world class competitive industry, we are it.

Today our industry, this very competitive semiconductor industry, is facing a problem that makes its future much less certain. We confront the problem of government targeting and because of our position of world leadership as well as our potential for contributing to future world growth, we are an obvious target for world class nations, such as the Japanese Government, to try and take over our marketplaces.

What I would like to do today is give you an example of what targeting as done by the Japanese Government's affect is on our industry. We have a few charts.

The first one shows you the U.S. share of the Japanese semiconductor market from 1972 until the present. It is a blue line at the bottom which is essentially flat.

I realize the print is small and I apologize for that, but at the bottom in green blocks, we have listed several of the liberalization measures that the Japanese Government has put forth in an effort verbally to inspire more imports into Japan of U.S. products.

In the early seventies, through 1975, the Japanese basically removed quotas from imports of integrated circuits. However, in the orange color you see, several countermeasures were put forth by the Japanese Government in order to prevent increasing the U.S. participation in the Japanese semiconductor market.

By the way, the word "countermeasure" was coined by the Japanese Government, not by me, in order to describe these actions.

Such actions are rationalization of the industry, which basically means weeding out smaller, less expensive companies in favor of larger ones. These measures came in the form of trade development bank loans, subsidized loans.

Basically, what it did was it kept the U.S. share down at a level that today is actually below the level when there were official quotas. Therefore, we feel that there really is no adequate participation of the U.S. companies in the Japanese semiconductor market.

The effect of this has two effects, basically; the first one is the effect of U.S. products in Japan, but there is a secondary effect which I will discuss later, which is the effect of Japanese products in the United States and how they affect our competitiveness in world markets.

This first story represented by these two graphs is an example of a product invented in the United States called a microprocessor, invented in the early 1970's, which was being exported to Japan through the middle and late 1970's. The top chart represents our exports to Japan for 1978 through 1981.

As you can see, there is a healthy growth pattern through 1977, 1978, 1979, then something happened, and what happened was NEC, Nippon Electric Co., started producing the 8080; in other words, it was a local producer of this high technology semiconductor.

At that point, it wasn't just a decrease in order that we saw for this product in Japan, but rather a total cancellation of all outstanding orders.

That is why you see represented in red a spike that actually goes below zero. We had negative orders, or cancellations which consumed all of our market in Japan. And that market never reappeared.

As you can see, after that 1979 debacle we had absolutely no business in Japan.

In contrast, the lower chart shows you worldwide business of U.S. manufacturers of this microprocessor and shows that it has no corresponding precipitous drop in orders.

Therefore, this is what we call the phenomena of the vanishing market. As soon as there is local production for a relatively demand product, all the United States dries up.

In the United States, we have a separate problem, really, which is just as devastating. That is illustrated by the pricing practices of Japanese companies when they mount export drives into the U.S. market.

The chart you see here is an example of what we call our learning curve in dynamic random access memories or DRAM's. This is price per bit of this memory component versus the amount of functions sold or what we call a cumulative volume in bits.

It shows you a rather—on this chart at least—a rather regular decline from 1975 all the way out to 1980. This decline is what we call our classic learning curve. Every time you double your volume, the price declines about 30 percent, because your costs decline about 30 percent.

This is despite numerous entrants and withdrawals and revolutionary technology between 1975 and 1980. The technology is just completely turned around three or four times in that period, and yet, we followed a classic learning curve.

In mid-1980, the Japanese mounted their export drive of 84,000 Dynamic RAM's, and you can see a rather precipitous drop in the price that would be not realized had there not been an incredible push into this country.

It was a coordinated export drive. The Japanese built up capacity in excess of demand, and in order to fill the capacity they had to destroy the pricing.

As a matter of fact, pricing declines were 2½ times the usual price declines that we normally see.

If it had been 10 percent or 15 percent, we could have argued that away as being just a new guy on the block trying to get in, but 2½ times was extreme. It was so extreme that on the bottom chart that I show here, you see the—the aggregate U.S. manufacturers of memory products showed a rather precipitous drop in their profits.

As a matter of fact, the red illustrates the red ink on their balance sheets to the tune of $30 and $40 million worth of losses, because of these rather unwarranted price declines.

This was not because of the recession. The top chart shows that U.S. shipments continued to increase in this period of time, but because of this enormous drop in price, there was no way in which U.S. manufacturers could turn a reasonable profit.

So we have shown two examples here, an example of the United States trying to send their products to Japan, and an example of the Japanese sending their products to the United States. In one case, we did not successfully penetrate their market, in the other case they successfully penetrated and captured a significant market share in the United States.

Mr. FLORIO. Wouldn't the Japanese argue that with respect to your first point that unless they took some action in terms of closing their market at the outset, their capability of developing this type of product, or this industry, that you would be doing to them what they have subsequently done to you, which is to undercut the price because they didn't have a developed industry, and by virtue of your ability to penetrate the market there, you would stifle their ability to develop the market, and hence, they cut off your ability to get in, and that was the way that they developed their own market?

Is that a legitimate expectation of what the Japanese would say if they were here?

Mr. LIDOW. There is no question that that is part of their argument of why they did it. We are not talking about Mr. Iashika and Sons' company, we are talking about Toshiba and Atachi, two of the largest electronic companies in the world.

These are not companies that are at a serious disadvantage either technologically or financially in marketplaces around the world. We feel that the protection that was given these companies was, as well was all the others in the country of Japan, was designed not to produce a competitive set of companies, but to produce a dominant set of companies which would later parley this experience in semiconductors into dominance in the computer and information systems market.

I guess there is—to answer the question—it is a matter of degree. We feel that they have completely—they have gone orders of magnitude beyond the degree necessary to establish a competitive company in Japan or local manufacturer. They have gone to the point where their building capacity is greater than the world demand, inspiring their companies not to make profits, but to capture world market share.

These things are damaging to us, because price isn't the question anymore. In the United States, we had to build our state-of-the-art plants with our profits. In Japan, they could do it with loans. There is a big difference.

I guess one of the biggest examples of this destructive, rather than constructive, competition is the fact that there were about 12 participants in the 16,000 Dynamic RAM, 12 U.S. participants and now there are, I believe, 3 U.S. participants in the 64,000 and possibly fewer than that in the next generation, 256,000.

So we are at the position now where it is not intelligent for our merchant U.S. companies to invest in future Dynamic RAM products because there is no profit in there. There is no way to recoup the enormous investment that is necessary.

The capital investment situation is no brighter. We are very, very quickly being matched almost dollar for dollar in capital investment. As you see by the first chart on the left, the Japanese

have increased all through the recession from 1976 almost monotonically through today, in millions of dollars in capital equipment.

A lot of this is done with favorable bank loans that don't have to be paid back until profits are recouped, such subsidies as that.

In contrast, the U.S. merchant capital investment has declined in the last 2 years. We only have so many dollars we can put in, and when the industry as a whole is not making profits, there is not much left over to invest in capital equipment.

If you look at the U.S. merchant plus the captives we still hold an edge in capital investment, but it is not as great as it once was.

As you can see on the far right, the Japanese are also beginning to match us in dollars in research and development which I consider to be one of the most dangerous signs, particularly since the Japanese research and development is somewhat more in collusion than in the United States.

It would be unthinkable for two U.S. companies to, at least at the outset, share basic R&D information, whereas, in Japan, a lot of times consortiums are formed, the VLSI program, where the information is pooled. Instead of—it was estimated that the Japanese saved $1.5 billion through the research and development done at the VLSI program because of the fact that the companies did not have to duplicate the research and development in that program.

That is $1.5 billion that the U.S. companies had to actually spend.

In conclusion, I would just like to say that there is a solution to the targeting problem. Targeting is like a pressure vessel, you first start off by protecting your home markets, you develop a heavy demand which incubates the new product, sorts out quality problems, technical problems in a very protected environment.

When the domestic volume grows significantly, there is manufacturing experience that can be gained, then plants can be built, and as the plants are built, the capacity is designed such that there is a significant amount of export capability and an export drive is mounted usually in concert with two or three companies.

If we can get inside this pressure vessel, we can reduce the pressure, namely, if we can have access to the Japanese market, they cannot incubate their products. We really need to push very heavily on opening the Japanese markets to U.S. products.

We need affirmative action. We need growth that is faster than the growth of the markets. In a recent NEC press release, they stated they would increase their purchase of U.S. semiconductors by 20 percent this year. What was not stated in that release was that the NEC will purchase 25 percent more semiconductors in toto.

Therefore, we lost our market share. We need affirmative action. We need to be able to build our plants freely in Japan and have access to these low-interest, very, very preferential loans. If we can get behind this bamboo wall, I think we can dissipate the energy that is built up through targeting.

I would also like to submit to you a legislative agenda which I believe was in your package, and as well, the outline of the remarks by Mr. George Scalise who was supposed to be here, but gives this statement to the U.S. high-tech working group over at the Commerce Department.

[Testimony resumes on p. 493.]

[Statement of Mr. Scalise, with attachments, follows:]

STATEMENT OF GEORGE M. SCALISE
Sr. Vice President & Chief Administrative Officer
Advanced Micro Devices, Inc.

on behalf of the

SEMICONDUCTOR INDUSTRY ASSOCIATION

Mr. Chairman, I am George M. Scalise, Senior Vice President and Chief Administrative Officer, Advanced Micro Devices, Inc. I am here to testify on behalf of the Semiconductor Industry Association, which represents the majority of U.S. merchant and captive producers of semiconductors in matters of trade and government policy.

As you are aware, our industry is a leader in America's international competitiveness. Semiconductor process and product innovations have caused a "microelectronics revolution" in the past two decades which affects virtually all areas of our economy and society. Our costs have constantly declined and so have our prices. In an era of inflation and slow growth, we have invested heavily in new automated equipment, resulting in dramatic improvements in productivity and efficiency. The competitiveness of the firms in our industry is well known -- both domestically and around the world. It is not an exaggeration for me to say that to the extent the U.S. has an efficient, productive world class competitive manufacturing industry, we are it.

Yet today our industry faces a less certain future. We confront a competitive challenge from abroad which is placing us, as individual profit-making enterprises, at a serious disadvantage. This challenge results from Japanese government policy -- the practice of industrial targeting -- which is only now becoming well known and understood in this country. The effects of Japanese targeting, and the market distorting practices which it entails, are becoming so serious that they

threaten this country's long-term ability to grow and remain competitive in semiconductors.

The Problem of Japanese Industrial Targeting

Targeting is a form of competitive hard ball under which the Japanese government identifies industrial sectors which it wishes to promote to a position of world competitive prominence, if not dominance, and takes a series of government-directed measures designed to ensure that result. Many of these measures distort free market competition and violate international agreements. But particularly when employed as part of a comprehensive promotional strategy, they have proven highly effective in placing Japanese firms in a position of international competitive advantage. I have submitted to your Committee a study prepared by the Semiconductor Industry Association, The Effect of Government Targeting on World Semiconductor Competition, which describes Japan's targeting of the semiconductor industry and the impact of that program on the U.S. industry.

As the study describes, in the mid-1970's the powerful Japanese Ministry of International Trade and Industry (MITI) set a long range economic goal for Japan -- preeminence in the high technology industries. As in earlier targeting programs, MITI took a wide range of mutually-reinforcing promotional measures to ensure that Japanese industry attained that goal. MITI protected Japanese high technology firms from foreign imports and investment. MITI organized Japan's high technology industries -- participating with them in setting industry-wide goals for research, development and production. MITI encouraged the

formation of research cartels to avoid duplicative R&D and share costs and results. MITI provided numerous financial incentives, including grants for R&D, low-interest loans, tax breaks, and assistance in securing private-sector bank loans to its high technology firms.

Because semiconductors are the basic building blocks of many other high technology sectors (telecommunications systems, robotics, computers), MITI's promotional effort initially placed a very heavy emphasis on semiconductor development -- and we in the semiconductor industry have been among the first of the U.S. high technology industries to begin to feel the Japanese program's impact.

Domestic Market Protection

The SIA study describes how the Japanese government protected its "infant" semiconductor industry through the mid-1970's with quotas, restrictions on foreign investment, and other measures. At the same time it encouraged and assisted Japanese semiconductor firms to import U.S. technology. This permitted domestic semiconductor producers to establish production capabilities and a strong domestic market position at a time when the U.S. industry enjoyed clear technological leadership.

Under U.S. pressure, Japan removed its formal semiconductor import and investment barriers in the mid-1970s. However, despite repeated major efforts by U.S. firms to expand their presence in Japan over a period of decades, U.S. sales today account for under 10 percent of Japanese domestic consumption--a smaller share than when the market was protected by formal

quotas. In part, this reflects "countermeasures" undertaken by the Japanese government to offset the relaxation of formal barriers to the domestic market. The first chart I have with me shows the various "liberalization" measures Japan has taken over the past decade with respect to semiconductors. As can be seen, these measures have been offset by a series of liberalization "countermeasures"--a term which was coined by the Japanese, not myself. The net result has been a consistently negligible U.S. market share.

An additional barrier to U.S. firms is the Japanese market structure--the same firms that produce most of Japan's chips also account for most of its semiconductor consumption. They control most domestic demand, and have the incentive and the ability to resist imports--and a long history of doing so.

U.S. semiconductor firms selling their products in Japan have repeatedly found that when a Japanese product comparable to their own becomes available, their own sales fall off sharply, sometimes virtually to zero. An example of this is depicted in the second chart, which shows the experience of three U.S. firms selling 8080-type microprocessors in Japan. The top chart shows U.S. 8080 bookings in Japan, which were reasonably stable through mid-1979. Soon after Japanese firms were able to supply the whole Japanese market, however, U.S. firms' sales virtually disappeared (The negative figures reflect canceled bookings). Subsequent bookings have been virtually nil. This experience should be contrasted with the same three companies' experience in the world market (bottom chart) with the same product during the

CHART ONE

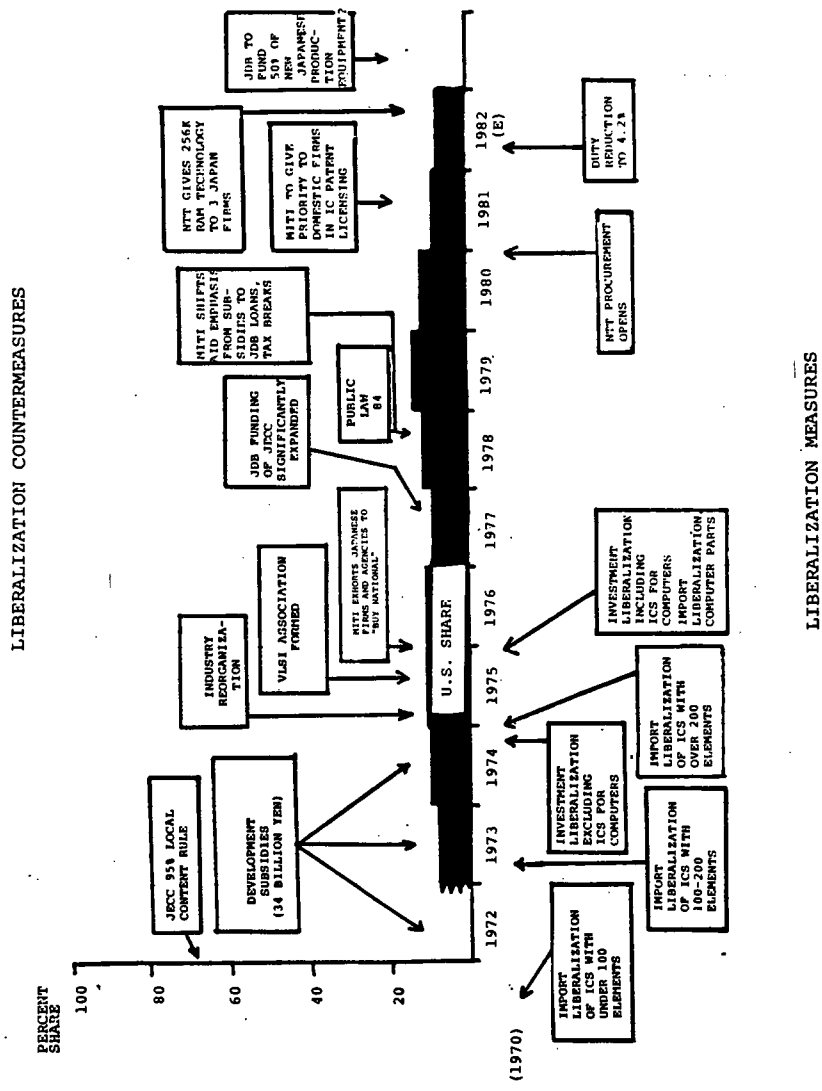
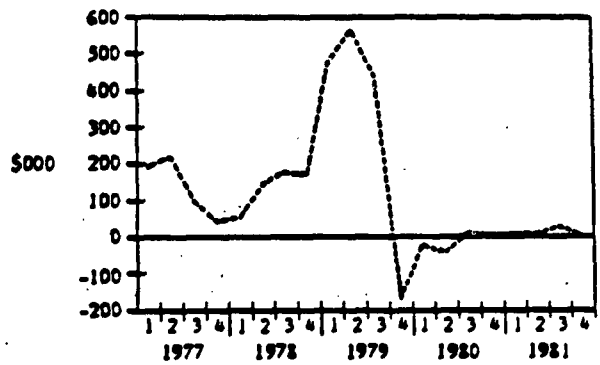

LIBERALIZATION COUNTERMEASURES
LIBERALIZATION MEASURES
PERCENT SHARE
100
80
60
40
20
(1970)
1972
1973
1974
1975
1976
1977
1978
1979
1980
1981
1982 (E)
U.S. SHARE
JECC 95% LOCAL CONTENT RULE
DEVELOPMENT SUBSIDIES (34 BILLION YEN)
INDUSTRY REORGANIZATION
VLSI ASSOCIATION FORMED
MITI PROMOTES JAPANESE FIRMS AND AGENCIES TO "BUY NATIONAL"
JDB FUNDING OF JECC SIGNIFICANTLY EXPANDED
MITI SHIFTS AID EMPHASIS FROM SUBSIDIES TO JDB LOANS, TAX BREAKS
PUBLIC LAW 84
NTT GIVES 256K RAM TECHNOLOGY TO 3 JAPAN FIRMS
MITI TO GIVE PRIORITY TO DOMESTIC FIRMS IN IC PATENT LICENSING
JDB TO FUND 50% OF NEW JAPANESE PRODUCTION EQUIPMENT?
NTT PROCUREMENT OPENS
DUTY REDUCTION TO 4.2%
INVESTMENT LIBERALIZATION INCLUDING ICS FOR COMPUTERS; IMPORT LIBERALIZATION COMPUTER PARTS
IMPORT LIBERALIZATION OF ICS WITH OVER 200 ELEMENTS
INVESTMENT LIBERALIZATION EXCLUDING ICS FOR COMPUTERS
IMPORT LIBERALIZATION OF ICS WITH 100-200 ELEMENTS
IMPORT LIBERALIZATION OF ICS WITH UNDER 100 ELEMENTS

CHART TWO

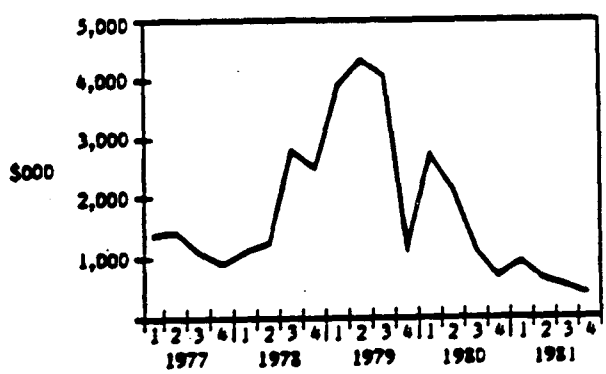
ESTIMATED UNITED STATES BOOKINGS OF
8080-TYPE MICROPROCESSORS TO JAPANESE MARKETS



Source: Company Estimates

Figure DD:

ESTIMATED UNITED STATES BOOKINGS OF
8080-TYPE MICROPROCESSORS TO WORLD MARKETS



Source: Company Estimates

same time frame. As you can see, in contrast to the experience in Japan, U.S. bookings tapered off gradually as the life cycle of the product came to an end.

A protected home market does more than simply deny sales to U.S. firms, although that is certainly a serious problem. Protection gives Japan the ability to nurture prospective growth sectors to the point where they can suddenly challenge U.S. high technology firms very aggressively in the world market. As a 1980 advertisement run by 16 Japanese firms in Scientific American observed,

> Protection has been provided those industries that are in need of protection because of their newness and their fragility as emerging industries. Thus, protection is negotiated for the semiconductor and computer industries, and telecommunications. . . . Sectors of high value added, and high technology, with high growth potential, are afforded as much protection as can be arranged.

Protection in the home market has enabled Japanese semiconductor firms to develop a large sales volume for new products, achieving economies of scale and "learning" economies -- cost savings which manufacturing firms learn to achieve as they produce more and more of a particular product. Ultimately, such protection has enabled Japanese firms to enter the world market with devices they have learned to make very cheaply.

Without domestic protection, we do not believe that Japanese targeting would be nearly as effective as it is -- in fact, it might not work at all. That is why in our trade program we have stressed as our number one objective the complete opening of the Japanese semiconductor market to U.S. imports and investment.

The U.S. government is currently conducting ongoing negotiations with Japan in the bilateral High Technology Working Group. This effort has the potential for addressing current high technology trade problems with Japan. We have asked the U.S. government to inform Japan in the High Technology Working Group discussions that the United States expects to see a dramatic improvement in U.S. semiconductor sales in Japan by this summer -- reflected in an increase in U.S. sales that is substantially greater than the increase in total sales in the Japanese market. We want to see a return to free market conditions. It will take the efforts of both the U.S. and Japanese Governments to achieve this objective.

The Japanese Export Drive

Domestic market protection was only one aspect of the Japanese targeting program. In addition, the government extended massive financial aid to the industry -- subsidies, low interest loans, tax breaks, free or low cost R&D, access to government research personnel and facilities, and other aid. The industry was organized by the government into collaborative groups ("tie-ups"), exempt from the antitrust laws, to maximize scale economies and share research and development efforts.

In 1975-76, MITI launched a major industry-government collaborative R&D program designed to promote Japanese capabilities in very large scale integration (VLSI), one of the most complex and commercially significant semiconductor technologies. The VLSI Project was a "research cartel," partially funded by the government, featuring a collaborative

division of R&D labor by the participating firms -- Japan's leading semiconductor producers -- and a sharing of the results among the various participants. This enabled each company to develop new technologies at a fraction of the cost incurred by U.S. firms, who must conduct their R&D independently. A major participant in this project was Nippon Telephone & Telegraph (NTT), Japan's government-owned telecommunications monopoly, which possesses the foremost electronics research laboratories in Japan, rendered major semiconductor R&D assistance to Japanese firms (this included use of NTT's personnel and facilities, results of NTT research turned over to Japanese firms at low cost or free of charge.)

At the same time that the VLSI Project was under way, Japanese firms began a major buildup of semiconductor production capacity -- focusing heavily on capacity needed to produce advanced VLSI devices, including the 16 kilobit and 64 kilobit random access memories (16K and 64K RAMs) -- computer memory chips that enjoy widespread potential demand and which contribute to a producer's technological capability in virtually all other semiconductor product lines. The 64K RAM is the most advanced computer memory chip available on the market today, and is forecast to become the largest-selling semiconductor device in history. In the context of world semiconductor competition, RAMs represent the "high ground," and the Japanese were moving, with government help, to seize that high ground.

Japan began exporting large numbers of 16K RAMs in the late 1970's, and by early 1981, <u>six</u> Japanese companies were producing

and exporting 64K RAMs. At that time, only three U.S. companies, proceeding on their own, were producing this advanced device, and one of these companies later withdrew its design. Japanese companies turned out 64K RAMs faster than the world market could absorb them, and Japanese companies led 64K RAM prices rapidly downward. In 1981, the price fell from $25-30 per unit to about $8 by year's end. By the end of 1981, Japanese firms had captured 70 percent of the world market for this device.

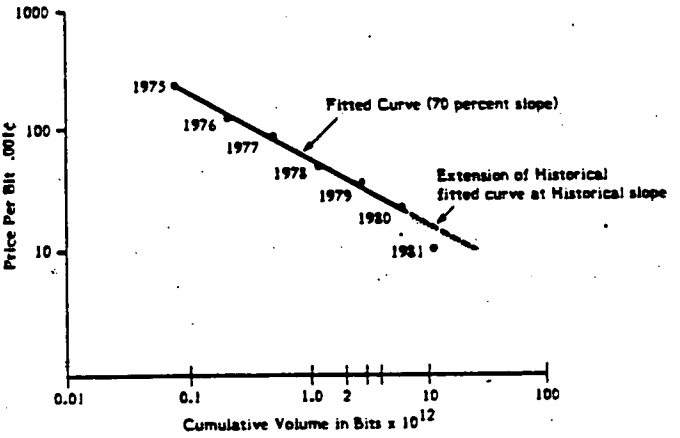
The third chart I have with me shows that 1981 RAM prices, initiated by the Japanese, were much lower than would have been predicted, given the consistent historical industry experience. The experience curve for the industry, depicted in the chart, has followed a consistent pattern for many years -- the price per bit has declined at a predictable rate of 30 percent for each doubling of industry output. This rate of price decline has remained constant despite substantial competitive ferment in the industry -- entry and exit of individual firms, new product generations, recessions and so on. Then in 1981, coincidentally with the Japanese 64K RAM export effort, the price fell 2 ½ times that fast -- a break with precedent that is simply unprecedented. In this connection it is significant that one Japanese semiconductor executive has predicted that no one will be profitable at the projected mid 1983 64K RAM price of $5.00 per device.

This kind of pricing has hurt the U.S. industry. The fourth chart shows the impact of Japanese exports of 16K and 64K RAMs on five of the six leading U.S. producers. Between the first

CHART THREE

HISTORICAL DYNAMIC RAM PRICE PER BIT v. CUMULATIVE VOLUME IN BI

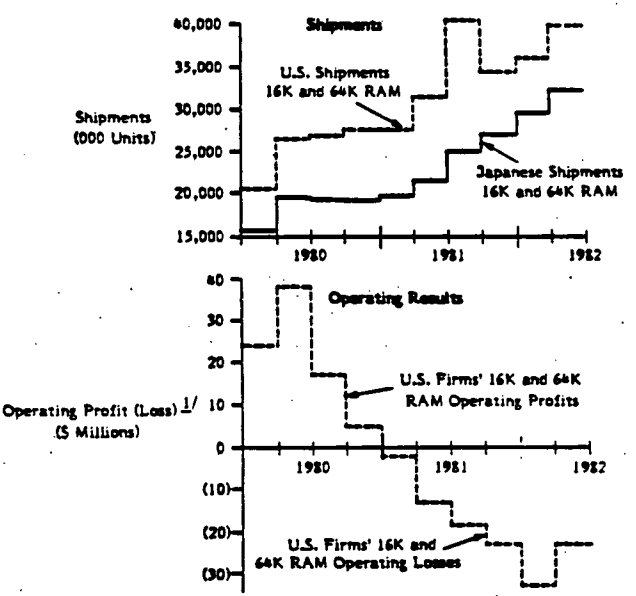
Data Points Represent Industrywide Mid-Year Average Price
Per Bit and Year End Volume, All Generations of RAMs



Source: Dataquest

CHART FOUR

CUMULATIVE 16K AND 64K DYNAMIC RAM
SHIPMENTS AND OPERATING RESULTS, 1980-1982



1/ Five U.S. firms' submissions composite net pre-tax operating results.

quarter of 1981 and the fourth quarter of 1982, these five producers suffered a cumulative net pre-tax operating loss of $148 million on these two product lines. The period of heaviest losses coincided with the biggest volume of Japanese shipments. (The sixth producer has indicated that it too lost money on the 64K RAM in 1981 and 1982, so these losses are, if anything understated.) You will note that in this composite of 16K and 64K RAM results, the U.S. firms had more shipments than the Japanese. The bulk of the U.S. shipments, however, are accounted for by the 16K RAM -- the older generation product. In 64K RAMs, the later generation product, the Japanese outsold U.S. firms by more than 2 to 1 in 1981.

Moreover, the outlook is even more grim for the next generation product, the 256K RAM, which may be commercially introduced as early as this year. Individual U.S. firms must invest large sums -- one estimate is $160 million -- to commercialize the 256K RAM. Yet U.S. and Japanese firms have not recovered their investment in the prior generation product, the 64K RAM. In Japan, however, the government telephone monopoly, NTT, designed a 256K RAM and turned the technology over to four leading Japanese firms free of charge. Thus, the preeminent research laboratory in Japan is turning over state-of-the-art 256K RAM technology to Japan's preeminent semiconductor producers. Japanese firms are now rushing to invest in 256K RAM production facilities, and two of these firms -- Hitachi and Oki -- have announced they will begin mass production of the 256K RAM in the second half of 1983.

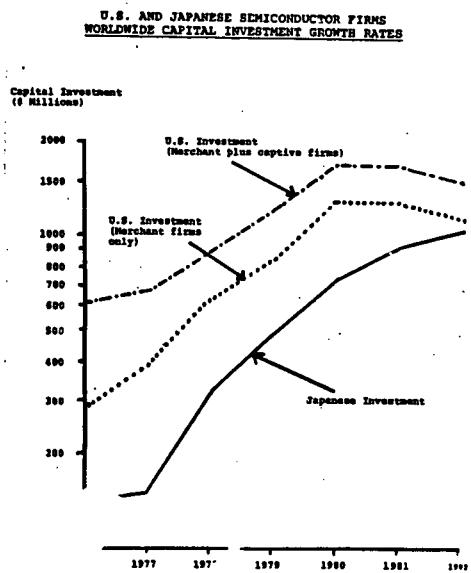
Deterrent to U.S. Investment

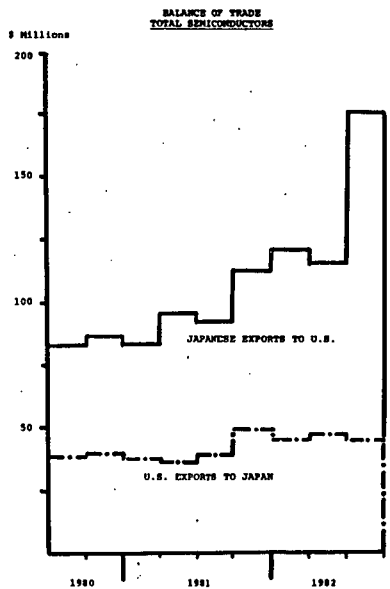
The impact of the 16K and 64K RAM losses on U.S. firms has been serious--in effect they are a deterrent to further U.S. investment in the product areas the Japanese have chosen to dominate. Little incentive exists to invest in sectors at which the Japanese are taking collective "aim." Thus, U.S. semiconductor companies which produced earlier generations of RAMs are refraining from entering production of the 64K RAM. Whereas 12 U.S. companies at one time produced 16K RAMs, by mid-1982 only 5 were producing 64K RAMs, and of these, only 2 were in large scale production. While the increasing cost of RAM production and development may have deterred some of these firms, others have indicated that Japanese pricing has caused them to defer further investment in the 64K RAM. Moreover, while additional firms may enter the market, as one Japanese semiconductor executive commented, "the latecomers will be shaken out." The number of U.S. firms producing the next generation of RAMs, the 256K, may well be even less than at the 64K level.

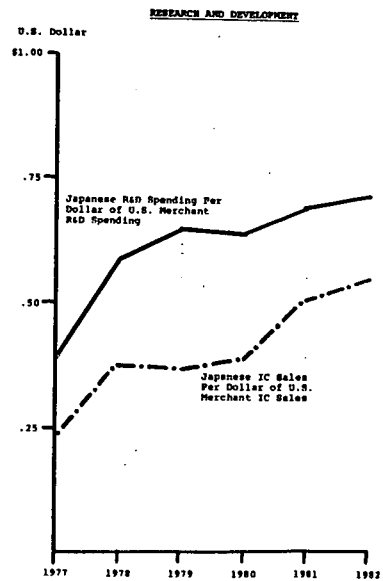
The fifth chart I have with me shows how the competitive balance is rapidly beginning to tip against the U.S. semiconductor industry. The graph on the left indicates that while capital investment growth by U.S. semiconductor firms remained strong through 1980, it leveled off in 1981 and is actually declining in 1982. Meanwhile the Japanese are continuing to increase their level of capital investment and are now virtually matching U.S. merchant firms' investment dollar for dollar. The middle figures show that the U.S.-Japan balance of

CHART FIVE

U.S.-JAPAN COMPETITION IN SEMICONDUCTORS







trade, both in semiconductors and integrated circuits, has been running heavily against the U.S. for the past two years, and has begun to deteriorate even more seriously in recent months, as reflected in the figures for the third quarter of 1982. In research and development U.S. firms are still outspending Japan, but Japanese firms are gaining fast, and because of the joint R&D projects, they are able to get more R&D per dollar invested. These charts demonstrate how quickly competitive reversals in high technology can occur.

The Need For An Effective Response

Targeting entails many promotional measures-- market protection, subsidies, cartels, and other devices designed to give Japanese firms a competitive advantage over our own. These measures are particularly effective in high technology sectors because they reinforce several key elements of competitive success in those sectors -- the ability to sustain a high level of expenditure on research and development and a high level of capital investment. The results are typically manifested in the form of sudden onslaughts of low-priced exports, and abrupt loss of sales by U.S. firms in Japan. In the end, the result has often been abandonment by U.S. firms of the targeted areas to the Japanese.

SIA believes that Japanese targeting practices violate U.S. rights under the General Agreement on Tariffs and Trade (GATT), and we have asked the U.S. Government to examine Japanese practices in light of Japan's obligations under the GATT. However, we feel that while Japanese targeting violates America's

GATT rights, we do not believe that the most appropriate response is to close our market, but to press the Japanese to open their own market. In semiconductors, Japanese practices create a "pressure vessel" in which surplus capacity is built up in a protected environment -- and ultimately unleashed in the form of damaging export drives which undercut U.S. profitability and discourage further investment. Active participation by U.S. firms in the Japanese market -- including access to government financing on the same terms as Japanese firms and participation in Japanese joint R&D programs -- will "decompress" the pressure vessel and greatly diminish the prospect of sudden, damaging export drives from Japan.

To be sure, Japan has frequently asserted that its market is already open. We submit that given Japan's recent history of protectionism in this industry, and the low sales performance of U.S. firms in Japan as compared with their performance in the rest of the world, the Japanese market cannot be regarded as "open" until U.S. firms' sales as a percent of total sales in Japan show a very substantial increase. We have asked U.S. government negotiators to press the Japanese government on this point and to insist that U.S. sales, as a percent of total sales, show a substantial increase by this summer. If this does not occur, additional steps may be necessary.

Conclusion

This country simply cannot afford to see its high technology industries weakened or destroyed by foreign industrial policies. The high technology industries represent the most efficient, productive, and growth-oriented manufacturing sector of the U.S. economy -- one which reinforces the economic health of all other manufacturing and service sectors. Continued U.S. strength in high technology is essential if we are to retain a strong economy, a high standard of living, and a solid export base through the remainder of this century. The challenge posed to our high technology industries by government targeting is, in effect, a challenge to our national economic well-being.

The Effect of Japanese Government Targeting on World Semiconductor Competition

Semiconductor Industry Association
20380 Town Center Lane, Suite 155
Cupertino, California 95014
Tel. (408) 255-3522

Semiconductor Industry Association

Semiconductors – National Resource, International Target

Semiconductors (both discrete devices and integrated circuits) are the basic building blocks of many of the high technology industries – industries which hold the key to this country's economic future. Incorporating thousands of electronic functions in an extremely small area – usually no larger than a quarter inch square, semiconductors have made possible many of the most important technological advances of the past two decades, from personal computers to sophisticated missiles.

Highly innovative, efficient, and competitively successful, U.S. semiconductor firms have been held up as proof of the continued ability of the United States to foster industries capable of world leadership. America's advantage in semiconductors has, in turn, enabled our nation's industries to maintain a competitive lead in many other advanced technology fields, including computers and communications systems.

The health of the semiconductor industry is essential . . . [to] the nation's productivity and international competitiveness.

The health of the semiconductor industry is essential if the U.S. is to strengthen its domestic economy and export base during the remainder of this century. Semiconductors will continue to play a vital role in determining the competitiveness of many advanced technology industries. Increasingly, close working relationships between semiconductor sellers and buyers are a critical factor in the success of those industries. Semiconductors are pivotal to creating

new jobs in advanced sectors, and enabling jobs to be maintained in older industries. Semiconductors are improving the nation's productivity and international competitiveness.

. . . the U.S. semiconductor industry faces a serious challenge.

Today, however, the U.S. semiconductor industry faces a serious challenge. In the mid-1970s, the Japanese government determined that its firms should dominate the world market in certain critically important semiconductor product lines, and launched a national effort to achieve that goal. In effect, Japan mounted an industry-government drive to achieve commercial objectives – much as the U.S. once organized a national effort in the 1960s to put a man on the moon.

U.S. semiconductor firms are now feeling the impact of the Japanese effort. They have suffered substantial operating losses in the product lines targeted by Japan, and are beginning to refrain from further investment in the areas which Japan has chosen to dominate. This has ominous implications for the industry's future.

Japanese Industrial Policy

. . . unless there is some foundation, some backing, no one will have the courage to . . . [invest in integrated circuits]. It would be too risky.

NEC Executive Director Hattori,
quoted in ***Nikkon Kogyo***,
December 12, 1974

The Japanese government has for over two decades tried to create a "foundation" and "backing" for its domestic semiconductor industry.

. . . the Japanese government protected its domestic semiconductor industry . . . .

In the 1960s and early 1970s, the U.S. semiconductor industry enjoyed a clear technological superiority over Japan. During this period, the Japanese government protected its domestic semiconductor industry through import quotas and exclusion of foreign investment. Japan permitted imports of U.S. semiconductor products which its own firms could not make and which Japanese end-products firms needed to remain competitive – for example, ICs for pocket calculators and digital watches. However, as the Electronics Industry Association of Japan noted in 1975, "the import of overseas ICs was checked when similar ICs were domestically manufactured." This permitted Japanese semiconductor firms to develop technological capability, establish production facilities, and build a dominant and secure domestic market position – laying the groundwork for rapid growth in the 1970s. The U.S. industry, in stark contrast to its leading position in the rest of the world, was limited to a very weak position in the Japanese market.

In the mid-1970s, the powerful Japanese Ministry of International Trade and Industry ("MITI"), whose "most important task is to protect and foster domestic industry in the face of fierce international competition," set a long range goal for Japan – world leadership in the high technology industries. Because of the pervasive importance of semiconductors to these industries, the promotion of Japan's semiconductor industry was a central element of this program. MITI "targeted" this industry for accelerated growth.

MITI . . . set a long range goal for Japan – world leadership in the high technology industries.

MITI took a series of steps to promote Japan's semiconductor industry, supervising the "organization" of the industry into industrial groups to rationalize R&D and production, and effectively exempting these firms from Japan's antimonopoly laws. A detailed "Elevation Plan" was established for the industry, setting forth specific targets for (1) research and development of specified semiconductor technologies, supported by government subsidies; (2) semiconductor production supported by government low-interest loans; and (3) rationalization of the Japanese industry, also supported by government loans.

Between 1976 and 1982, the Japanese government provided at least $500 million in grants and loans to major Japanese semiconductor firms in connection with these objectives. An additional $1.5 billion was channeled *to these same firms* for objectives in closely related sectors (e.g., computers) which involve semiconductor support. In fact, these figures grossly understate the value of the government's assistance. They do

. . . the Japanese government provided at least $500 million in grants and loans . . . .

not include such things as tax advantages, use of government facilities, and free access to the results of government research and development – benefits which are far less easily measured. The figures also do not reflect the large cost savings to Japanese firms, which would otherwise have had to acquire capital and advanced technologies on an individual basis. One Japanese executive estimated that, without government assistance, Japanese firms would have spent five times what they actually spent to acquire advanced semiconductor technologies. Moreover, direct government support, although substantial, is a small part of the real benefit to Japanese firms. Government funding provides a signal to the Japanese banks as to which industries are favored, and thus are the best prospects for loans.

. . . without government assistance, Japanese firms would have spent five times what they actually spent . . . .

The net effect of MITI's promotional measures was to organize and channel the collective resources of Japan's largest electronics firms toward certain narrow and well-defined commercial goals – most notably, superiority in Very Large Scale Integration (VLSI), the most advanced semiconductor technology, and the one that is critical to the production of components for the next generation of office equipment, computers, and telecommunications systems.

Protectionism has been and remains an important element of Japanese policy. "Liberalization" of the semiconductor and computer industries in 1974-76 supposedly ended the official barriers to semiconductor imports and direct foreign investment in Japan.

However, unofficial barriers remain, condoned if not encouraged by the Japanese government. There is an observable "buy Japan" preference exercised by major consumers of semiconductors in Japan.

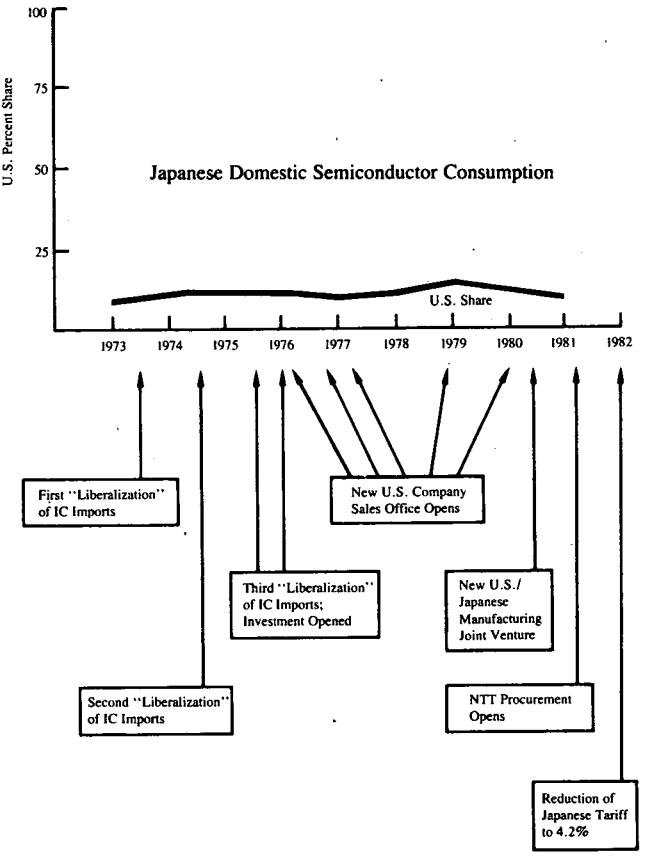
The value of market protection to Japanese firms has been and is substantial. Such protection results in additional revenues for Japanese firms, the value of which has been estimated to exceed the value of government financial assistance to them. Most of this revenue has been gained at the expense of U.S. producers which otherwise would have made the additional sales. The elimination or reduction of official barriers to imports and foreign investment over the past 10 years has had no appreciable effect on U.S. participation in the Japanese market. As Chart I shows, intensified U.S. efforts to penetrate Japan between 1973 and 1981 did not result in an increase in U.S. sales as a percent of Japanese domestic consumption — strongly suggesting that despite "liberalization," the Japanese market remains protected.

. . . despite "liberalization," the Japanese market remains protected.

Chart I

Japan's Market Remains Closed

U.S. share in 1981 is the same as its share in 1973, despite various "liberalization" measures and U.S. investment efforts.



Impact of Japanese Policies

The so-called "VLSI era" has dawned under the initiative of Japanese semiconductor makers, led by NEC and Hitachi. Industrymen see that Japanese makers will far out distance their American rivals in 64K RAM mass production in the coming few years.

Japan Economic Journal
November 10, 1981

The targeting system has created a business environment for Japanese firms in which the risks of rapid, large scale investments in capacity expansion, and aggressive pricing to increase market shares are outweighed by the risks of *failing* to take such steps and thus losing favored status in Japan. Japanese firms race to build capacity and market share – a competition that in recent years has spilled over into world markets with substantial adverse impacts on U.S. semiconductor firms.

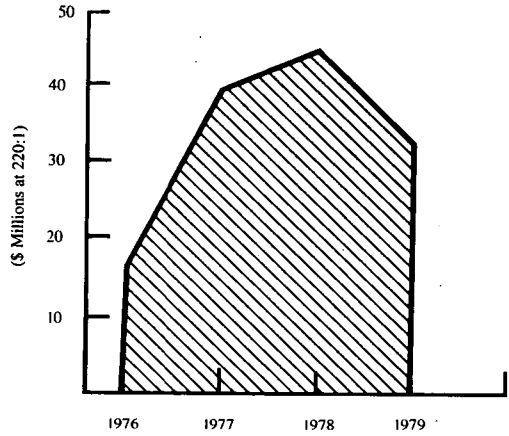
A graphic demonstration of the effects of Japanese policies is the 64K RAM* experience in 1980-82. Chart II summarizes the sequence of events.

*RAMs are the basic memory storage devices in most computers. Each "K" represents approximately 1000 "bits," or binary digits (a "yes" or "no," or a "1" or "0"). Thus a 16K RAM can store approximately 16,000 "bits" of information. RAMs with 16K or larger capacity are regarded as VLSI devices; the 64K RAM is currently the most advanced RAM commercially available.

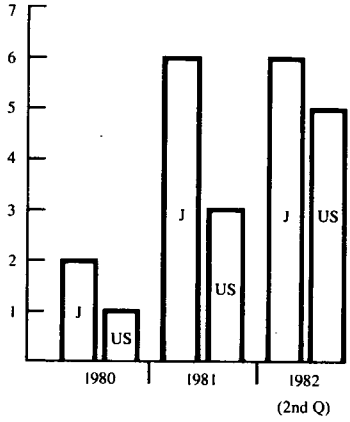
Chart II

The 64K RAM Experience

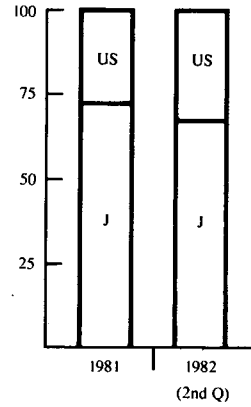
Japanese Government Financial Aid to the VLSI Project



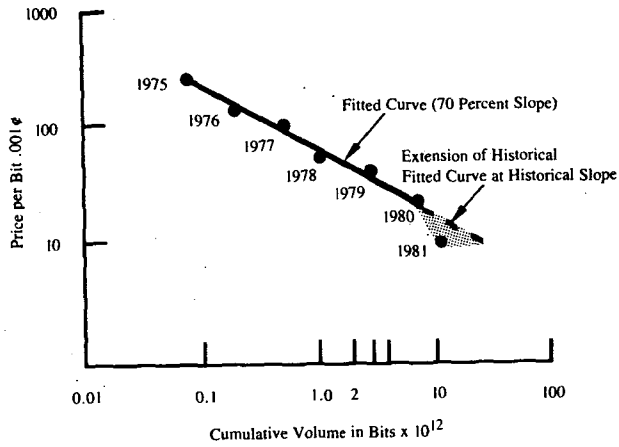
Coupled with other assistance, the VLSI Project enabled Japanese firms to enter the 64K RAM market *before* U.S. firms and to establish a dominant world market share.



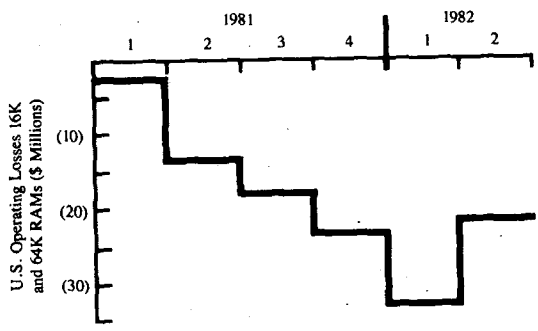
Number of Firms Attaining Volume Production (20,000 units per quarter)



World Market Share 64K RAMs



Led by Japanese pricing, all RAM prices fell sharply in 1981, in an unprecedented break with the historical pattern.



U.S. firms experienced large losses on RAM sales.

The support efforts of the Japanese government enabled six Japanese firms to go into volume production of 64K RAMs by early 1981, ahead of all but two U.S. firms. A critical factor that allowed so many firms – including some that had never produced RAMs before – to get into production before U.S. firms was the joint VLSI research cooperative that subsidized research and development, and shared technology among Japanese firms. U.S. firms had to develop their technology individually, and, as of early 1981, only two were successful.

. . . the Japanese began cutting prices sharply . . . .

RAM prices . . . declined at over 2-1/2 times the [historical] rate.

With their early start, and with a large number of competitors vying for a still small market, the Japanese began cutting prices sharply. The race for 64K RAM market share also led to deep price cutting for 16K RAMs, the prior generation of product – a much larger market, in which U.S. firms were still stronger than the Japanese producers. The result of aggressive Japanese price cutting was a drop in 64K RAM prices from $25-30 to about $8 during 1981 – a decline of more than two-thirds, coupled with significant declines in 16K RAM prices. The net effect was a marked downward displacement of the historical price patterns. Traditionally RAM prices fell 30% for each doubling of volume. In 1981, they declined at over 2½ times that rate. One Japanese semiconductor executive remarked in late 1981, "I don't think anyone will be profitable at the projected (mid-1983 64K RAM) price of $5 for that period."

The effect of the Japanese export effort on U.S. producers has been serious. One indicator is the fact that seven of the twelve U.S. producers of 16K RAMs are not producing 64K RAMs. Those who did choose to stay in the RAM business have suffered substantial losses – over $140 million in 1981 and 1982.** These results can only further discourage U.S. firms from competing in the RAM market in the future, particularly when production of the next generation RAM (256K) will require an investment of $100-150 million as the price of entry. As one industry observer recently remarked, "It's become a new game, called 'you bet your company.'"

"It's become a new game, called 'you bet your company.'"

The implications of U.S. disinvestment in dynamic RAMs are serious. RAMs have traditionally generated technological capability that has been translated into leadership in other semiconductor product areas. Producers of RAMs must master techniques which, once learned, can be applied to virtually all other semiconductor types – and, as a result, RAMs have been termed the "bellwether" for the industry. Moreover, the 64K RAM is forecast to become the highest-volume product in the industry's history.

The implications . . . are serious.

**These losses do not include one of the two largest U.S. producers, which has publicly reported it is losing money on RAMs.

The Japanese government continues to target the semiconductor industry . . . .

The RAM experience repeats a pattern familiar to many other industries targeted by the Japanese, and represents the "entering wedge" of an all-out assault on other semiconductor markets. The Japanese government continues to target the semiconductor industry for special assistance. It has budgeted nearly $300 million over the next decade for semiconductor and related research projects; very recently, it developed design and manufacturing technology for the 256K RAM in government laboratories and shared it with Japanese companies at no cost.

. . . the Japanese market is still effectively protected against foreign competition.

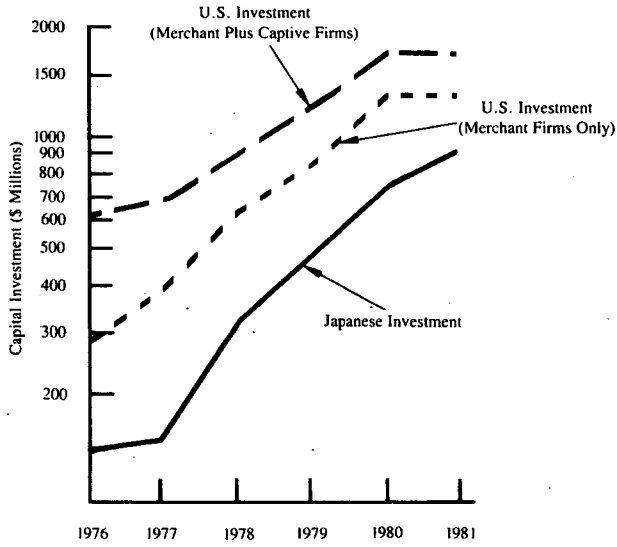
It is also clear that the Japanese market is still effectively protected against foreign competition. U.S. sales as a percent of Japanese domestic semiconductor consumption, never large, are now *declining* and are actually lower than at points in the past when the market was officially protected. Moreover, U.S. firms within the last three years have repeatedly experienced a sudden drop in sales – and at times virtually a total loss of market – as soon as Japanese firms have been able to supply a particular part.

As can be seen in Chart III, the Japanese firms have responded to the government's targeting incentives and have expanded capital investment more rapidly than U.S. firms, particularly in 1981, when investment growth by U.S. firms came to a halt. Preliminary data for 1982 indicates the U.S. firms have *not* increased expenditures, while Japanese capital investment has continued to grow.

U.S. semiconductor companies normally have spent 15-20% of their total revenues on capital investment. In addition to the risks posed by

Chart III

U.S. and Japanese Semiconductor Firms' Worldwide Capital Investment Growth Rates



Notes: Figures for Japanese firms represent fiscal years beginning April 1.

Yen conversion: (1976 – 296.2:1) (1977 – 265.9:1)
(1978 – 205.9:1) (1979 – 221.3:1)
(1980 – 224.8:1) (1981 – 221.3:1)

Source: U.S. International Trade Commission Data (1976 – 78)
SIA Estimates (1979 – 81)

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generally prevailing adverse economic conditions, the Japanese have created a substantial additional investment risk for U.S. firms – that, backed by the government of Japan, Japanese firms will continue to price very aggressively to gain market. While the Japanese government effectively covers risk for Japanese firms, U.S. firms must fend for themselves in this kind of high stakes game –

understandably an unattractive prospect for U.S. producers. Thus a strong incentive exists to disinvest in products that Japanese have targeted. Such has already been the case in the RAM business, and will be repeated in other semiconductor product lines, unless something is done to fundamentally reduce the risks U.S. firms face in competing with the Japanese target system. In effect, by reducing the risk of aggressive investment and pricing for its own firms, the Japanese targeting policy *increases* the risks for U.S. firms.

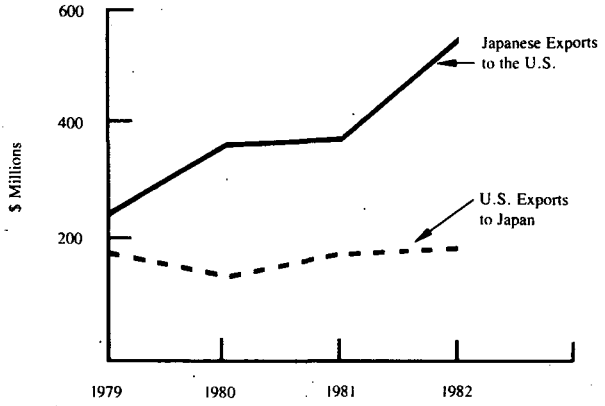
. . . by reducing the risk . . . for its own firms, the Japanese targeting policy increases the risks for U.S. firms.

The magnitude of the challenge to the U.S. semiconductor industry is becoming clear in recent trends in bilateral trade with Japan (Chart IV). While U.S. exports to Japan have been steady for three years and the U.S. percent of Japan's domestic consumption has declined sharply, Japanese exports have increased dramatically and Japan's sales as a percent of U.S. consumption have doubled. Moreover, most U.S. imports of Japanese semiconductors are "hidden" – the devices are incorporated in imported Japanese consumer electronics and information industry products, and do not show up in U.S. trade statistics. One U.S. semiconductor firm estimated the value of such "hidden" imports at $675 million in 1981. Japanese producers may in fact already account for a larger share of U.S. consumption than U.S. producers account for in Japan – compelling evidence of the success of Japan's national industrial policy in giving Japanese producers an arbitrary advantage in international competition.

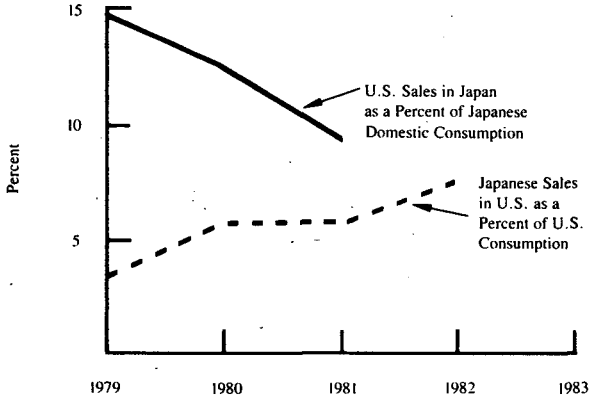
. . . Japanese producers [have] an arbitrary advantage . . . .

Chart IV

Recent Trends in U.S.-Japan Semiconductor Trade



Import Sales as a Percent of Total Domestic Semiconductor Consumption



Sales include merchant only.
Domestic consumption includes merchant and captive.

A Government-Industry Response

The Japanese government has undertaken a deliberate and concerted effort to protect and promote an established domestic semiconductor industry. This target industry policy has distorted the conditions of competition in world semiconductor markets and has enabled Japanese companies to challenge the technological superiority and economic viability of the U.S. industry. The U.S. government must now decide to respond to this targeting strategy and take immediate action to restore the conditions of competition that are essential to a healthy U.S. semiconductor industry.

The U.S. government must . . . respond and take immediate action . . . .

Targeting, with all of its ramifications, has fundamentally distorted free market competition and threatens the long-term viability of many firms in the U.S. semiconductor industry. Significantly, Japan's targeting and protectionist policies have harmed U.S. firms in a way which entitles the U.S. to seek redress under international agreements signed by both Japan and the U.S. – most notably, the General Agreement on Tariffs and Trade (GATT) and the Subsidies Code negotiated in the Tokyo Round of Multilateral Trade Negotiations. A number of steps should be taken by the U.S. government to offset the impact of current and past Japanese government policies. Some constructive measures have already been instituted; others are needed.

First, the U.S. government should announce as U.S. policy that foreign industrial targeting practices will not be allowed to undermine U.S. technological and economic leadership in this critical industrial sector. The future growth of the U.S. economy depends on the continued vitality of this industry.

. . . announce . . . U.S. policy . . . [regarding] foreign industrial targeting practices . . . .

Second, the U.S. government must identify, analyze, and counter the distorting effects of foreign industrial targeting practices. The U.S. government should establish, in cooperation with industry, a monitoring system with respect to major commercial merchant semiconductor product lines (excluding firms which produce solely for their own use). Such monitoring will give early warning of export drives, and will be available to alert the U.S. government to possible predatory export trends by Japanese firms as well as the continuing existence of barriers to market access to Japan. The U.S. government should provide assurances that it will take appropriate action under the U.S. trade laws if monitoring reveals the existence of unfair trade practices.

. . . establish a monitoring system . . . .

Third, the U.S. government should insist that U.S. semiconductor firms receive commercial opportunities in Japan that are fully equivalent to those enjoyed by Japanese firms — including those favored by MITI. Such "national treatment" is asking no more than Japanese firms already enjoy in the U.S. today. U.S. firms must receive real, not cosmetic

. . . insist . . . [on] "national treatment" . . . .

market access, reflected in significantly greater participation by U.S. firms in the Japanese market. This will require an affirmative action program to normalize competition in Japan. The Japanese government should establish necessary programs to see that this result is achieved.

. . . seek enforcement of Japan's obligations . . . .

Fourth, in order to establish free market competitive conditions internationally, the U.S. government should promptly seek enforcement of Japan's obligations through consultations and other procedures available under the General Agreement on Tariffs and Trade, and the Subsidies Code negotiated in the Tokyo Round of Multilateral Trade Negotiations, and should be prepared to exercise U.S. rights under such agreements, if necessary. The effects of Japanese semiconductor policies have, in a very real sense, impaired the benefits given the United States under the GATT in as far as semiconductor trade is concerned.

. . . use the implementation of these policies . . . as a model . . . .

Fifth, the U.S. government should use the implementation of these policies with respect to Japan as a model for dealing with targeted industry practices in other countries.

. . . enact legislation . . . .

Sixth, the U.S. Congress should enact legislation that provides the authority and means necessary to ensure that the U.S. government can carry out the policies and measures outlined above effectively.

The U.S. government and industry must take steps to meet this challenge, and do so quickly, if the U.S. industry is not to suffer erosion of its high technology advantage, with consequent damage to our economy, our employment, and our overall international competitiveness. The U.S. companies affected recognize their responsibility to support these efforts and will do everything possible to meet these challenges.

. . . government and industry must take steps to meet this challenge . . . quickly . . . .

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SEMICONDUCTOR INDUSTRY ASSOCIATION
LEGISLATIVE PRIORITIES 1983

1. TRADE LEGISLATION

ISSUE: Current U.S. trade laws are inadequate to address the harmful effects of foreign government targeting practices in high technology.

STATUS: On January 25, 1983, Sen. Danforth re-introduced a bill which incorporated high technology trade legislation backed by SIA in 1982.

POSITION: SIA supports passage of this and other legislation that will enable the U.S. government to deal more effectively with foreign market distorting practices.

2. EXPORT CONTROLS

ISSUE: The Export Administration Act of 1979 expires this fall and will be subject to renewal.

STATUS: New legislation will be proposed which would severely tighten U.S. export controls.

POSITION: SIA, while supporting measures to strengthen national security, opposes measures which would unnecessarily restrict exports and raise costs. SIA also supports a system of controlling technology transfer through implementation of a comprehensive operations license which recognized and utilized the mechanisms U.S. firms use to protect proprietary and business information.

3. R&D TAX CREDIT

ISSUE: U.S. firms are allowed a 25 percent tax credit for R&D expenditures which exceed prior years' levels.

STATUS: The credit is scheduled to terminate in 1985 and some members of Congress may seek to repeal it this year.

POSITION: SIA supports expansion of the R&D credit and its extension beyond 1985. SIA also proposes a zero based credit for corporate support for university research and education.

4. COPYRIGHT PROTECTION

ISSUE: U.S. copyright and patent laws do not clearly protect semiconductor circuit designs.

STATUS: Senator Hart and Rep. Don Edwards will introduce a bill clarifying copyright protection to semiconductor designs.

POSITION: SIA urges enactment of this legislation.

5. ELIMINATION OF SEMICONDUCTOR DUTIES

ISSUE: Tariffs on semiconductors constitute a barrier to trade and an additional cost which lessens U.S. competitiveness and diverts resources from R&D and capital investment.

STATUS: Authority is needed to reduce or eliminate U.S. semiconductor duties below present levels.

POSITION: SIA supports enactment of legislation to eliminate semiconductor duties as a means of encouraging other countries to take similar action.

6. ANTITRUST EXEMPTION FOR JOINT R&D

ISSUE: U.S. firms operate at a competitive disadvantage in relation to their foreign competitors because their joint R&D efforts through industry cooperative research organizations are deterred by U.S. antitrust laws.

STATUS: A number of legislative alternatives have been advanced to address this problem. Representative Edwards and Senators Glenn, Kennedy and Mathias favor one version. Senator Hart favors another.

POSITION: SIA would favor legislation to clarify U.S. antitrust laws with respect to joint R&D conducted through industry cooperative research organizations to strengthen the international competitiveness of U.S. firms.

SIA SEMICONDUCTOR INDUSTRY ASSOCIATION
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SIA POSITIONS ON LEGISLATIVE ISSUES 1983*

A. Trade Issues

1. LOCAL CONTENT LEGISLATION

ISSUE: Legislation was introduced in 1982 which would require most automobiles built in the U.S. to utilize predominantly U.S.-made parts and U.S. labor.

STATUS: This legislation will be introduced again in 1983 and strongly supported by the UAW.

POSITION: SIA opposes passage of local content legislation because risk of retaliation or emulation would endanger the high level of high technology exports.

2. FREEDOM OF INFORMATION FLOW

ISSUE: There have been efforts to increase government control over the technical information presented in journals, conferences and other forums to prevent its availability to potential foreign adversaries of the United States.

STATUS: There may be legislative or regulatory proposals to tighten controls on the dissemination of technical information.

POSITION: SIA believes that any such proposals deserve careful scrutiny for their potentially adverse effects on the free exchange of scientific and technical data.

---

* The issues on which SIA will take a lead are identified separately. These are issues on which SIA will support the initiatives of others.

3. PERFORMANCE REQUIREMENTS

ISSUE: Foreign governments impose trade-related performance requirements on foreign investors to achieve national policy objectives (local content rules, equity participation requirements, etc.).

STATUS: The Administration is considering legislative proposals to increase its leverage in dealing with this problem.

POSITION: SIA would support appropriate measures to enhance the President's ability to address this problem.

B. Tax Issues

1. DISC BENEFITS

ISSUE: U.S. tax laws permit U.S. firms to defer a percentage of income from export sales (42%) from taxation ("DISC" provisions).

STATUS: The administration is likely to propose legislation replacing DISC (Domestic International Sales Corporation) benefits in 1983 with a tax measure designed to provide comparable benefits to U.S. companies.

POSITION: SIA supports continuation of the benefits provided by or a substitute for DISC which provides benefits substantially equivalent to the DISC as a means of stimulating U.S. exports.

2. INCREASE IN U.S. TAX BURDEN

ISSUE: Due to the federal deficit, proposals are likely to be introduced in the 98th Congress which would increase taxes.

STATUS: A variety of tax proposals are likely to be considered many of which could adversely impact the U.S. semiconductor industry.

POSITION: If Congress deems it necessary to increase taxes, SIA will address these proposals on their merits. SIA would oppose any tax proposal which would disadvantage semiconductor firms in relation to companies in other industries.

3. UNIVERSITY EQUIPMENT DONATION INCENTIVES

ISSUE: High technology firms enjoy limited tax benefits from donation of inventoried equipment to universities.

STATUS: The American Electronics Association (AEA) will sponsor a bill which would expand the tax benefits accruing from equipment donation and extend the benefits to manufacturing and business equipment.

POSITION: SIA supports the AEA proposal.

4. REDUCTION OF LONG-TERM CAPITAL GAINS TAX

ISSUE: Reduction in the long-term capital gains tax would offer a greater incentive to equity investors.

STATUS: Proposals to reduce this tax could be introduced in 1983.

POSITION: SIA would support proposals to reduce the long-term capital gains tax.

5. DEPRECIATION SCHEDULES

ISSUE: New ACRS depreciation schedules adopted in 1981 inadvertently penalize firms with production equipment with a very short useful life.

STATUS: Little prospect of ACRS reform this year.

POSITION: SIA would support changes in the ACRS which would provide for expensing short-lived or obsolete equipment. SIA would oppose changes in ACRS which would further disadvantage semiconductor companies and supports extension and expansion of the R&D tax credit as a means of offsetting these disadvantages.

6. SECTION 861

ISSUE: At present IRS regulations are suspended which reduce the amount of foreign taxes which can be credited against a firm's tax liability by allocating R&D expenses to income earned abroad.

STATUS: This suspension will expire in 1983.

POSITION: SIA supports a reconsideration on a permanent basis of the IRS rules allocating R&D expenses to income earned abroad.

C. Technology Issues

1. INCREASED R&D SUPPORT

ISSUE: This year measures are likely to be proposed which emphasize incentives to R&D to increase the competitiveness of U.S. industries.

STATUS: It is not clear at present what form the proposed incentives will take.

POSITION: SIA would support consideration of such proposals on their merits but would oppose any proposals that would imply central government control or direction of commercial R&D efforts.

2. GOVERNMENT FUNDING FOR INDUSTRY COOPERATIVE RESEARCH

ISSUE: Proposals have been advanced to encourage government funding of industry cooperative research.

STATUS: SIA members have suggested this subject as an area of possible legislative action.

POSITION: SIA would support government funding of industry-led joint research programs such as the Semiconductor Research Cooperative provided that no conditions were attached to such funding.

D. Manpower issues

1. SCIENTIFIC/TECHNICAL EDUCATION INCENTIVES

ISSUE: Incentives are needed to increase the number of science and engineering graduates from U.S. institutions, and to improve the quality of education.

STATUS: The American Electronics Association (AEA) is developing a series of legislative initiatives in this area.

POSITION: SIA strongly urges support for legislative initiatives in this area as critical to the long term growth of the high technology industries.

2. SIMPSON/MAZZOLI

ISSUE: Legislation introduced (but not passed) in 1982 ("Simpson/Mazzoli Bill") potentially restricts the ability of foreign science and engineering graduates to work in the U.S. upon graduation.

STATUS: This legislation will be reintroduced this year.

POSITION: SIA opposes those portions of this bill which adversely affect the availability of engineers needed by U.S. industry. This could seriously impact our ability to grow in the U.S.

The Effect of Government Targeting on World Semiconductor Competition

A Case History of Japanese Industrial Strategy and Its Costs for America

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The political and economic stability of the world throughout the most part of this century has been rhetorically called Pax Americana in an analogy to the Peace of Europe in the 19th century. Although the U.S. remains the preeminent world power, its relative status is declining.

- Japan Ministry of International Trade and Industry,
  The Vision of MITI Policies in the 1980s

PREFACE

The purpose of this paper is to describe the decade or more of coordinated effort by the Japanese government to put the Japanese semiconductor producers in a dominant world-wide position in key product lines. The Japanese government has worked closely with private Japanese firms to reorganize the industry; rationalize production; protect its home market; subsidize research, development, and production; and in a number of ways to promote its industry's bid for a commanding world market position.

By primarily utilizing Japanese sources to document this effort, we allow the story to be told from the perspective of the participants.

The organization of an industry for a national goal is not completely foreign to the United States. We have engaged in major joint-government-industry efforts in wartime, for the national defense in the post-war period, and for space exploration in the last two decades. These efforts have marshalled national resources and achieved objectives that no individual firm or group of companies could have achieved. The Japanese government has employed a similar technique to achieve commercial objectives.

The Japanese semiconductor targeting policy has caused serious adverse consequences for producers in this country. U.S. investment is declining in those product lines which the Japanese have chosen to dominate. In building a consensus with respect to areas in which Japanese industry should expand, there has been a consistent pattern in Japan of installing substantially greater capacity than needed to meet reasonable projections of domestic demand. This has been true in shipbuilding, steel, televisions, fiber optics, and microelectronics. For a Japanese producer, the risks of failing to install such capacity are greater than the risks of doing so. For other competitors in the marketplace, the result is disinvestment in the targeted product areas.

The U.S. semiconductor firms are part of a highly competitive industry. There are a large number of competitors, the industry is highly innovative, and prices continue to decline. However, the incursion of a government-backed group of foreign firms is now lessening the ability of U.S. companies to continue to compete internationally. Through a government/industry combination abroad, market power is developing which is impacting the U.S. industry.

This paper is designed both to point out the urgent need for an American policy response to this challenge and to serve as an input for the American debate on industrial policy questions which is now taking shape. It should also serve as a basis for serious concrete bilateral discussions with the Government of Japan which are ongoing.

The facts are now well known as to the nature of competition with the Japanese microelectronics industry. The effects of the Japanese national effort to target this industry are now also evident. All that is missing is an adequate American response to the challenge so clearly posed.

FOREWORD

The Semiconductor Industry Association (SIA) was chartered in 1977 by six U.S. semiconductor manufacturers to represent the common interests of the industry in matters of trade and public policy. Today 57 firms are members of SIA. In addition to trade and public policy, there are SIA committees on occupational health, environment, safety, trade statistics, and law.

This paper is an attempt to summarize in one place the events that are unfolding in world semiconductor competition, as a result of the Japanese government's promotion of its semiconductor industry. It was prepared for SIA by Thomas Howell of Verner, Liipfert, Bernhard and McPherson, Chartered, and by Warren Davis, SIA's Director of Government Relations. John Greenwald of Verner, Liipfert, a principal U.S. negotiator and draftsman of the Subsidies Code negotiated in the Tokyo Round of multilateral trade negotiations, prepared Part IV, "Japanese Semiconductor Policies and the Rules of the International Trading System", and contributed substantially to the shape of the paper as a whole.

A number of individuals within the semiconductor industry gathered data, contributed to, and extensively reviewed the paper. Without their continuing comments, guidance, and criticism, preparation of this paper would not have been possible.

Portions of the statistical work were prepared by Michael Kubiak, SIA's Manager of Statistical Programs, and by Richard Boyce, Assistant Professor of Economics, State University of New York and Binghamton. Statistics published by Dataquest, Inc. were essential to the preparation of this paper.

The paper was reviewed by George Eads, former member of the President's Council of Economic Advisers; Robert Leone of the Cambridge, Massachusetts Consulting firm of Putnam, Hayes and Bartlett; and William Noellert, staff economist, Verner, Liipfert, Bernhard & McPherson. Elaine Frangedakis of Verner, Liipfert contributed research on Japanese law. Final editing and production of the paper in its present form was the responsibility of Sheila Sandow, SIA's Manager of Publications.

A number of prior works have proven particularly valuable in the preparation of this paper. They include W. F. Finan, "The Exchange of Semiconductor Technology Between Japan and the United States" (October 21, 1981); Semiconductor Industry Association, The International Microelectronic Challenge (May 1981); W. F. Finan, The International Transfer of Semiconductor Technology Through U.S.-Based Firms (December 1975); M. Borrus, J. Millstein, and J. Zysman, International Competition in Advanced Industrial Sectors: Trade and Development in the Semiconductor Industry (February 18, 1982); Charles River Associates, Innovation, Competition and Government Policy in the Semiconductor Industry (September 1980); J. Gresser, High Technology and Japanese Industrial Policy: A Strategy for U.S. Policymakers (October 1, 1980).

The authors of this paper are deeply indebted to the authors of these prior works.

ALAN WOLFF

Partner

Verner, Liipfert, Bernhard
and McPherson, Chartered

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EXECUTIVE SUMMARY

In the past two decades, a number of new U.S. industries have arisen which have enjoyed strong growth, high levels of productivity and profitability, and the ability to compete successfully in the world market. These are the knowledge intensive or high technology industries, which include computers, aerospace, and telecommunications—industries which hold the key to this country's economic future.

Semiconductors—both discrete devices and integrated circuits—are the basic building blocks of many of the high technology industries. Semiconductors, which can incorporate thousands of electronic functions in an extremely small area—usually no larger than a quarter inch square—have made possible most, if not all, of the major technological advances which have occurred in the electronics-based high technology manufacturing sectors in the past two decades, ranging from personal computers to advanced weapons.

The U.S. has traditionally led all other nations in semiconductor technology. Highly innovative, efficient, and competitively successful, U.S. semiconductor firms have been held up as proof of the continued ability of the U.S. to foster industries capable of world leadership. The U.S. advantage in semiconductors has in turn enabled the U.S. to maintain a competitive lead in most other high technology fields, including computers, communications systems, and "smart" weapons. The semiconductor industry, and the other industrial sectors to which it contributes, are essential if the U.S. is to strengthen and revitalize its economy and export base in the remainder of this century, and to maintain a strong national defense posture.

Today, however, the U.S. semiconductor industry faces a serious challenge—a challenge that is being expanded to other industries.

Japan's Industrial Policy

In the late 1960s and early 1970s, the Japanese government protected its domestic semiconductor industry through import restraints and exclusion of foreign investment. It controlled the licensing of foreign technologies within Japan. This combination of policies was designed to keep the U.S. semiconductor industry from taking advantage of its technological leadership to establish a strong market position in Japan as it had in Europe and elsewhere. The Japanese government's efforts permitted domestic semiconductor producers to establish production capabilities and a strong domestic market position—laying the groundwork for the industry's rapid growth in the late 1970s.

In the mid-1970s, the Japanese government set a long range goal—world leadership in the high technology industries. The development of Japan's semiconductor industry was a central element of this program.

Accordingly, the Japanese Ministry of International Trade and Industry (MITI) targeted Japan's semiconductor firms for accelerated growth. MITI took a series of major steps to ensure that Japan's leading semiconductor firms would achieve marketplace and technological preeminence:

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a) Through a process of industry-government consultation, industry-wide goals were established;

b) MITI reorganized the Japanese semiconductor industry in conjunction with those goals, exempting them from the operation of Japan's antimonopoly laws;

c) A joint industry-government R&D effort, the VLSI Project, was instituted to develop advanced semiconductor technologies, particularly very large-scale integrated circuits (VLSI); participating firms received $132 million in government loans over four years which need be repaid only if the technologies developed pursuant to the loans are profitable;

d) Additional financial assistance was extended to semiconductor firms, including outright grants and low interest loans (at an approximate value of between $340 million and $1.9 billion between 1976 and 1982), as well as special depreciation and other tax benefits (the numbers vary widely because of the overlap between semiconductors and closely related technologies);

e) "Buy Japan" practices were condoned and even encouraged to limit opportunities for foreign products in the domestic market as well as in government procurement, giving Japanese producers an assured source of demand.

All told, Japanese semiconductor firms are estimated to have received between $507 million and $2 billion in government funds between 1976 and 1982 as well as numerous tax and other advantages.

The comparative advantages enjoyed by leading Japanese firms as a result of these policies are summarized in Figure A. The net effect of these measures was to organize and channel the collective resources of Japan's largest electronic firms--augmented by numerous forms of governmental assistance—toward certain well-defined commercial goals, including superiority in VLSI, the technology critical to producing components for new generations of computers, telecommunications, and office equipment.

Targeting Enabled Japanese Firms to Invest and Price Aggressively

The Japanese semiconductor industry made great strides forward as a result of this assistance. The VLSI Project, while drawing heavily on U.S. technology, produced over 1000 patentable semiconductor technologies, and enabled Japanese firms to pull abreast of the U.S. industry in VLSI capability. Japanese firms undertook major capital investment in semiconductor production capacity—between FY 1978 and FY 1982, most leading firms are estimated to have tripled their level of investment.

Reflecting the industry's collective focus on relatively narrow objectives, much of the Japanese firms' capital investment was devoted to production capacity for a few

Figure A

COMPARATIVE ADVANTAGES ENJOYED BY TARGETED FIRMS IN JAPAN

Information Industries and Microelectronics

	MITI-Favored Japanese Firms	Other Japanese Firms	Foreign Firms in Japan
Entry into Industry	Selected, subsidized and assigned task.	Screened and restricted entry under rationalization process.	Investment legally barred until 1976, discriminatory private and government procurement until present.
Fair trade (competition) laws	Exempted. May form cartels under MITI direction.	Subject to Fair Trade Laws.	Subject to Fair Trade Laws.
Cooperative Research	Subsidized participation with technology transfer among projects.	Limited participation and access to patents.	Restricted participation and access to patents.
Financing	Japan Development Bank (JDB) low interest loans. Japan Electronic Computer Company (JECC) subsidizes Japanese customers.*	Limited capital availability. Normal market rates and payment terms.	Restricted access to local capital market in yen. Normal market rates and payment terms.
Tax	Large first year write-off in addition to standard depreciation schedules.	Standard depreciation schedules.	Standard depreciation schedules.
Acquisitions and Mergers	Arranged at MITI discretion	100% approval of acquired firm's Board required.	100% approval of acquired firm's Board and government approval required.

* The Japan Development Bank is a public corporation. JECC is a joint venture of Japan's leading computer and semiconductor firms which is funded in part by low-interest loans from the Japan Development Bank.

Source: SIA

critical semiconductor types. These products enjoy widespread demand, have enormous market growth potential, and are sufficiently complex that mastery of their technology serves to create a "stepping stone" to production of other device types. Most notably, the Japanese firms expanded capacity for production of random access memories (RAMs), the basic memory storage components of most computers. Beginning in 1977, Japanese firms began exporting large numbers of 16K RAMs (each "K" refers to the ability to store 1024 bits of information), and in early 1981, they began to export significant numbers of 64K RAMs, currently the most advanced RAM commercially available.

Japanese Firms Captured U.S. Producers' Markets

Targeting gave Japanese semiconductor firms an advantage over their U.S. counterparts, enabling them to expand their share of the world RAM market at the expense of U.S. semiconductor firms. The Japanese exported large quantities of RAMs at very low prices. At times, the prevailing market price, set by Japanese "price leaders," was well below that of U.S. producers.

By the end of 1981, Japanese firms held an estimated 38 percent share of the world 16K RAM market, and 70 percent of the 64K RAM market. U.S. firms lost heavily. Five major U.S. semiconductor firms, reporting quarterly operating results on a confidential basis, collectively reported net pre-tax losses of $77.0 million on the 64K RAM between the first quarter of 1981 and the end of 1982. The same firms, which collectively reported pre-tax profits of $84.9 million on the 16K RAM in 1980, suffered cumulative net pre-tax operating losses of $66.4 million on the 16K RAM from the first quarter of 1981 through the third quarter of 1982.

The impact of the Japanese export effort has been so serious that a number of U.S. firms which have until now been major producers of dynamic RAMS are refraining from further investment in this product line.

Targeting Encourages Investment by Japanese Firms and Discourages Investment by U.S. Firms

Increasing disinvestment in the key RAM product lines has serious long-term implications for U.S. semiconductor firms. Experience and technology advancements gained in development of the complex RAM technology have traditionally enabled U.S. firms to retain leadership in a number of other less complex semiconductor product lines. Profits and experience generated from each generation of RAMS have enabled U.S. firms to invest in R&D and production capacity for the next generation of RAMs--and thus to retain technological leadership not only in memory devices, but in other semiconductor product lines as well.

The Japanese challenge comes at the very time that access to capital has become a more urgent concern for semiconductor firms. Japanese semiconductor firms already enjoy advantages in access to capital which flow from industrial structure and a variety of government policies. By reducing the risk of investment for Japanese firms, these factors tend to reduce the cost of capital and enhance its availability. At the same time, Japanese targeting diminishes the availability of capital to U.S. firms by increasing their

competitive risks. This dynamic threatens to produce an "investment gap" which poses a long-term problem of serious proportions for the U.S. industry.

U.S. Semiconductor Firms Have Not Been Permitted to Penetrate the Japanese Domestic Market

While Japanese firms have been free to make major inroads in U.S. firms' 16K and 64K RAM market share, U.S. merchant semiconductor firms have been largely limited in their penetration of the Japanese domestic semiconductor market. U.S. firms' share of that market has never exceeded twelve percent for any sustained period. The U.S. share has not increased significantly despite successive "liberalization" measures by Japan and repeated attempts by U.S. firms to invest in Japan.

The Japanese government has, through formal and (since 1975) informal measures protected its domestic semiconductor market. In 1974-75 the Japanese market was nominally liberalized. However, there is substantial evidence that despite formal "liberalization," the government continues to condone de facto "buy Japan" policies and practices. In fact, the "liberalization" actions taken in the last decade, individually and collectively, have not led to any significant increase in U.S. participation in the Japanese semiconductor market.

The continued resistance of the Japanese market to imports is a major problem for U.S. semiconductor firms. The Japanese market represents one quarter of the global market and is growing rapidly--more rapidly than either the U.S. or the European market. Japanese market protection has already meant substantial lost sales and the resulting loss of revenues, foregone research and investment expenditures, and thousands of lost job opportunities and revenues for U.S. firms and workers. In addition, the difficulty U.S. firms have encountered in competing effectively in Japan has enabled Japanese firms to build up large capacity and eventually to launch export drives which have had serious adverse consequences for U.S. firms. (A related problem has been the erosion of the U.S. customer base--that is, the consumer electronics industry that accounts for much semiconductor demand. To cite one example, Japanese success in consumer electronics--i.e., television, radio, stereos, and video tape recorders--has substantially reduced much of the U.S. market for U.S. semiconductor producers, and provided a secure market for Japanese semiconductor producers.)

Without the Japanese government's actions to protect and support its domestic semiconductor industry, it is unlikely that Japanese firms would have been as successful in challenging the U.S. industry. The U.S. government must now act to assure that this government assistance does not lead to further erosion of U.S. competitiveness in this critical sector.

U.S. Government Action is Needed

Targeting, with all of its ramifications, has fundamentally distorted free market competition and threatens the long-term viability of many firms in the U.S. semiconductor industry. A number of steps should be taken by the U.S. government to offset the

impact of current and past Japanese government policies. Some constructive measures have already been instituted; others are needed.

First, the U.S. government should announce as U.S. policy that foreign industrial targeting practices will not be allowed to undermine U.S. technological and economic leadership in this critical industrial sector. The future growth of the U.S. economy depends on the continued vitality of this industry.

Second, the U.S. government must identify, analyze, and counter the distorting effects of foreign industrial targeting practices. The U.S. government should establish, in cooperation with industry, a monitoring system (excluding firms which produce solely for their own use) with respect to major commercial merchant semiconductor product lines. Such monitoring will give "early warning" of export drives, and will be available to alert the U.S. government to possible predatory export trends by Japanese firms as well as the continuing existence of barriers to market access to Japan. The U.S. government should provide assurances that it will take appropriate action under the U.S. trade laws if monitoring reveals the existence of unfair trade practices.

Third, the U.S. government should insist that U.S. semiconductor firms receive commercial opportunities in Japan that are fully equivalent to those enjoyed by Japanese firms—including those favored by MITI. Such "national treatment" is asking no more than Japanese firms already enjoy in the U.S. today. U.S. firms must receive real, not "cosmetic" market access, reflected in significantly greater participation by U.S. firms in the Japanese market. This will require an affirmative action program to normalize competition in Japan. The Japanese government should establish necessary programs to see that this result is achieved.

Fourth, in order to establish free market competitive conditions internationally, the U.S. government should promptly seek enforcement of Japan's obligations in multilateral forums (through consultations and other procedures available under the GATT and the MTN Subsidies Code) and should be prepared to exercise U.S. rights under such agreements if necessary.

Fifth, the implementation of these policies with respect to Japan should form a model for dealing with targeted industries practices in other countries.

Sixth, the U.S. Congress should enact legislation that provides the authority and means necessary to ensure that the U.S. government can carry out the policies and measures outlined above effectively.

The U.S. government and industry must take steps to meet this challenge, and quickly, if the U.S. industry is not to suffer erosion of its high technology advantage, with consequent damage to our economy, our employment, and our future growth potential. The affected U.S. companies recognize their responsibility to support these efforts and will do everything possible to meet these challenges.

BACKGROUND

Many American integrated circuit makers and the U.S. administration itself are greatly concerned about Japanese domination of the U.S. market for 64-kilobit dynamic random access memories, the most densely integrated semiconductor devices now commercially available.... What makes the Americans nervous is the fact that semiconductors are very likely to determine the level of a country's computer, telecommunications, robotics, aerospace and other high technology industries in the future. The reason is that microchips now constitute the "core" components of highly-sophisticated products. Some people call semiconductors "the crude oil of the 1980s."

- Japan Economic Journal, June 29, 1982

The political and economic stability of the world throughout the most part of this century has been rhetorically called Pax Americana in an analogy to the Peace of Europe in the 19th century. Although the U.S. remains the preeminent world power, its relative status is declining.

- Japan Ministry of International Trade and Industry, The Vision of MITI Policies in the 1980s

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Beginning in the late 1970s Japanese firms launched a major export drive in semiconductors. This export drive was the direct outgrowth of an extensive, long-range program developed, orchestrated, and partially financed by the Japanese government to propel its semiconductor industry to world leadership. The Japanese export effort was characterized by an extremely rapid increase in the volume of devices sold and price reductions so steep that non-Japanese firms could not match them profitably. It was an effort aimed at one critically important semiconductor product line--high density random access memories (RAMs).[1/] By the end of 1981, Japanese firms had captured approximately 38 percent of the world market for the 16K RAM and 70 percent of the world market for the 64K RAM. U.S. semiconductor firms suffered substantial losses in 1981-82

1/ RAMs store digital information which can be changed. They are the basic memory storage components in computers. Metal oxide semiconductor (MOS) RAMs are one of the fastest growing semiconductor product lines. The numbers which precede the "RAM" acronym refer to the approximate number of bits (a "yes" or "no", or "1" or "0") of digital information that can be stored on each device. Thus a 1K RAM can store 1024 bits of information.

as a result of low-price, high-volume Japanese RAM sales. Five U.S. merchant[2/] semiconductor firms reported cumulative net operating losses of $143.4 million for the 16K and 64K RAM between the first quarter of 1981 and the fourth quarter of 1982.[3/]

It would be a mistake to view this competitive development as an isolated episode. In fact, the Japanese high-density RAM export drive represents an initial salvo in a competitive challenge to the U.S. semiconductor industry similar to those which Japan has mounted in other key industries, such as consumer electronics, machine tools, motorcycles, and ball bearings. In the past, comparable challenges have culminated in the loss by U.S. firms of world leadership, and in some cases almost total loss of market.

Today, the Japanese have made it clear that their goal is preeminence in all of the "knowledge-intensive" industries—and they see dominance in semiconductors as crucial to attaining that goal. Given the strategic and economic importance of the semiconductor industry, it is imperative that the U.S. government recognize the stakes involved.

Loss or even serious injury to the U.S. semiconductor industry would be profoundly damaging to this country. Our industrial base, and indeed, our future as an industrial power, increasingly depend on semiconductor technology. Semiconductors form the basic memory and logic elements of computers. They are revolutionizing such diverse fields as telecommunications, automobiles, industrial robotics, aviation, security systems, genetics, medicine, and virtually all segments of the consumer electronics and information processing industry. They have pervasive military and space applications; they have made possible, for example, the development of precision guided "smart" weapons and cruise missiles. In a very real sense our national security rests on these devices.

Until very recently, the U.S. semiconductor industry was the unquestioned world technological leader. Highly innovative, efficient, and willing to take risks, U.S. semiconductor firms have frequently been held up as proof that the U.S. market system can still foster dynamic industries capable of competing successfully in world markets. The semiconductor industry and other high technology sectors have been identified as one of the "growth" industries upon which this country's economic future may well rest. The survival of these industries is essential if the U.S. is to maintain a solid manufacturing and export base in the 1980s and beyond.

Now these industries are threatened. It is vital to understand how this has occurred.

2/ "Merchant" semiconductor firms produce semiconductors for sale to other firms. "Captive" semiconductor firms produce for their own internal consumption.

3/ While the current recession may have affected these firms' results, the demand for RAMs grew markedly during this period—and the firms themselves tend to attribute the bulk of their losses to Japanese competition, not recession.

I. Japan's Competitive Industrial Strategy

> Japan can be proud of its ability to attain objectives. When a clear final product image is given the Japanese ability to finalize a product is strong.
>
> - Japan Economic Journal, August 10, 1982

> (I)n the semiconductor industry, affected by technological innovation, a maker who succeeds in mass production ahead of rival makers wins out eventually.
>
> - Japan Economic Journal, May 6, 1980

An understanding of Japan's competitive industrial strategy—as applied in virtually all of its key industries—is a precondition to understanding the significance of the current Japanese RAM export drive. The Japanese strategy, reinforced by government "targeting" policies, has produced the same production/export pattern in industry after industry—motorcycles, machine tools, ball bearings. That pattern is now unfolding—in predictable fashion—in semiconductors.[4/] Basically, Japanese firms, with government guidance and help,

1) establish and develop an industry in their home market, deliberately keeping that market insulated from foreign competition to assure the industry a high volume, profitable base;

2) identify a few product lines in that industry for which demand is high and which are therefore most susceptible to high-volume, automated production;

3) make large investments in advanced production equipment to produce these key product lines;

4) launch "entering wedge" export drives in these product lines, characterized by a high volume of exports and extremely aggressive pricing, in which they secure a commanding presence, if not dominance, in the key product lines; and

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4/ For a description of this strategy, see Sanford Rose's article in Fortune, January 30, 1978, and Magaziner and Hout, Japanese Industrial Policy (1980), pp. 12-34.

5) "scale the product ladder," building on the experience and market presence gained through "entering wedge" product lines to introduce diversified models, until dominance of the foreign market as a whole is achieved.

This Japanese strategy is based on a central principle of production efficiency: unit costs of production decline as production experience accumulates. As a firm produces more units of a particular product, it gains experience and achieves economies which are translated into lower costs. Lower costs in turn enable the firm to price aggressively, expanding its market share and ensuring the continued demand needed for future growth. Such pricing weakens the firms' rivals, who cannot produce the product as cheaply, and who face strong incentives to withdraw from the market.[5/]

The first sign of a major Japanese challenge is usually the vigorous entry by Japanese firms into one or two popular, high-volume product lines—"hanagataban"[6/]—not the whole range of products offered by an industry. U.S. firms, experiencing extreme competitive pressure in these product lines, have frequently conceded them to the Japanese. In the 1960s, in the face of the Japanese challenge, U.S. consumer electronics firms largely abandoned production of transistor radios and tape recorders, and motorcycle manufacturers abandoned production of lightweight motorbikes. This has given Japanese firms their "entering wedge." Building on production experience gained by producing large volumes of "hanagataban," Japanese firms—now enjoying cost advantages based on experience and scale—have proceeded to diversify, introducing new, more specialized models, until in some cases they have come to dominate the market as a whole.

A competitive strategy aiming at volume production does not violate the rules of the international trading system—indeed, U.S. semiconductor firms themselves employ such a strategy. However, the Japanese have added a crucial element to the competitive equation—government targeting. Government targeting entails a series of government measures which are designed to ensure that Japanese firms achieve a volume advantage over their rivals:

5/ This phenomenon has traditionally been expressed graphically in terms of a "learning curve," which indicates that unit costs of production fall at a predictable rate for each doubling of production volume. For an analysis of this phenomenon, see Boston Consulting Group, Perspectives on Experience (1970); See also FTC Bureau of Economics, The Semiconductor Industry; A Survey of Structure, Conduct and Performance, pp. 45-46.

6/ "Hanagataban" literally means "star edition" in Japanese, and refers to the most popular models or product lines in an industry.

- Financial assistance. The Japanese government funnels part of the capital and other resources to favored firms in the targeted sectors, fueling their efforts to expand production capacity quickly.

- Lessening of risk. Major, rapid capital investments and aggressive pricing can be highly effective in securing initial market advantage. But these techniques pose high risks for the investing firm; a sudden fall in demand can be disastrous. Government targeting of a particular industry substantially lessens the risk of rapid investment for firms in that sector.

- Industry "rationalization" and guidance. The government helps direct the competitive efforts of Japanese firms toward specific goals, such as dominance of a particular product line or the development of specific technologies. The government pressures Japanese firms to organize cartels to divide and allocate product R&D and production, and encourages smaller and less effective producers to withdraw. These measures avoid dilution of effort and promote economies of scale.

- Domestic market protection. The Japanese government has retarded U.S. firms' penetration of the Japanese domestic market, and, at the same time, has actively worked to procure technology from U.S. firms and to disseminate it widely among Japanese firms. These measures have increased the volume of demand for Japanese products, and diminished the volume of demand for U.S. products despite initial U.S. technological advantages.

These forms of government intervention in the marketplace fundamentally distort free market competition and virtually inevitably lead to competitive reverses--some of them very serious--for U.S. firms, regardless of those firms' relative level of efficiency, productivity, and innovative ability. This happened in color televisions and machine tools in the 1970s. It is happening today in semiconductors. The Japanese intend to make it happen tomorrow in computers and telecommunications.

II. Japan Targets Semiconductors

> When Japan captured a majority market share of 64K RAMs, there was, understandably enough, an uproar in the U.S. It was because the U.S. realized that Japan had a greater objective--that of gaining a leadership in the world's computer market.
>
> - Japan Economic Journal, August 10, 1982

In the mid-1970s, the Japanese government committed itself to attaining pre-eminence in the "knowledge-intensive" industries--computers, data processing, communications, electrical machinery, robotics, and others--as a leading national economic priority.[7/] The Japanese government recognized that semiconductor technology provided the basic underpinning for all of these industries.[8/] Semiconductors, particularly very-large-scale integrated circuits (VLSI),[9/] were identified as one of the main elements of the whole Japanese high technology effort, and particularly as the key to dominance in computers.[10/]

Accordingly the semiconductor sector was targeted for accelerated growth and the leading Japanese firms in this sector, Nippon Electric (NEC), Fujitsu, Toshiba, Hitachi, Matsushita, Oki, and Mitsubishi--some of which rank among the largest industrial enterprises in the world--were singled out for an extensive program of government assistance.

7/ In 1975, Japan's Ministry of International Trade and Industry (MITI) released Japan's Industrial Structure: A Long-Range Vision, in which it indicated that the knowledge-intensive industries were the key to Japan's future economic development.

8/ MITI concluded that semiconductors were crucial after an intensive industry-government effort to capture the world lead in computer systems in the early 1970s was undercut by innovation which utilized state-of-the-art semiconductor technology. JIPDEC Report, Summer 1978, No. 34, p. 5; Japan Economic Review, July 15, 1973, p. 4; May 15, 1974, p. 12; Borrus, Millstein, and Zysman, International Competition in Advanced Industrial Sectors: Trade and Development in the Semiconductor Industry, pp. 88-89.

9/ 16K and 64K RAMs are both "VLSI" devices. Sometimes referred to as "super" or "ultra" LSI, VLSI refers to integrated circuit (IC) chips containing a minimum of 5,000 logic gates or more than 16,000 "bits," or binary digits, of memory. VLSI technology represents an enhancement of large-scale integrated circuit technology (LSI) devices which contain 100 or more logic gates or circuitry of similar complexity. LSI and VLSI devices comprise the basic logic and memory elements of most advanced types of computers.

10/ Japan Economic Journal, August 10, 1982, p. 15.

A. MITI's Role

> MITI's most important single task is to protect and foster domestic industry in the face of fierce international competition.
>
> - Japan Economic Journal, August 1, 1978

Japanese industrial policy, for the most part, has been controlled by the Ministry of International Trade and Industry (MITI), the government agency largely responsible for orchestrating Japan's recovery from World War II. MITI is charged with shaping the structure of the nation's industries, supervising the healthy growth of those industries and their production and distribution activities, managing Japan's foreign trade and commerce, and controlling patents, industrial technology, and technology acquisition.[11/] MITI uses a variety of incentives and controls, including influence over financing, tax policies, import-export measures, and "administrative guidance" to induce Japanese firms to compete vigorously and dynamically, but at the same time to move in directions that are consistent with overall national goals. Over the years, as Japan's economy has matured, MITI has successfully "targeted" industries of increasing sophistication--coal, electric power, fertilizer, and steel in the late 1940s and 1950s, heavy machinery and chemicals in the 1960s.[12/]

By the mid 1970s MITI already possessed the legal authority needed to undertake extensive measures on behalf of the semiconductor industry, including the setting of goals, the provision of various forms of financial assistance, and the formation of cartels.[13/] MITI had exercised this authority extensively, directing Japanese semicon-

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11/ Public Law No. 275, July 31, 1952, MITI Establishment Law.

12/ MITI, Japanese Industrial Policy (June 1981), pp. 1-3.

13/ Governmental authority to extend such benefits was originally provided for in Public Law No. 171, 1957, the Basic Electronic Industry Provisional Development Law ("Denshinho"). The authority was renewed in Public Law No. 17, 1971, the Law for Provisional Measures to Promote Specific Electronic and Machinery Industries ("Kidenho").

ductor firms to form cartels,[14] issuing directives blocking U.S. semiconductor imports,[15] and providing subsidies and other financial aid[16]—help which was credited with fostering the rapid growth of Japan's semiconductor industry.[17] MITI's legal authority was renewed and strengthened in 1978 by the enactment of the Public Law 84, 1978, the Law for Provisional Measures for the Promotion of Specific Machinery and Information Industries ("Kijoho"), which is currently in effect.

In mid and late 1975, MITI organized the leading semiconductor firms into two government-supervised industrial groups (NEC-Toshiba and Fujitsu-Hitachi-Mitsubishi), and fixed as the primary long-range goal the development of Japan's VLSI capability.[18] It subsequently established an "Elevation Plan" for the semiconductor sector and budgeted amounts needed to implement the Plan. The Plan included (1) specific targets for semiconductor research and development supported by government funding, (2) specific targets for semiconductor production, supported by government loans, and (3) specific targets for "rationalization" of the Japanese semiconductor industry (also supported by government loans).[19]

14/ The Japanese IC makers formed three industrial groups (NEC-Toshiba, Oki-Mitsubishi, and Fujitsu-Hitachi) in 1971 under MITI guidance. MITI sought cartel designation for this grouping pursuant to Public Law 17 for production of TTLs and DTLs (two types of semiconductors) having 100 or less elements. The purposes of the cartel formation were stated as 1) reduction of production cost; 2) prevention of excessive competition; and 3) price stabilization through unified and concentrated production. Nihon Kogyo Shimbun, January 8, 1972 (SIA translation). See also Japan Economic Journal, January 5, January 19, February 20, June 15, July 1, and December 14, 1971; Denshi Buhin, December 12, 1971.

15/ Japan Economic Journal, October 22, 1974, May 4, 1971; Nihon Kogyo, December 12, 1974; Nihon Keizai, March 27, 1981.

16/ Japan Economic Review, May 15, 1974.

17/ Ibid.

18/ MITI's industry organization efforts are detailed in Appendix A.

19/ MITI Machine and Information Industry Bureau, Trade and Industry Research Group, Commentary on Public Law 84 (1979). To cite an example of one aspect of the plan, with respect to semiconductor testing facilities, MITI budgeted 2 billion yen for wafer testing facilities ($9 million at 220:1), 2 billion yen for chip testing facilities, and 2 billion yen for module testing facilities. This represents a small portion of the total semiconductor elevation plan.

MITI's program was an extremely ambitious one. The Japanese government channeled at least $507 million to major Japanese semiconductor companies in direct aid (subsidies and loans) between 1976 and 1982, a figure which would be much higher if grants and loans to closely related sectors are included.[20/] These figures are based on publicly available Japanese sources; the extent to which additional aid may have been channeled to Japanese firms is not known. Further, the dollar amount of the financial aid involved grossly understates the value of the MITI program to the major Japanese semiconductor companies. MITI organized joint R&D projects which reduced R&D costs per firm to a fraction of the level they would have been absent such projects.[21/] MITI's

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20/ The figure is difficult to estimate precisely because much of the aid to the semiconductor sector was and is merged with aid to closely related sectors, such as computers and fiber optics. The $507 million figure was derived by counting all of the funds already expended on the VLSI and New Function Elements projects, and half the budgeted amounts already expended on the Supercomputer and Optoelectronics Projects. Although figures are not available for every year for the JDB loans for production equipment modernization, the annual totals have ranged from $38.6 million (1976) to $45.5 million (1981). For purposes of this computation a conservative annual figure of $38 million was used. In addition, the figure allocates five percent of the combined annual Japan Development Bank (JDB) loans made for industry restructuring and aid to the Japan Electronic Computer Company (JECC) to the semiconductor sector between 1976 and 1982. If the full amount of the JDB loans were included in the total (an inclusion which is arguably justified), the government aid to Japanese firms totals at least $2 billion. (The exchange rate used for all computations was 220:1.) Even these figures are conservative; they do not include tax benefits, the use of government personnel and research facilities in industry-government R&D programs, the results of government R&D turned over to Japanese firms free of charge, and other benefits extended by the government to the industry.

21/ Nihon Kogyo Shimbun described how such joint working relationships were conducted when it reported on February 19, 1974:

> The government's "integrated circuit development promotion subsidies," for which grantees have been already designated, are targeted to five themes including silicon gate, MOS-LSI, CMOS-LSI, and high-efficiency-industrial-use linear IC; and the development of these themes will be undertaken by two independent companies—Hitachi and Toshiba—and three groups organized from seven companies. Of these groups, Mitsubishi Electric and Oki Electric as a group assumed the development of N channel MOS-LSI, specifically to work on low electricity consumption and high-speed microprocessor. As for the division of labor between the two companies, Mitsubishi will develop microprocessor's LSI itself and Oki the low cost package. The two companies have so far maintained a cooperative arrangement in the development of the IC for ultra high-efficiency large computers for which the government was pushing hard to counter the liberalization of computers. With the receipt of the subsidies for the development of N

(footnote continues)

selection of several large producers as the major beneficiaries of its aid effectively forced other Japanese producers to cut back or drop altogether their own semiconductor production—guaranteeing the major producers economies of scale and secure market in Japan.[22/] The favored status enjoyed by these firms ensured easier access to private capital. The net effect of MITI's industrial "guidance" was to organize and channel the collective resources of five of Japan's largest industrial combinations toward the achievement of a relatively narrow goal—superiority in VLSI. This effort initially involved joint work on 4K and 16K RAM technology, and ultimately enabled six Japanese firms to introduce the 64K RAM, one of the most advanced VLSI devices, by the fall of 1980. At that time, only two U.S. firms, developing the 64K RAM on their own, were ready to enter the market.

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channel MOS-LSI this time, they are strengthening the cooperative arrangement further to accomplish not only the objective of the subsidies but also other tasks. As a part of the arrangement, the two companies established a "semiconductor conference" to exchange information, to provide a division of labor and cooperation in the production process, and to coordinate in sales. (SIA translation)

22/ Nihon Keizai reported on March 30, 1981 that as the largest semiconductor firms accelerated their levels of investment, smaller producers (Pioneer, Alps, TDK) were cutting back their in-house semiconductor production, limiting it to specialized lines, focusing on R&D and design rather than production, or dropping out altogether -- and procuring from the larger makers:

> As a result, since the weak, small, nonspecialized makers cannot make ends meet solely by inhouse production, they have to think of outside sales, but they cannot compete with the large scale makers in this activity, and so if they are not careful, they run the risks of plunging themselves into a quagmire.... And so from here on the large scale production of semiconductors will fall more and more into the hands of the larger makers, and the large users of semiconductors, such as the machinery and electrical makers, will move toward designing semiconductors and the R&D field, thus creating a division of labor. (SIA translation)

B. Industry-Government R&D Projects

> In this (VLSI) project, NTT, MITI, and the semiconductor makers cooperated, so that both in name and reality, this was a national project.
>
> - Nihon Keizai, February 28, 1980 (SIA translation)

> MITI officials say that joint undertakings is (sic) of crucial importance because the industry and NTT, while having much in common to be studied in developing VLSI, face enormous cost requirements and technical difficulties. They add that cooperation will help avoid duplication of efforts and speed up development.
>
> - Japan Economic Review, August 15, 1975

The centerpiece of MITI's initial promotional effort was a major, government-funded joint R&D project known as the VLSI Project (Figure B). This was a collaborative program by the government and Japan's five leading semiconductor firms which was designed to give Japanese firms the ability to develop and produce leading-edge VLSI technologies. It was funded by MITI through interest-free conditional loans ("Hojokin"), often referred to as "subsidies," which are repayable if and when participating companies make a profit from the technologies developed under the project. (Figure C; there is evidence that they have not been repaid.) These loans were matched by funds contributed by the semiconductor firms.[23/]

The VLSI Project was a "research cartel"; participating firms divided R&D tasks to avoid duplicative effort, and pooled their results. The Project was jointly undertaken and staffed by MITI and Nippon Telephone & Telegraph (NTT) (Japan's public telecommunications monopoly), and Japan's five leading semiconductor firms—NEC, Hitachi, Toshiba, Fujitsu, and Mitsubishi. A central laboratory with about 100 personnel conducted fundamental research into semiconductor technology. Its findings were turned over to two "applications" groups that developed marketable products from the basic research—one group focused on developing IBM-compatible technologies, while the other developed non-IBM-compatible technologies.[24/]

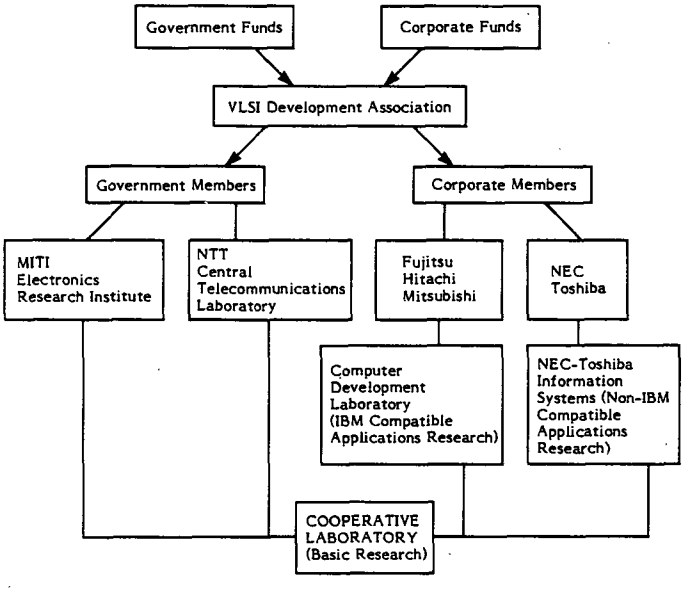
23/ U.S. Embassy cable, Tokyo, May 1982.

24/ Electronics, June 9, 1977, p. 101. The VLSI Project is described in more detail in Appendix A.

25-904 O - 83 - 24

Figure B

ORGANIZATION OF THE VLSI PROJECT



Source: Japan Agency of Science and Technology;
Hout and Magaziner, Japanese Industrial Policy, p. 104

The program was coordinated through the VLSI Association, an industry-government research association which has served as a prototype for similar subsequent programs. The VLSI Project promoted extensive cross-fertilization of ideas between and among Japanese firms and government scientists and, at the same time, gave each participating firm access to advanced technological know-how at a very low cost. An executive from one participating firm, NEC, commented that without the VLSI program,

Figure C

FINANCING THE VLSI PROJECT
1976 - 1979

(expressed in Dollars at 220:1)

Year	"Matching" Funds Provided by Participating Firms ($000)	"Hojokin" 1/ Loans by MITI ($000)
1976	20,455	15,905
1977	61,364	39,273
1978	61,364	45,691
1979	47,727	31,391
TOTAL	190,910	132,260

1/ Interest-free, refundable if and when technologies developed pursuant to the VLSI Project have become profitable. None refunded to date.

Source: U.S. Department of State

Japanese chip manufacturers would have spent five times as much on R&D in the development of electron beam technology.[25/] Ultimately, over 1,000 new VLSI patents were developed pursuant to this project.[26/] Significantly too, reflecting its goal of enabling Japanese firms to pull abreast of U.S. firms technologically, one-third to one-half of the program's entire budget was spent to purchase the most advanced semiconductor manufacturing and test equipment from U.S. manufacturers.[27/]

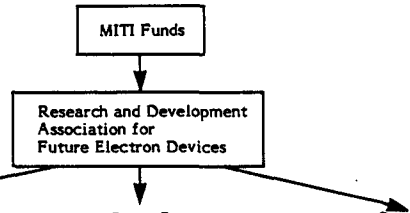
25/ The Economist, April 5, 1980, p. 75.

26/ Japan Economic Journal, September 2, 1980.

27/ Borrus, Millstein, and Zysman, op. cit., p. 55; Electronic News, July 14, 1975; September 27, 1976; January 31, 1977. Dempa Shimbun reported on February 19, 1980, that Japanese semiconductor firms were relying heavily on processing equipment made by U.S. firms.

Figure D

THE NEW FUNCTION ELEMENTS PROJECT, 1980 - 1990



	Group A	Group B	Group C
Members	Fujitsu Hitachi Sumitomo	NEC Oki Toshiba Mitsubishi Sharp Matsushita	Toshiba Hitachi Mitsubishi
Goals	Develop lamination techniques for building multiple-layered structures in which each layer is one atom thick; develop techniques for reducing cathode-to-anode distance within individual semi-conductors to within 5000 Angstroms	Develop methods for incorporating IC elements into chips in layers to increase density of elements by 40-50 times.	Develop element, mounting integration and evaluation technologies with the ultimate aim of producing highly integrated ICs, ICs capable of withstanding extremes of heat and radiation.

Source: U.S. Embassy, Tokyo, May 1982

MITI's promotional effort did not end with the VLSI Project, which has been succeeded by a new generation of government-funded joint semiconductor R&D projects. One of the most significant is the "New Function Elements" portion of Japan's Fifth Generation Computer Project, the details of which are summarized in Figure D.[28/] New Function Elements Project expenses are fully covered by government

28/ MITI organized this project as an incorporated "foundation" in order to deflect "criticism from overseas saying Japan fosters high technology under government-private cooperation." Nihon Kogyo Shimbun, August 5, 1981. (SIA translation)

funds, in the form of consignment payments ("Itakuhi") which participating companies are not required to refund to the government.[29] MITI initially earmarked 25 billion yen ($114 million at 220:1) for the New Function Elements Project.[30] In addition, a number of other government-funded and guided joint R&D programs are under way which involve semiconductors or semiconductor technologies. The financing for the various joint projects is summarized in Figure E.[31]

Finally, the Japanese government itself is conducting its own intensive semiconductor R&D programs, and at least in some cases, making the results of that R&D available to Japanese firms free of charge. In a very significant recent development, NTT transferred to NEC, Fujitsu, and Hitachi--at no cost--design and manufacturing technology for a 150-nanosecond 256K RAM device which it had developed.[32] In effect, NTT has designed and provided technological know-how to Japan's three leading producers, free of charge, for the next generation of RAM devices, the 256K RAM.

29/ The participating companies (Fujitsu, Hitachi, NEC, Oki, Matsushita, Sharp, Toshiba, Sanyo, Mitsubishi, Sumitomo) have organized themselves into the "Research and Development Association for Future Electron Devices", which contracts with MITI to do specific subprojects. Patents obtained will be government property and will be licensed by MITI (U.S. Embassy, Tokyo). MITI recently indicated it would give priority to domestic firms in licensing patented or patent-pending technologies developed in this project. Japan Economic Journal, June 16, 1981.

30/ Nikkei Sangyo Shimbun, August 5, 1981 and August 6, 1981.

31/ The "Supercomputer" project is designed to intensify speed of present general-purpose computers. Research will include development of new high-speed logic and memory elements, and possible alternatives to semiconductor technology (Josephson Junction Elements, Gallium-arsenide field effect transistors and high election mobility transistors). Nikkan Kogyo Shimbun, August 6, 1981; U.S. Embassy, Tokyo. The Optoelectronics project is designed to develop optoelectronic ICs for sensing devices (image transmission) and transmission of data in larger quantities than is possible using electrical impulses. U.S. Embassy, Tokyo; Nikkei Sangyo Shimbun, May 22, 1981. In addition, MITI makes specific R&D grants to individual companies to perform R&D concerning "important technologies." Many of these grants involve semiconductor, computer, or electronics technologies. A list of twenty such grants for 1982 is attached to Appendix B (Attachment B-1). Source: MITI Machine and Information Industries Bureau.

32/ Electronic News, October 11, 1982. Similarly, in 1981 MITI proposed to establish an "IC Design Center" to design custom ICs for the specialized needs of particular users "who cannot satisfy their needs from the existing mass-produced ICs." Nikkan Kogyo Shimbun, June 17, 1981. (SIA translation)

Figure E

JAPANESE GOVERNMENT SUBSIDIES FOR JOINT SEMICONDUCTOR R&D

Project	Budgeted Amount ($ Million at 220:1)	Time Frame	Form of Payment	Joint Recipients	
VLSI Project	$132.3	1976-79	Hojokin	NEC Hitachi Fujitsu	Toshiba Mitsubishi
Supercomputer 1/	104.5	1981-89	Itakuhi	Fujitsu Hitachi NEC	Toshiba Mitsubishi Oki
Optoelectronics 1/	81.8	1979-86	Itakuhi	Fujitsu Hitachi NEC Furukawa Sumitomo	Toshiba Mitsubishi Matsushita Oki
New Function Elements	113.6	1981-90	Itakuhi	NEC Toshiba Sanyo Matsushita Hitachi	Oki Mitsubishi Sharp Sumitomo

1/ Much, but not all of program devoted to semiconductor R&D

Source: U.S. Embassy, Tokyo

These Japanese industry-government R&D programs should be contrasted with U.S government-sponsored military and space semiconductor R&D programs. The Japanese programs are directed at producing technologies with commercial applications; the U.S programs are not.[33] While the Japanese R&D programs directly bolster the competitiv

33/ In the late 1950s and early 1960s, U.S. semiconductor firms did enjoy substantia commercial benefits as a result of government-sponsored R&D and procurement fo the Minuteman and Apollo programs. However, the advanced semiconducto technologies designed especially for today's military equipment have little direc commercial application, in contrast to the comparatively primitive technologie produced two decades ago. At present a number of U.S. semiconductor firms ar participating in a Department of Defense (DOD)-funded research program t develop very high speed integrated circuits (VHSIC). While some commercial (footnote continues)

capabilities of Japanese firms, the commercial fallout from U.S. military and space R&D programs is comparatively small, and it has been pointed out that U.S. military R&D programs divert U.S. scientists and engineers away from commercial applications 34/

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useful knowledge will probably be derived from the program over the long term, most of the program's funds are directed toward areas of no apparent commercial value. For example, VHSIC research on radiation hardening of components may generate some commercially useful knowledge about alpha particles which negatively affect memories, but most radiation hardening research is useful only to the military. Similarly, VHSIC circuits must meet 85 degree centigrade temperature specifications and the goal is 125 degrees. No commercial applications need these high temperature operating specifications.

34/ R. B. Reich, "Making Industrial Policy", in Foreign Affairs, Spring 1982, p. 870; Charles River Associates, Innovation, Competition and Government Policy in the Semiconductor Industry (September 1980), p. 6-65.

C. Financial Assistance

> (S)pecial financial funds with special interest rates (electronics, machine industry elevation funds) set aside in Japan Development Bank...will be made available for loans to those industries designated in this legislation. The purpose of the loans is to provide necessary equipment funds to achieve objectives such as to begin industrial production or to increase production output, to improve product performance or quality, or to decrease production costs as prescribed in the elevation plans for the apparatus to enhance industrialization and rationalization, thus, smoothly propelling the elevation of the said industries.
>
> - MITI Machine and Information Bureau, Commentary on Public Law 84, p. III (SIA translation)

In addition to R&D assistance, Japanese semiconductor firms received other government financial aid. Figure F, based on a 1978 Japanese industry publication, is representative of the broad range of measures taken by the government to promote the information industry (most of the figures have subsequently been revised upward).

An important aspect of this assistance took the form of loans made at favorable interest rates by the Japan Development Bank (JDB)[35/] to the leading producers of semiconductors. These are partially summarized in Figure G. JDB assistance was of several types.[36/] First, loans at favorable interest rates were made for "restructuring" of the

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35/ The JDB is a public corporation which has a key role in promoting prospective "growth" industries. In its words it is expected to supply "long term funds from time to time to the areas considered important by the national policy standard." JDB International Department, "Functions and Activities of the Japan Development Bank" in Trezise and Suzuki, "Politics, Government, and Economic Growth in Japan", in Asia's New Giant (Brookings 1976), p. 745.

36/ This assistance is usually expressed as assistance to the "information machine" or "computer" industry rather than the "semiconductor" industry per se. In Japan, the leading computer producers are also the leading semiconductor producers, and semiconductors are usually treated in summaries of government aid programs as "computer hardware." Government measures designed to assist the computer industry in part (and at times, in predominant part) are intended to assist semiconductor development. The VLSI Project, for example, was regarded as Japan's leading "computer hardware" promotional project in the mid-1970s. See, e.g., JIPDEC, Computer White Paper, 1977, pp. 35-36.

Figure F

1978 SUMMARY OF GOVERNMENT AID TO THE JAPANESE INFORMATION INDUSTRY

Classifications	Programs	Funding ($ Million at 220:1)		
		FY 1976	FY 1977	FY 1978
Hardware Promotion	VLSI development	15.9	39.3	45.7
	JDB financing for JECC	213.6	(1)	(2)
	JDB restructuring loans	(3)	(1)	(2)
	Promotion of computer use	2.7	.4	.5
	JDB loans for promotion of information systematization	(3)	(3)	(2)
	Promotion of computer security	—	—	11.4
Software promotion	JDB financing	(3)	(1)	(2)
	Other	67.0	54.8	46.7
	Promotion of system and technical development	20.5	17.5	12.6
	Basic expansion of data processing	.3	.4	.4

Notes: (1) Merged in budget, $236.4 million.
(2) Merged in budget, $254.5 million.
(3) In other JDB categories.

Source: JIPDEC Report, Summer, 1978, "Ten Billion Yen for VLSI Development". JIPDEC (the Japan Information Processing Development Center) is a non-profit industry-government association established "with the support of the Government and related circles."

Figure G

JAPAN DEVELOPMENT BANK (JDB) LOANS TO JAPANESE COMPUTER/SEMICONDUCTOR FIRMS 1971 - 1982

($ Million at 220:1)

Year	JDB Loans to Japan Electronic Computer Co. (JECC)		JDB Loans for "Restructuring" of Computer Industry	JDB Loans for Production Equipment Modernization
1971	$ 186.4 (1)			
1972	68.2 (3)			
1973	97.7 (3)		$ 6.8 (1)	$ NA
1974	147.7 (3)		NA (2)	NA
1975	209.0 (3)		NA (2)	38.6 (9)
1976	---------	$ 213.6 (4)	---------	38.6 (9)
1977	---------	250.0 (4)	---------	NA
1978	---------	254.5 (5)	---------	NA
1979	---------	227.3 (6)	---------	NA
1980	---------	218.1 (6)	---------	NA
1981	---------	209.1 (7)	---------	45.5 (10)
1982	---------	234.1 (8)	---------	NA

NA = Information not available

Sources:

(Note: Computer White Paper is published by JIPDEC, an institution sponsored by the leading Japanese computer/semiconductor firms at the behest of MITI and NTT)

(1) Computer White Paper 1975
(2) "Involved with odd budget frame," Computer White Paper 1975
(3) Computer White Paper 1977
(4) Merged in budget, Computer White Paper 1977
(5) Merged in budget, includes funds for promotion of software, Computer White Paper 1978
(6) Computer White Paper 1980
(7) Computer White Paper 1981
(8) MITI Bureau of Machine Information Industry (February 1982)
(9) JIPDEC Report No. 27 (1976)
(10) JECC, Computer Notes, February 1982

industry. The purpose of these loans was, and is, to strengthen the leading Japanese firms financially and to assist their efforts at capital investment. As a manual published by the Japan Electronic Computer Company (JECC), a corporation jointly owned and run by leading Japanese computer firms, explained in 1982,

> Funding by the JDB for structural improvement has been conducted since 1972, with the object of improving the strengthening of Japan's electronic computer industry from the standpoint of finances. This arrangement can be thought of as having performed a definite role in alleviating the financial gap between foreign-capitalized makers and domestic electronic computer makers.... From the standpoint of providing funds for equipment investment in this strengthening process, it can be said that the importance of this system (JDB loans) is high.37/

The JDB makes additional loans at favored rates to the major computer/semiconductor firms for the modernization of production equipment. Ten billion yen (about $45.5 million at 220:1) was budgeted for this purpose in 1981.38/ Figure H depicts the semiconductor technologies designated for these special loans, which mature in 5-10 years (with 7 years the standard) and carry a 1-year grace period. Finally, the JDB continues to make large, low-interest loans to JECC, which has served as a major conduit of government funds to the leading computer/semiconductor firms.39/

37/ JECC, Computer Notes (February 1982) (SIA translation), pp. 207-208. Similarly, JIPDEC noted in 1978 that "this system is highly significant because its guarantee of funds serves to encourage equipment investment." JIPDEC Report (Summer 1978, No. 34, p. 5); MITI Machine and Information Industry Bureau, Points of Emphasis in Policy Implementation for FY 1982.

38/ JECC, Computer Notes (February 1982) (SIA translation), p. 209, MITI Commentary on Public Law 84 (SIA translation), Chapter IV, Section 3. The most favorable interest rates (6.65 percent) are applied to "equipment used to advance industrialization" — production equipment which moves beyond the R&D phase to actual production. Special interest rates (7.65 percent) are also available on funds loaned "to promote the rationalization of certain equipment." Ibid.

39/ JECC is a joint venture of Japan's leading computer hardware firms organized under MITI guidance to promote and ensure demand for domestically-made computers. JECC is funded primarily by funds from private sources (bank loans), but its largest single creditor has been the JDB. JECC buys computers from Japanese firms with the funds so raised, and leases them to consumers on very favorable terms. JECC serves as a major, government-backed "customer" for the Japanese producers. (Its activities are described in more detail in Appendix B.)

Figure H

JAPAN DEVELOPMENT BANK (JDB) SPECIAL INTEREST RATES FOR PRODUCTION EQUIPMENT FOR DESIGNATED SEMICONDUCTOR TECHNOLOGIES

Most Preferential Special Interest Rate (6.65%)	Special Interest Rate (7.65%)
- MOS ICs with 100,000 or more elements and bipolar ICs with 5,000 or more elements	- ICs
- Compound semiconductor elements (red emission elements excluded)	- Piezoelectric ceramic elements
- Liquid crystal display cells (dot matrix type)	- Materials for electronic apparatus including high purity silicon
- Compound semiconductor materials having gallium and phosphorus as principal ingredients	
- IC parts, including compound IC parts, surface elastic wave used filters, connectors, and multi-layer print wiring boards	

Interest rates shown are those applicable as of June 1, 1979.

Source: MITI Machine and Information Bureau Trade and Industry Research Group Commentary on Public Law 84, pp. 111-122 (SIA Translation)

While these forms of assistance were of obvious value to Japanese semiconductor producers, they had added value, together with the "hojokin," as an inducement for private sector lending.[40/] As the General Accounting Office noted in 1979,

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40/ See Trezise and Suzuki, op. cit., p. 795. Business Week indicated on December 14, 1981 (p. 52) that the government may also channel funds to Japanese firms through private banks. It reported that

> At the Long Term Credit Bank, a privately owned institution that makes loans for R&D and plant expansion, a banker describes how it works; "The government of Japan, to implement certain industrial developments, purchases debentures from the LTCB, which in turn channels these funds into areas of the economy specified by the government."

> Commercial banks were able to get an explicit "reading" of the industries and companies which the government wished to favor from noting the companies to which the Japan Development Bank (JDB) made loans. The government made no attempt to supply all of the needs of companies in strategic industries through the JDB. In fact, the Bank's loans were typically only a fraction of the firms' credit needs, but the JDB loan meant that the large commercial banks would then give these firms priority for funds.41/

As MITI Director General, Research and Statistics Department Makoto Kuroda indicated in 1981 in referring to promotional measures in the machine and electronics industry,

> The real purpose of such tax and financial measures is more of a symbolic and psychological nature, and they are utilized for the opportunity to announce governmental goals and desires, or for their rallying effect.42/

Japanese semiconductor firms also received special tax advantages. These included the ability to depreciate semiconductor production facilities by an amount equal to one-third the book value of facilities used to produce newly-developed technologies in the first year of use, in addition to accelerated depreciation under normal tax schedules. Thus, approximately 60 percent of book value may be depreciated the first year.43/ Special depreciation provisions have been a factor in the ability of the Japanese producers to build up capacity quickly and invest heavily in the most modern production equipment available. In addition, Japanese firms received deductions for R&D and export promoting tax incentives.44/

Finally, Japanese firms remained relatively free from foreign competitive pressure in their home market. This phenomenon, which is addressed in detail in Section III, was attributable in large part to a "buy Japan" attitude reinforced by the Japanese government.

41/ General Accounting Office, United States and Japan, Trade Issues and Problems, p. 185 ("GAO 1979"). JDB loans for investment in various computer/semiconductor projects must be made on the recommendation of MITI, which decides "whether or not their proposed plans are necessary to achieve appropriate production scales, work collaboration, specialization, and other items for rationalization; selects qualified corporations; and makes recommendations for loans to Japan Development Bank." MITI, Commentary on Public Law 84, Section 3(I)(4). (SIA translation)

42/ MITI, Japanese Industrial Policy, June 1981, p. 5.

43/ J. Gresser, High Technology and Japanese Industrial Policy: A Strategy for U.S. Policymakers (October 2, 1982), p. 24 at 34n.

44/ See Appendix B.

D. Capacity Buildup

> (T)he 11 Japanese semiconductor manufacturers intend to make huge capital and equipment investments in fiscal 1981, amounting to 195 billion yen in total, up 15 percent, on a construction basis.
>
> - Japan Economic Journal, June 16, 1981

> It is the consensus among Japan's 10 major semiconductor makers that the fate of the electronics makers will depend in the future on the strength of their semiconductor division.... (T)hey feared that the management strategy of their firms will be affected if they neglect making investments in the semiconductor sector, which represents the nucleus of electronization. Such investment competition is becoming further intensified with the target placed on the imminence of the VLSI era.
>
> - Japan Economic Journal, May 6, 1980

Beginning in the late 1970s Japanese firms began a major buildup of semiconductor production capacity—a buildup which not only continued, but accelerated despite the onset of a worldwide recession. As Figure I indicates, most major Japanese semiconductor firms at least tripled their annual rate of investment in semiconductor production facilities in the five years 1978-82. Throughout 1980 and 1981, Japanese producers continually revised upward their initial projected investment levels—notwithstanding the fact that prices were falling rapidly and demand was below expectations.[45/] Much of this investment was directed toward production capacity for 64K RAM devices.

Fujitsu was the first firm (Japanese or U.S.) to market a 64K RAM device, and was producing them in comparatively small commercial quantities throughout 1979 and 1980. Three more Japanese firms—Hitachi, Toshiba, and Mitsubishi—began circulating 64K RAM samples in late 1979 and early 1980, and between the second quarter of 1980

45/ Japan Economic Journal, October 14, 1980; December 12, 1980; May 6, 1981; September 15, 1981; October 14, 1981; November 3, 1981; November 10, 1981.

Figure I

JAPANESE SEMICONDUCTOR FIRMS' CAPITAL SPENDING FOR SEMICONDUCTOR PLANT AND FACILITIES

($ Million Invested)

	FY 1978	FY 1979	FY 1980	FY 1981	FY 1982
NEC	70.5	122.7	136.4	186.4	218.2
Hitachi	45.5	68.2	90.9	127.3	159.1
Toshiba	27.3	45.5	45.5	90.9	145.5
Fujitsu	52.7	72.7	100.0	150.0	150.0
Sharp	9.0	40.0	15.0	45.5	65.5
Matsushita	22.7	45.5	77.3	100.0	120.5
Mitsubishi	27.3	36.4	45.5	59.1	90.9
Sanyo	6.8	19.5	36.4	55.9	55.9
Oki	15.5	24.1	54.5	56.8	38.6
Sony	20.5	22.7	36.4	43.6	47.3

Conversion: 220:1

Source: Japan Economic Journal, May 6, 1980, June 8, 1982, October 26, 1982
EDP Japan Report, August 10, 1981

ANNUAL PRODUCTION CAPACITY OF 64K RAMS BY MAJOR JAPANESE PRODUCER, 1981-82

Estimated Annual Capacity
(Unit: 1,000 pieces)

Company	July 1981*	December 1981*	August 1982**	December 1982**	March 1983
Hitachi	2,400	8,400	12,000 1/	26,400	NA
Fujitsu	3,600	7,200	12,000	24,000	NA
Mitsubishi	600	2,400	13,200	NA	19,200
Oki	360	3,600	12,000	NA	18,000
Toshiba	840	3,600	2,400	12,000	NA
NEC	1,200	3,600	14,400	NA	30,000
Total	9,000	28,800	66,000	129,600	

1/ March 1982

Sources:

*/ BA Asia Ltd., The Japanese Semiconductor Industry, 1981-82, Table 5.10

**/ Dataquest estimates

Figure J

ENTRY OF JAPANESE SEMICONDUCTOR FIRMS INTO THE 64K RAM MARKET

	1979				1980				1981				1982	
	1	2	3	4	1	2	3	4	1	2	3	4	1	2
*Fujitsu	X	X	X	X	X	P	P	P	P	P	P	P	P	P
*Hitachi	-	-	-	S	S	X	P	P	P	P	P	P	P	P
*Mitsubishi	-	-	-	S	S	S	X	X	P	P	P	P	P	P
*Toshiba	-	-	-	-	S	S	X	X	X	P	P	P	P	P
Oki	-	-	-	-	-	-	-	S	X	P	P	P	P	P
*NEC	-	-	-	-	-	-	-	S	P	P	P	P	P	P
Matsushita	-	-	-	-	-	-	-	-	-	-	-	S	S	S

S = circulated samples
X = production, under 20,000 units
P = production, 20,000 or more units
* = VLSI Project participant

Line demarcates large scale production (20,000 or more units)

Source: Dataquest

and the first quarter of 1981, five Japanese firms followed Fujitsu into commercial production of the 64K RAM (Figure J). (At that time--early 1981--only three U.S. merchant semiconductor firms were producing 64K RAMs in commercial quantities and of these, one subsequently withdrew its design.)

E. Export Drive

> It now seems certain that the world's 64K RAM market will be led by NEC, Hitachi, and Fujitsu Ltd., with the latter two planning to turn out 1 million and 700,000 units of 64Ks by next March, respectively.
>
> - Japan Economic Journal, November 10, 1981

> According to the sources, this year's first-half semiconductor production and sales of the 11 companies were simply excellent. Their combined output swept up as much as much as 42 percent over the corresponding period last year. Such an upsweep in semiconductor production reflected a huge increase in exports to the U.S. of computer memory chips, chiefly of the 16-Kilobit RAM (random access memory) type.
>
> - Japan Economic Journal, December 23, 1980

> Japan is going to become the world's largest production base for VLSIs.
>
> - Japan Economic Journal, December 1, 1981

Japanese firms produced 64K RAMs faster than the world market could absorb the new devices. Japanese 64K RAM production capacity increased sevenfold from an annual capacity of 9.0 million devices per year in July 1981 to an estimated 66.0 million/year in August 1982 (Figure I). As Figure K indicates, in 1981 Japanese production of 64K RAMs was over double the domestic demand, and nearly equaled total world demand. When combined with U.S. production, the result was a substantial oversupply, at least over the near term.

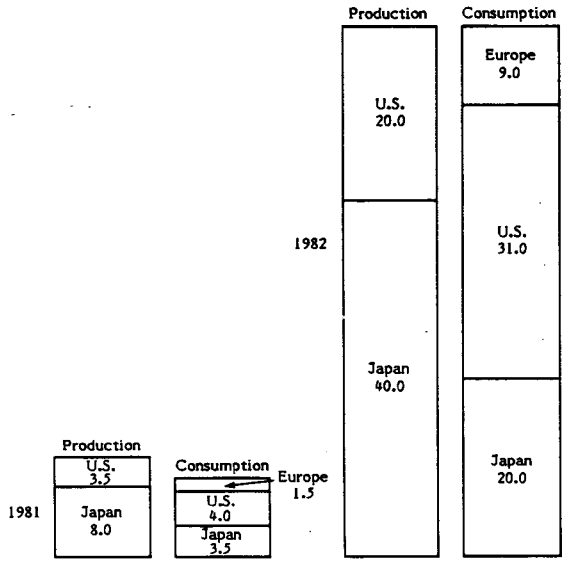
Prices of both the 16K and the 64K RAM fell rapidly as the Japanese firms began to introduce significant quantities of the 64K device in mid- and late-1981. The Japan Economic Journal reported on November 3, 1981 that

> Japanese producers have been stepping up mass production (64K RAM) volume since the middle of this year in anticipation of greater demand for more sophisticated memory units.... However, it turned out that demand was not so strong as expected earlier. As a result prices of 64Ks plunged to about 2,000 yen ($9 at 220:1) or less per chip from 20,000 yen ($90 at 220:1) only a year earlier.

25-904 O - 83 - 25

Figure K

PRODUCTION AND CONSUMPTION OF 64K DYNAMIC RAMS
(Millions of Units)



Source: SIA, Dataquest

As the article suggests, Japanese firms initiated sharply falling price levels, and effectively set the market price for the 64K RAM. For fourteen consecutive months (December 1980 - January 1982) various Japanese suppliers booked orders for the lowest reported price in the world market for the month in question. During the first quarter of 1981, when the prevailing market price for the 64K RAM was $25-$30, Fujitsu was offering them for $15. Throughout 1981 Japanese suppliers continued to lead prices downward, at times undercutting the prevailing U.S. market price by as much as $5 per device. During 1981 the price of a 64K RAM dropped from $25-$30 per device to about $7.75. By early 1982, several Japanese firms were quoting prices of $5.00 per device, and one was offering $4.25 for fourth quarter 1982 delivery.[46/]

Such aggressive pricing had a telling effect in the marketplace. By the end of 1981, Japanese firms held a 70 percent share of the world market for the 64K RAM and a 38 percent share of the 16K RAM market.[47/] The impact of the rapid drop in prices on U.S. semiconductor producers was severe. Five leading U.S. semiconductor firms reporting results on a quarterly basis collectively suffered net operating losses of $66.4 million on the 16K dynamic RAM and $77.0 million on the 64K RAM between the first quarter of 1981 and the fourth quarter of 1982 (fourth quarter results based on estimates; 16K RAM results for fourth quarter 1982 not available).

Japanese pricing has led a drop in world RAM prices that is unprecedented. This is illustrated in Figure L, which plots industrywide dynamic RAM price "per bit"[48/] as a function of cumulative industry output on log-log scales. Each plot point represents the annual average sales price per bit of dynamic RAM devices (all generations--1K, 4K, 16K, and 64K) for a given year.

46/ Industry sources.

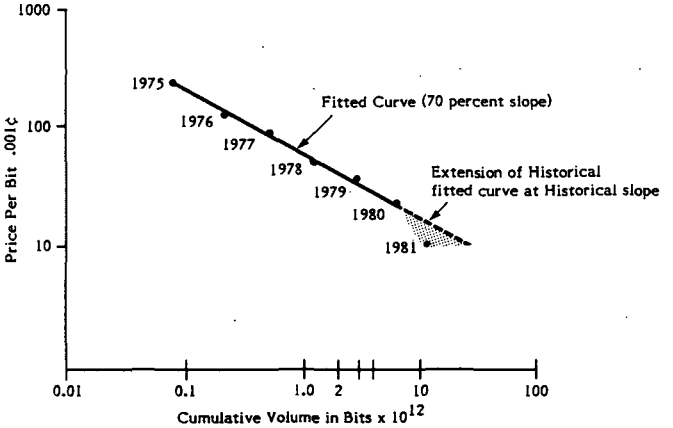
47/ The Department of Justice has recently raised allegations that Japanese firms may have collaborated to hold prices at artificially high levels. It is hard to understand DOJ's grounds for these allegations, given the precipitous decline in prices led by Japanese producers. Although in recent months (mid-1982) there has been a shortness of high-density RAM supply and a moderating of the price decline, whether or not grounds exist for DOJ's allegations is not known.

48/ A "bit" is a unit of information equal to one binary decision (such as "yes" or "no", or "1" or "0"). 1K RAM can store 1024 bits. If it is priced, for example, at $10.00 per device, the price per bit would be approximately $.01.

Figure L

HISTORICAL DYNAMIC RAM PRICE PER BIT v. CUMULATIVE VOLUME IN BITS

Data Points Represent Industrywide Mid-Year Average Price
Per Bit and Year End Volume, All Generations of RAMs



Source: Dataquest

It is noteworthy that between 1975 and 1980, world dynamic RAM prices declined in a highly consistent pattern. With only minor deviations, the RAM price per bit declined along a "70 percent slope"—that is, the price per bit consistently fell at a rate of 30 percent for each doubling of cumulative industry output. The 70 percent slope in effect reflects the experience of the entire industry and all generations of RAMs over an extended period. Through 1980 this slope remained constant despite recession, entry and exit of competitors, intense competition, and the introduction of new generations of RAMs. The 1975 recession caused only a very slight deviation from the 70 percent slope. The introduction of a new RAM generation (16K), quadrupling the number of bits on a chip, did not cause a noticeable break in the 70 percent slope. During the 1975-80 period, competition in dynamic RAMs was intense (one study characterized it as a

"memory race"[49/]). Significantly, dynamic RAM price behavior (i.e., the 70 percent slope) conformed almost precisely to the price behavior of integrated circuits generally (all types); the price per unit of integrated circuits has consistently declined for nearly two decades at a rate of 28 percent for each doubling of cumulative industry output.[50/]

In 1981, however, a sharp break occurred in this pattern, coinciding with the Japanese introduction of large volumes of 64K RAMs at low prices and sharp reductions in the price of the 16K RAM. Had the rate of price decline followed the traditional 70 percent slope, the 1981 average mid-year price per bit would have been 18.7 millicents. Instead, the actual mid-year price per bit was 11.4 millicents—39 percent lower than the level prices would have been expected to be, given actual cumulative volume and the observed historical relationship between cumulative volume and price (i.e., the 70 percent slope) (see Figure L).

A number of possible explanations for this phenomenon may be postulated. One is the fact that 1981 was a recessionary year, and recession can be expected to produce lower prices as demand slackens. However, the 1975 recession did not cause a break in the "70 percent slope" of comparable magnitude (see Figure M). Moreover, as Figure K indicates, demand for the 16K RAM continued to grow substantially in 1981, and shipments of the 64K RAM grew from 576 thousand units in the first quarter of 1981 to 6,900 units in the fourth quarter of the year--a twelvefold increase. As one U.S. producer commented, "This recession for us has been a price recession, not a volume (demand) recession."[51/] Another possible explanation for the sharp break in prices is the introduction of a new RAM generation (64K), which quadrupled the number of bits on a chip. However, the introduction of the 16K RAM (which also quadrupled the number of bits on a chip) did not cause a similar break in prices in the past.[52/]

49/ Charles River Associates, Innovation, Competition and Government Policy in the Semiconductor Industry, pp. 4-21 through 4-30.

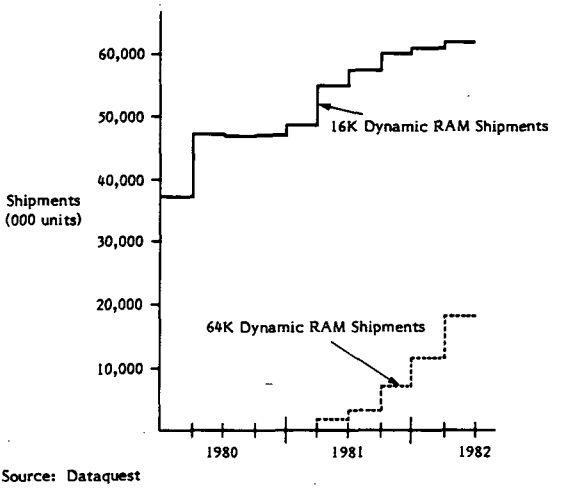
50/ R. Noyce, "Microelectronics", in Scientific American, September 1977, p. 68.

51/ Industry source.

52/ Japanese firms contend that 64K RAMs had to be priced at slightly less than four times the price of 16K RAMs -- otherwise customers would simply continue using four 16K RAMs. Electronic News, March 8, 1982. This is not necessarily the case, since use of a 64K RAM costs the user less than using four 16K RAMs to perform the same function. Use of four 16K RAMs instead of one 64K device entails four times as much space, four times the assembly cost, and more power supply. The steep price reductions in 64K RAMs coincided with a comparable fall in 16K RAM prices, since the 64K RAM could be used in place of 16K devices. See also Japan Economic Journal, November 3, 1981.

Figure M

CUMULATIVE WORLDWIDE SHIPMENTS, 16K AND 64K RAMS, 1980-82



Source: Dataquest

The other possible explanations for the 1981 break in prices involve the motivations of the price leaders, i.e., the Japanese semiconductor firms. The standard historical 70 percent price slope reflects, at least in rough fashion, the rate of cost reduction experienced by producers as their cumulative output has increased. In the present situation, Japanese semiconductor firms' costs may be so far below those of U.S. firms—or falling so fast—that they have been able to cut prices sharply, in a fashion uncharacteristic of past industry experience. Or, assuming their costs are not significantly lower than those of U.S. producers, Japanese firms may have opted to price aggressively in order to expand their initial market share, gambling that such pricing will be rewarded at some future point.

Both of these possibilities—1) Japanese firms' comparative costs and 2) their willingness to take risks in pricing in anticipation of possible future benefits—deserve further examination.

1. Japanese Costs

> At present, semiconductor makers are racing to establish 64K RAM mass production techniques to vie for larger shares of the VLSI market. Not a few of them, however, seem to have faced difficulty in raising production yields to a commercially feasible level. The current market price of 64K RAMs, which came down in expectation of mass production, does not necessarily reflect the true situation, some industrymen hold.
>
> - Japan Economic Journal, September 15, 1981

> Because (64K RAM) prices are falling so rapidly, industry analysts question whether any of today's players, including the Japanese, can be turning a profit today.
>
> - Business Week, December 14, 1981, p. 81

Japanese firms' aggressive pricing raises the question whether Japanese firms' production costs are significantly lower than those of U.S. merchant firms--enabling them to price in this fashion--or whether they are pricing below breakeven levels. The question of whether the Japanese are pricing below breakeven levels cannot be answered with absolute precision, not only because cost data for Japanese firms is not available, but because even if it were, it is not clear how diversified Japanese firms allocate their costs across various product divisions.[53/] Nevertheless, based on what is known of Japanese firms' production costs, in most categories--particularly operating expense--Japanese firms do not appear to enjoy significant cost advantages over U.S. firms. Only Japanese government measures appear to explain Japanese firms' ability to price in this fashion.

To a large degree, Japanese RAM producers are using the same production and quality control equipment (and hence techniques) as U.S. RAM producers.[54/] Therefore

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53/ Japanese firms never report their operating results by division, so it is difficult to verify whether or not their semiconductor operations are profitable. However, it is noteworthy that no Japanese firm has apparently begun to repay "hojokin" loans made for VLSI development--loans repayable if and when technologies developed pursuant to the loans are profitable.

54/ Industry sources; Dempa Shimbun, February 19, 1980; Consulting Group BA Asia Ltd., The Japanese Semiconductor Industry, 1980, p. 161.

it is not likely that they enjoy radical cost advantages flowing from superior production equipment or techniques. There does not appear to be a significant difference in yields, capacity utilization, or raw materials cost (although U.S. firms enjoy some cost advantage because of lower variable die costs). Japan may enjoy a slight edge over U.S. firms in labor costs, but the difference, if any, does not appear to be significant enough to account for the sharp drop in prices in 1981.[55/] Significantly, Texas Instruments produces all of its 64K RAMs in Japan, with local labor--and it has not generated a profit on this product line.[56/]

Moreover, most Japanese firms do not appear to enjoy cost advantages from economies of scale, accumulated production experience, or a steeper rate of cost decline as production volume increases. At present, two U.S. producers each hold at least 15 percent of the world 64K RAM market. At the same time, at least four Japanese firms (Oki, Mitsubishi, Toshiba, NEC) each hold a world 64K RAM market share of less than 10 percent, and some of these firms (Oki, Mitsubishi) have been among the most aggressive price cutters. If anything, the two U.S. producers (who are not breaking even) enjoy scale and experience cost advantages over these four Japanese producers. Furthermore, there is evidence that Japanese firms' costs do not decline more rapidly than those of U.S. firms as cumulative output increases.[57/]

In several areas not related to direct operating costs, however, Japanese firms clearly do enjoy cost advantages—and in those areas, the intervention of the Japanese government has directly or indirectly helped to lower their costs. R&D subsidies, and the cartelization of R&D to eliminate duplicative effort, have lowered Japanese R&D costs; "hojokin" loans effectively permit deferral of some R&D costs, and "itakuhi" grants

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55/ One U.S. firm estimates that wage rates for both U.S. and Japanese semiconductor firms (including fringes) average around $7.80 per hour. Japanese firms' labor costs are increased by large annual bonuses given to employees (typically five months' salary). Another firm estimates that Japanese labor costs are about 80 percent of those of American firms, a difference which, if accurate, would not be significant given the fact that labor costs account for a relatively small (15-20 percent) portion of operating expense for the production of 16K and 64K RAMs.

56/ On January 4, 1982, Electronic News reported that TI was not expected to show a profit on the 64K RAM until the end of 1982.

57/ In 1979, the Japan Information Processing Development Center (JIPDEC), an association organized by the Japanese semiconductor firms themselves, estimated that Japanese semiconductor firms' unit costs dropped by 25 percent for each doubling of cumulative volume — a lower rate than the percent reportedly experienced by U.S. firms. JIPDEC Report, Summer 1979, p. 4; Charles River Associates, op. cit., p. 2-31.

eliminate them altogether. Low interest, long-term loans and special depreciation tax policies have likewise helped to lower Japanese firms' capital costs (industrial structure affords them additional cost advantages). If the fully allocated R&D and capital costs of U.S. and Japanese semiconductor firms could be compared,[58/] Japanese firms would probably hold the edge—but an edge at least in substantial part attributable to government intervention on their behalf.

58/ Such a comparison would be difficult because diversified companies have considerable flexibility in allocating such costs over a range of product lines.

2. Japanese Risk

> VLSI factory construction has already been started by many (Japanese firms), but such ventures are enormously expensive. Such competitive investments could be a gamble because the VLSI technological prospects are still volatile.
>
> - Japan Economic Journal, December 23, 1980

> Japan has close to a 70% share in the U.S. market for 64K RAM (random access memory), the forerunner of VLSI. This fact has led to renewed friction between the United States and Japan in the field of semiconductors. However, it was the success of market strategy rather than the technology itself which contributed to Japan's large market share. Japanese companies took considerable risks in going ahead with the mass production of 64K RAM at a time when there were numerous risks involved and little guarantee of the expansion of the market.
>
> - Masanori Moritani, Senior Researcher, Nomura Research Institute, in Journal of Japanese Trade and Industry, May 1982, p. 27

Whether or not one concludes, after reviewing the evidence, that some or all Japanese firms are pricing at unprofitable levels, it is clear that they have priced to gain initial market share and that they have succeeded in capturing a dominant share of the world 64K RAM market. As a business strategy, such pricing can pay off over the longer term, but it is a strategy involving high risks. If a product has a large market potential—and the 64K RAM does[59/]—major investment in capacity (in anticipation of demand) and aggressive pricing in the early growth stages of the product may be rewarded many times

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59/ One observer calculates that the 64K RAM market—under 1% of the worldwide semiconductor market in 1981—should reach $1.6 billion in sales by 1985. Rosen Electronics Letter, March 26, 1982. The New York Times reported on February 2, 1982, that it was estimated that the 64K RAM market would grow from 8 million units in 1981 to 700 million units by 1985.

over later, with a dominant market share of a major product line, if the market develops as predicted.[60]

However, the market may not develop as predicted, and if demand does not develop as anticipated, a producer who has made major investments (in low initial pricing and/or production facilities) may be in serious trouble.[61] Thus, while the payoff, in profitability, from rapid initial investment in capacity and market share (through pricing) can be substantial, both the initial costs and the ultimate risks of such behavior can be great--especially where, as with the 64K RAM, a large initial investment is required. NEC's Executive Director Hattori stressed this risk factor in 1974 when he summarized the importance to Japan's semiconductor firms of MITI's backing in excluding U.S. IC imports from the Japanese market:

> (I)n the past, Japanese minicomputer makers have relied on American ICs, and MITI gave administrative guidance, putting these things on the negative list. I think it was only then that the industry was able to say to themselves 'now we can consider capital investment,' and they were able to take the first step toward capital investment, because the demand was stabilized.... In short, unless there is some foundation, some backing, no one will have the courage to do so. It would be too risky. This is the number one point.[62] (emphasis added)

60/ The Boston Consulting Group (BCG) observed in its Perspectives on Experience that:

> The basic objective in pricing a new product should be to prevent competitors from gaining experience and market share before the new product has achieved major volume. If this is done, it is possible to achieve a cost advantage over competition which cannot profitably be overcome by any normal performance on the part of competitors.

In a number of U.S. industries, firms base their initial pricing on projections of sales volume and costs over the life cycle of the product. Start-up expenses are capitalized, and anticipated profits are amortized over the product life cycle.

61/ This is particularly so in a volatile industry such as semiconductors, characterized by relatively short product life cycles and leapfrogging innovation. As the Boston Consulting Group observes in Perspectives on Experience (pp. 41-42):

> (T)he lower the initial price, the greater the investment required before the progressive reduction of cost will result in a profit. This in turn means that once again the comparative investment resources of the competitors involved can become a significant, or even the critical, determinant of competitive survival.... It is even conceivable that the financial resources required to follow this type of initial pricing strategy may exceed those available to the firm.... Even when one firm or another can supply the financial resources required, it still may be such a large sum that failure would bankrupt the firm. (emphasis added)

62/ Nikkon Kogyo, December 12, 1974. (SIA translation)

Japanese firms clearly accepted the risk of large capital investment and aggressive pricing with respect to the 16K and 64K RAM. Here, targeting has played a crucial role. While Japanese semiconductor firms' ability to take risks in a particular product line is enhanced because they are large, vertically integrated, diversified producers of many types of products, the fact is that the Japanese government, through targeting, further reduces the risk of aggressive investment and pricing behavior.[63/] This is because of the unique combination of incentives and protections which targeting creates.

Under targeting, the risk to a Japanese producer of heavy investment in capacity and aggressive pricing is less than the risk of failing to take such steps:

- Targeting reduces the risk of high levels of capital investment and aggressive pricing--and it is this risk factor which normally acts as a curb on a given firm's investment and price-cutting. Targeting in effect tells Japanese firms "where the future lies"--and enables them to invest accordingly.[64/]

- Targeting creates tremendous pressure on Japanese firms to expand their market share. A firm's continuing demonstration of competitive success, reflected in market share, ensures its continued access to the many forms of assistance bestowed by MITI on favored firms in targeted sectors.

These factors combine to produce a "market share at any cost" mentality among Japanese firms. The primary risk which they face under the targeting system is not unprofitability, per se, but loss of market share to other Japanese firms in the targeted sector--and ultimate exclusion from, or reduction of status within, the group of favored

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63/ Several years ago the same diversified, vertically integrated Japanese firms were stressing the unacceptable risks of investing in large-scale IC production without MITI backing. Ibid.

64/ In semiconductors, for example, MITI has indicated that semiconductor technology will enjoy pervasive applications at all levels of Japan's future economy--and given that assurance, an investment in semiconductor production capacity may well look like a very good risk, even if such capacity does not generate a short-term profit. Significantly, MITI has spelled out anticipated future applications of innovative technologies throughout Japan's economy, and has indicated that semiconductor technology will find application throughout the critical sectors of Japan's economy. MITI Publication B1-44, The Industrial Structure of Japan in the 1980s, pp. 46-59.

firms designated by MITI as the continued recipients of its loans and other aid.[65] These benefits offer a significant incentive to retain "favored" status. Indeed, the targeting system actually creates some disincentives to profit generation—such as the "hojokin" R&D loans extended in the VLSI project, repayable only if products developed pursuant to the loans prove profitable. In such an instance, a firm which prices conservatively, for profitability, may not only lose market share as a result, but will be required to repay the loans; on the other hand, by pricing aggressively, the same firm can expand its market share and improve its position in the competition for MITI-favored status.[66]

65/ MITI recently indicated with respect to its current subsidized semiconductor R&D programs that it

> has decided to be more selective in choosing industrial participants in the project, weeding out every technological laggard, American style.

Japan Economic Journal, June 16, 1981.

66/ For example, Japan's computer/semiconductor firms received such "hojokin" loans (sometimes referred to as "subsidies") in the early 1970s for computer R&D. These firms' success in expanding their market share has been hailed in Japan; however, on September 8, 1981, the Japan Economic Journal reported that "six domestic computer makers are unable to return subsidies," a fact which the Journal attributed to the firms' pricing:

> Fujitsu Limited, Hitachi Ltd., Nippon Electric Co., Toshiba Corp., Mitsubishi Corp., and Oki Electric Industry Co. have received a total of 57,470 million $261 million at 220:1 worth of subsidies for five years since fiscal 1972 for development of super high performance computers.... It was learned recently that none of the six Japanese computer builders has paid back the subsidies. They are required to repay the subsidies when they earn profits from the sales of computers which they have developed on the subsidized projects. No repayments means that they are still unprofitable. This sharply contrasts their recent remarkable achievements in computer hardware technology and Fujitsu's (reported) outranking of IBM Japan Ltd. to become the nation's largest computer maker. The low profitability of Japanese computer makers is ascribed to their excessive price cutting, marketing competition and huge research and development costs.

3. The Result

> If the (semiconductor) industry really follows through with this ambitious equipment investment program in spite of the current business slump, its total production in the current fiscal year will reach approximately $500 million, a sharp gain of 24.4 percent over the preceding fiscal year.... The trouble, however, is that the markets for new IC products capable of taking over the leadership position from desktop electronic calculators and color TV sets have just started forming and will take a considerable length of time to mature. The only possible way out for sharply increased IC production, therefore, is exports.
>
> - Japan Economic Journal, October 22, 1974

The Japanese targeting system creates a business environment in which the risks of rapid, large-scale investments in capacity and aggressive pricing are outweighed by the risks of failing to take such steps, and losing favored status. The result, inevitably, is capacity-building "races" by Japanese firms, aided by low-interest government loans and special depreciation tax policies, and the creation of much greater capacity than is needed to satisfy domestic demand. Targeting ensures that the occasional negative consequences of such aggressive investment and pricing, however, are not borne by the Japanese firms, but by foreign firms.

At those points in the economic cycle when domestic demand falters as a result of recession, Japanese firms come under even greater pressure to export so as to avoid cutting back production—indeed, they are encouraged to do so by a panoply of government-sponsored export-promoting incentives.[67] This has been the genesis of many of the Japanese "export avalanches," which tend to coincide with downturns in the Japanese economy. Such "avalanches" have the added advantage, from the Japanese perspective, of increasing their firms' market shares overseas. During such recessionary periods, Japanese firms maintain high levels of production and "export unemployment" (and

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67/ These are summarized in Appendix B.

illiquidity) that would otherwise occur if its firms were required to cut back production in the face of declining domestic demand.[68]

U.S. firms are much less insulated from the effects of downswings in the business cycle than their Japanese counterparts. With the onset of recession, they face pressure to reduce capacity, capital investment, and R&D spending, particularly in those product lines where the business risk is high and the prospects of a satisfactory return are low. Moreover, it is precisely at these points—recessionary periods—that U.S. firms must also contend with a sharp increase in low-priced Japanese exports. This combination of recession and import competition can cause severe economic dislocation. This is what occurred in the semiconductor industry in 1980-82.

68/ Thus, in the case of ball bearings, the Japan Economic Journal reported that following the 1973 oil crisis,

> Domestic demands for bearings declined sharply and Japanese manufacturers had to seek other outlets to dispose of their huge output. Exports naturally came to serve as such outlets. Because of their experiences of somehow tiding over their crisis in the past, they chose to sell their products in overseas markets instead of sharply cutting down their production. This, as it turned out later, proved to be the start of Japan's notorious "export avalanches".... Japanese bearing plants are of truly gigantic capacities and of unrivaled technological superiority. The production capacity of a representative bearing plant in Japan is reportedly 10 times as big as its counterpart in any Western country. The trouble, however, is that such big and high performance plants have been built with borrowed money and, therefore, are destined to operate at full capacity in order to pay back the borrowed funds as soon as possible.... In order to dispose of the huge amounts of bearings being daily produced by such huge superior plants, manufacturers have to seek their outlets in overseas countries.

"Large Outlet Must be Sought for Superior Mass Production," in Japan Economic Journal, August 30, 1977, p. 20.

F. Impact

> (I)t is the national character that, if a given direction is defined, everyone rushes in that direction together. For example, when it was understood that the thing to aim at was miniaturization, this became the most desirable goal for the Japanese. Given a clear direction, the sequence is investment-rationalization-cost reduction-quality improvement... (W)hen we start running in a direction, there is no brake.
>
> - Dr. Shunkichi Kisaka, Executive Vice President, Matsushita Electric, in Scientific American, October 1982, p. 328

> If one thing is to be singled out for the severe Western criticism of Japan's export avalanches, however, it is the fact they tend to concentrate on a very few specified products.
>
> - Japan Economic Journal, August 30, 1977

The 1980-82 Japanese export drive hit U.S. semiconductor firms where it hurt--in memory devices, high-volume product lines that have not only been important profit generators for the industry, but which have generated technological capability that has been translated into leadership in other semiconductor product areas. As one U.S. industry observer put it,

> Producers of 64K RAMs must master the latest techniques in advanced wafer fabrication and low cost, high volume assembly methods. These techniques, in turn, lend themselves to enhancing production and reducing costs of almost every other device in the companies' product portfolios. Thus, the benefit of staying in the 64K RAM race extends well beyond any immediate gains from that device alone.69/

The 64K RAM also represents the largest potential volume semiconductor product ever. One industry analyst estimated that world RAM shipments would reach $1.6 billion by 1985, making it "the most important single component in the industry's history."70/

Figure N depicts the net operating results suffered by five U.S. semiconductor firms, by quarter, for the 16K and the 64K RAM, compiled from data submitted by the five firms on a business confidential basis. Not all U.S. dynamic RAM producers partici-

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69/ Rosen Electronics Letter, March 26, 1982.

70/ Ibid.

Figure N

CUMULATIVE NET OPERATING RESULTS OF FIVE U.S. SEMICONDUCTOR FIRMS BY QUARTER, 16K AND 64K DYNAMIC RAMS, 1980-82

16K Dynamic RAM
($ Millions)

	1980				1981				1982			
	1	2	3	4	1	2	3	4	1	2	3	4
Revenues	92.1	118.2	98.4	75.5	64.6	58.8	50.7	45.2	37.6	44.4	48.9	NA
Pre-Tax Operating Profit (Loss)	24.6	38.2	17.1	5.0	4.9	(7.1)	(9.2)	(15.1)	(18.2)	(9.5)	(12.2)	NA

64K Dynamic RAM*
($ Millions)

	1981				1982			
	1	2	3	4	1	2	3	4**
Revenues	2.7	5.3	5.1	5.3	8.0	13.8	26.4	44.6
Pre Tax Operating Profit (Loss)	(6.8)	(6.8)	(8.9)	(8.0)	(14.5)	(11.7)	(12.0)	(8.3)

Notes: * Not all five firms reported 64K RAM results.

** 4th quarter 1982 results estimated (by all reporting firms).

NA = Not Available

Source: Company Reports

pated in this survey, but these firms represent the bulk of U.S. production. The one major U.S. producer not participating in this survey has indicated in published accounts that it expects to incur operating losses with respect to the 64K RAM through the end of 1982, and, as a result, the losses depicted here are, if anything, understated.

As can be seen, operating losses on the 16K and 64K RAM have been substantial. The five producers collectively reported net operating profits of $38.2 million on the 16K RAM in the second quarter of 1980; by the second quarter of 1981, they were operating

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at a loss, and have not subsequently shown a profit. Cumulative net losses from the first quarter of 1981 through the third quarter of 1982 totaled $64.4 million. Net losses for the 64K RAM for calendar year 1981-1982 (including fourth quarter estimates) totaled $77.0 million. The five producers suffered a cumulative net loss on the 16K RAM and 64K dynamic RAM of $148.3 million during the period Q1 1981 through Q4 1982 (with 16K estimates for Q4 1982 not available).

While these losses may be attributable in part to recession, the U.S. merchant semiconductor firms tend to attribute the greater share of their losses to Japanese-led price declines rather than diminished sales volume. It is noteworthy that U.S. firms' 64K RAM losses have continued even though their sales volume has risen substantially in 1982--more than tripling between the fourth quarter of 1981 and the second quarter of 1982. Equally noteworthy is the fact that the period of heaviest U.S. losses--the first quarter of 1982--coincided with the sharpest increase to date in the volume of Japanese 64K RAM shipments. (See Figure O.) The same pattern is observable with respect to the 16K RAM: U.S. firms' losses were highest in the last half of 1981 and in 1982, despite an increased volume of shipments over 1980 levels, but coinciding with the peaking of Japanese 16K RAM shipments (Figure P). Figure Q summarizes the combined results for the 16K and the 64K RAM.

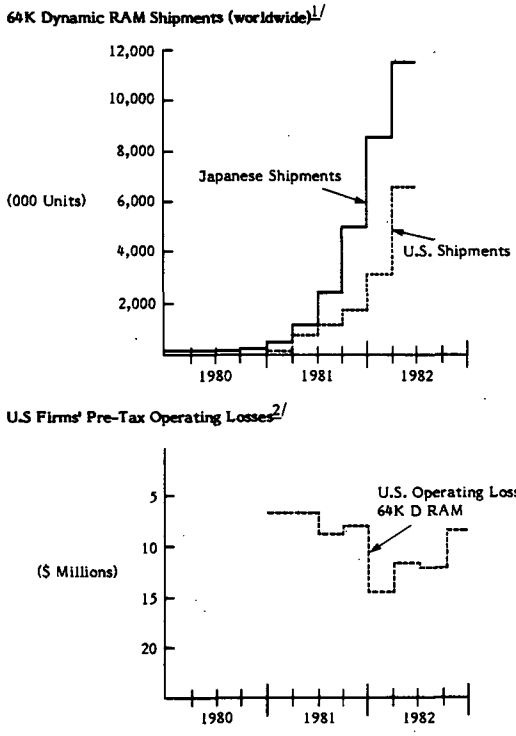
The Japanese semiconductor export effort has thus far been comparatively narrow. It has placed severe pressure on a few product lines, notably the 16K and 64K RAM. These devices enjoy particularly widespread application, can be produced in volume, and are essential technological "stepping stones" to other semiconductor types. These are the "hanagataban" or "entering wedge" products, and the pressure is mounting on U.S. producers to abandon these product lines. Targeting has enabled Japanese firms to concentrate heavily on these critical device types, to avoid diluting production experience, and to maximize their volume advantages.71/

71/ In the ball bearing industry, Japanese firms initially concentrated on production of universally popular bearings of 10 to 30 millimeters, with decisive competitive results. As the Japan Economic Journal recounted on August 30, 1977,

> Because of their great popularity and demands throughout the world, Japanese bearing manufacturers plunged headlong into their production in the high economic growth period in and after the late 1950s. They established new production facilities and put "hanagataban" models on a powerful mass production system.... Japan's four leading bearing manufacturers poured huge amounts of funds into modernization of production equipment and, at the same time, tried to minimize the labor required to run the facilities. In the 1960s, when these new facilities went into action, Japanese manufacturers were able to easily drive their foreign competitors out of the running as far as "hanagataban" models were concerned.

Figure O

U.S. FIRMS' STEEPEST 64K RAM OPERATING LOSSES COINCIDED WITH THE SHARPEST INCREASE IN JAPANESE SHIPMENTS (1st QUARTER 1982)



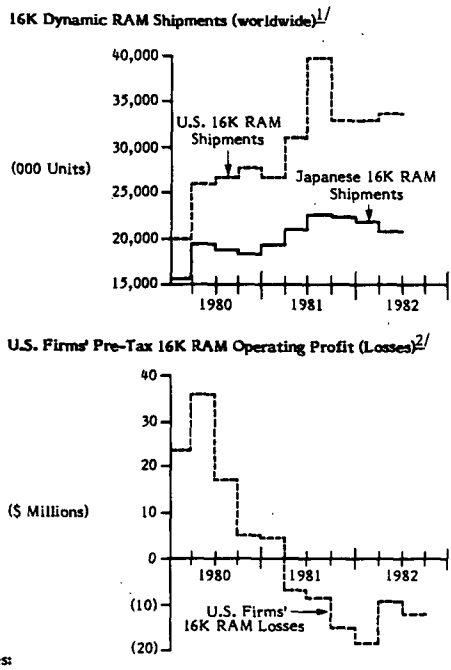
Sources:

1/ Dataquest

2/ Composite net operating results submitted by U.S. firms on a confidential basis

Figure P

U.S. FIRMS' 16K RAM OPERATING LOSSES COINCIDED WITH INCREASED JAPANESE 16K RAM SHIPMENTS



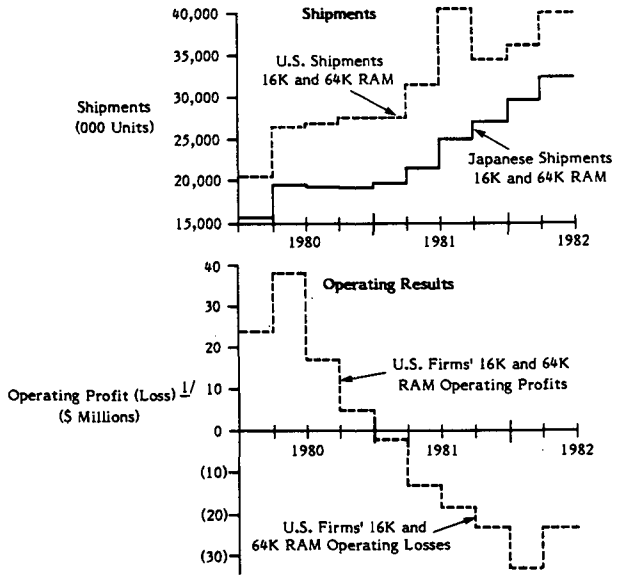
Sources:

1/ Dataquest

2/ Composite net operating results submitted by U.S. firms on a confidential basis

Figure Q

CUMULATIVE 16K AND 64K DYNAMIC RAM
SHIPMENTS AND OPERATING RESULTS, 1980-1982



1/ Five U.S. firms' submissions composite net pre-tax operating results.

G. The Deterrent to Further U.S. Investment

> The so-called "VLSI era" has dawned under the initiative of Japanese semiconductor makers, led by NEC and Hitachi. Industrymen see that Japanese makers will far outdistance their American rivals in 64K RAM mass production in the coming few years.
>
> - Japan Economic Journal, November 10, 1981

> I don't think anyone will be profitable at the projected (mid-1983 64K RAM) price of $5 for that period. The latecomers will be shaken out.
>
> - Keiske Yawata, NEC Electronics U.S. Chief, in Business Week, December 14, 1981, p. 62

> (I)f they drop out of 64K RAMs, more U.S. companies are giving up the biggest volume semiconductor market. The base for further R&D investment in new semiconductors is reduced, and we start an erosion of yet another major electronic technology.
>
> - U.S. semiconductor executive in Electronic News, October 11, 1982

The problem presented by the Japanese export offensive is more serious than the substantial dollar loss figures cited above suggest. The Japanese drive appears to be causing disinvestment by U.S. firms in the product lines coming under Japanese pressure, for while targeting has reduced the risk of investment for Japanese firms, it has correspondingly increased the risks for U.S. firms. Moreover, this has occurred during a recessionary period when U.S. semiconductor firms face strong economic pressure to reduce capacity, capital investment, and R&D expenditures, particularly in unprofitable product lines.

Figure R depicts the participation by U.S. firms in successive generations of RAM production. As can be seen, with respect to the 64K RAM, significant attrition has occurred. Whereas 12 to 15 U.S. firms participated in previous RAM generations, at present only five U.S. firms are producing 64K RAMs commercially. Moreover, of these, several have merely undertaken limited production runs. As Figure S indicates, at present only three U.S. firms are in full production (one of these is producing in Japan); a fourth firm is about to enter production after withdrawing its initial design, and a fifth firm is producing only small quantities of 64K RAMs. While some additional U.S. firms may enter the market, the 64K RAM has already been in substantial commercial

Figure R

U.S. AND JAPANESE FIRMS' PARTICIPATION
IN SUCCESSIVE GENERATIONS OF DYNAMIC RAM PRODUCTION

Dynamic RAM Generation	Number of U.S. Firms in Commercial Production	Number of Japanese Firms in Commercial Production
1K	14	8
4K	15	6
16K	12	6
64K 1/	5	6

1/ As of 2nd Quarter 1982

Source: SIA, Dataquest, USITC Publication No. 1013

production for over two years, and the newcomers' rivals will have achieved substantial cost advantages through prior volume sales.72/

Given the increasing capital and R&D investment required to produce successive generations of dynamic RAMs, it is clear that some U.S. producers may have dropped out of the market for this reason alone. On the other hand, however, because dynamic RAMs are the "bellwether for the industry"—the product that enables firms to reduce costs and enhance production in virtually all other semiconductor product lines—the decision to withdraw from further RAM competition is not one which any firm can take lightly. Moreover, it is noteworthy that roughly four years after Fujitsu's introduction of the first commercial 64K RAM, fully half of the ten U.S. firms which produced at the 16K level

72/ For purposes of this analysis, Texas Instruments (which operates a manufacturing subsidiary in Japan) is treated as a U.S. rather than a Japanese firm. All of TI's 64K RAM production has been in Japan and most of its 64K RAMs have been exported from Japan. However, TI has not benefited from the Japanese government subsidies and other assistance which have been afforded Japanese firms in targeted sectors.

Figure 5

THE NUMBER OF U.S. MERCHANT FIRMS IN THE DYNAMIC RAM RACE IS DWINDLING

	Production Status			
	16K Dynamic RAM		64K Dynamic RAM	
U.S. Producers	1979	1980 (first half)	1981	1982 (first half)
Firm A	Small Production	Production	None	None
Firm B	Small Production	Production	Sampled	Sampled
Firm C	Production	Production	Small Production	Withdrew original version, introducing new version
Firm D	Small Production	None	None	None
Firm E	Production	Production	Small Production	Production
Firm F	Production	Production	Production	Production
Firm G	Production	Production	Sampled	Sampled
Firm H	Small Production	None	None	None
Firm I	Production	Production	Production	Production
Firm J	Small Production	Small Production	None	None
Firm K			Sampled	Small Production

Production = more than 1 million units annually
Small Production = less than 1 million units annually
Sampled = circulating samples, no commercial production

Source: Dataquest

have refrained from entering the 64K RAM market, and only three of the remaining firms are in full production. By contrast, six Japanese firms are now in full production.

Recession and higher capital and R&D costs may be a contributing cause of the U.S. firms' attrition rate. However, the six Japanese firms' aggressive entry into the 64K RAM market has increased the level of risk sufficiently that it may be deterring U.S. firms which otherwise would have remained in the market from further investment

in this product line. In fact, at least one of the U.S. producers which refrained from 64K RAM production (after investing over $5 million in R&D for this device) cited Japanese pricing as the reason:

> Due to the continued pricing policies of the Japanese the prices of the 64K are well below prices expected based on a normal industry learning curve. This price depression has caused (Firm B) to hold off the introduction of the 64K dynamic RAM.73/

Significantly, based on product development lead times, U.S. firms should now be conducting intensive R&D on the next generation memory device, the 256K RAM. The fact that a number of major U.S. RAM producers now are refraining from doing so—and so apparently dropping out of the race—bodes ill for the future of the U.S. industry. The Japanese appear to be encouraging this process. Japanese firms have made frequent announcements of technological advances in the dynamic RAM field and indicated their commitment to large scale production of the 256K RAM.74/ Advertisements run by Japanese firms in U.S. publications suggest an arrangement in which each nation does what it supposedly does best—the U.S. should concentrate on R&D and design, and let Japan conduct the production and sales of the volume semiconductor product lines.75/

Japanese government targeting and the risks it creates for U.S. firms has been a primary factor in discouraging further investment in high density memory. Committing a company's investment resources (and perhaps its future) to a product line at which MITI and the Japanese firms are taking collective "aim" is a daunting prospect—particularly given recent past experience. As one U.S. semiconductor executive remarked recently,

> I can take on TI. I can take on Hitachi. But I can't take on the sovereign nation of Japan.

73/ Industry source.

74/ For example, the Japan Economic Journal reported on December 22, 1981 that Hitachi planned to "begin mass production" of 256K RAMs as early as the fall of 1982:

> The company's strategy to manufacture and market the 256K well in advance of the predicted date is apparently aimed at grabbing a big market share at a stroke before the entry of rival makers.

NEC has announced plans to mass produce 256K RAM in 1983. Japan Economic Journal, October 27, 1981. Toshiba has announced plans to begin commercial production of a "one megabit" RAM (i.e., approximately one million bits) in 1984. U.S. Embassy Cable, Tokyo (August 1982).

75/ See Scientific American, October 1982, p. 38.

The stakes are becoming higher. The entry cost at the 64K RAM level can run from $30 to $100 million, and, at the 256K RAM level, as high as $160 million. At this level of risk, when Japan "targets" a given product line, powerful incentives exist to invest instead in other product lines--or industries--where the risks are lower.[76] As one industry observer put it this year,

> No industry and no company can long survive if its major product line is hemorrhaging red ink. The 16K RAM experience, and to a lesser extent the 2716 EPROM, have been devastating in the last year for their participants. Some have been reappraising the prudence of staying in the memory business at all. After all, if a single company can lose more than $100 million in a single year in MOS memory (at least two did in 1981), what is their downside risk at the 256K or 1 megabit density levels? It's become a new game called "you bet your company."[77]

76/ National, AMD, Fairchild, and other leading firms have refrained from entering the market for the 64K RAM.

77/ Rosen Electronics Letter, March 26, 1982.

H. Capital Investment

> (Semiconductor) makers in Japan are in a position of being able to procure on their own huge amounts of funds for research and investments over a long period. There is a possibility that such "strength" enjoyed by the Japanese makers will result in raising the tone of attack against Japan by the American industry who are showing serious concern over the advance made by Japan.
>
> - Japan Economic Journal, May 6, 1980

> Very high rates of capital investment are required to stay in so fast a moving game as semiconductors. This is a game the Japanese are quite prepared to play. If sheer amount of capital investment determines the outcome, the U.S. position is in some danger, as growth rates of Japanese investment substantially exceed those of the United States....
>
> - J. C. Abegglen and A. Atori, in "Japanese Technology Today" (1982 edition), an advertisement placed by 15 Japanese firms (including Toshiba, Matsushita, and Sony) in the Scientific American, October, 1982.

Successful competition in the semiconductor industry requires a sustained high level of capital investment. As noted, firms which can bring capital plant on line most quickly at the outset of a product life cycle can secure decisive competitive advantage.[78/] Furthermore, the industry is rapidly becoming more capital-intensive. The Chase Manhattan Bank estimated in 1980 that in the next decade, the plant and equipment needed to generate an incremental dollar of sales will increase by around 40 percent.[79/] These increasing capital demands are due to a number of factors:

78/ Capital spending for plant and facilities for U.S. merchant firms now averages 15 to 20 percent of total revenues. If R&D costs are added to this figure, the total is 22 to 27 percent -- an extraordinarily high level of capital investment relative to other U.S. manufacturing industries. Semiconductor Industry Association, The International Microelectronic Challenge, p. 24.

79/ Chase Financial Policy, U.S. and Japanese Semiconductor Industries: A Financial Comparison (June 9, 1980) ("Chase Study").

- Short product life cycles require firms constantly to reinvest in new facilities to produce "new generation" products.

- As the rate of technological innovation accelerates, so does the rate of obsolescence of semiconductor firms' production and test equipment. New investment is constantly required to replace or retrofit such equipment.

- Process technology is becoming increasingly complex. As Figure T indicates, the cost of mask making equipment (one step in the production process) has increased one thousand percent from basic IC to VLSI technology.

- The semiconductor industry, while already highly automated, is becoming more so.

Figure T

THE INCREASING COST OF MASKING EQUIPMENT

Equipment	Cost per Unit	Circuit Technology
Printer	$ 15,000	Integrated Circuit
Projection Printer	120,000	Medium Scale
Projection Printer	240,000	Large Scale
Direct Step on Wafer	600,000	Large Scale
Electron Beam Writer 1/	1,500,000	Very Large Scale

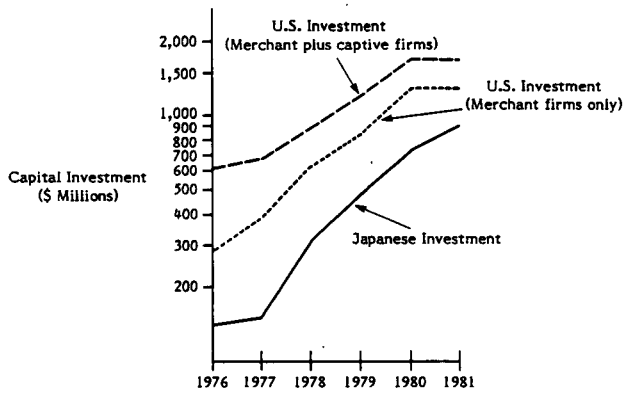
1/ Note: Electron beam writer throughput is lower than that of preceding operations.

Source: Science Magazine, May 2, 1980, p. 482

However, even as capital demands on U.S. semiconductor firms are growing, their continued ability to meet those demands is being weakened, and Japanese capital investment growth rates exceed those of U.S. semiconductor firms. Between 1978 and 1981, Japanese semiconductor firms' annual capital investment level grew by 210 percent (investment calculated in yen) while U.S. firms' (merchant and captive) annual capital investment level grew by 110 percent. In 1976 U.S. merchant and captive firms were

Figure U

U.S. AND JAPANESE SEMICONDUCTOR FIRMS' WORLDWIDE CAPITAL INVESTMENT GROWTH RATES



Notes: Figures for Japanese firms represent fiscal years beginning April 1.
Yen conversion: (1976—296.2:1) (1977—265.9:1)
(1978—205.9:1) (1979—221.3:1)
(1980—224.8:1) (1981—221.3:1)

Source: U.S. International Trade Commission Data (1976-78); SIA Estimates (1979-81)

spending $4.43 for every dollar invested by the Japanese; in 1981 U.S. firms spent $1.84 for every dollar of Japanese investment.

Figure U depicts (on semi-log scales) the growth rates of U.S. and Japanese semiconductor firms from 1976 through 1981. The figure indicates that while the levels of capital investment by U.S. and Japanese semiconductor firms grew substantially from the mid-1970s through 1980, in 1981, capital investment growth by U.S. firms abruptly leveled off—showing virtually no year over year growth—while Japanese investment increased by approximately 26 percent, from around $733 million in 1980 to $925 million in 1981.

Moreover, in 1982, Japanese semiconductor firms have substantially increased their capital spending over 1981 levels,[80] while U.S. semiconductor firms are reportedly "keeping capacity in check." As one U.S. semiconductor executive put it, "the industry isn't going anywhere right now."[81]

A basic problem faced by U.S. semiconductor firms is simply that their Japanese counterparts can raise capital more easily and at below market rates. This is so even though Japanese firms' returns are very low. In 1980 the Chase Manhattan Bank undertook a study comparing the relative financial strengths of the U.S. and Japanese industries. Its conclusion was that

> The U.S. semiconductor industry is currently in a strong position as the result of its technological leadership, sound financial condition and ability to earn an adequate rate of return on invested capital. However, the position of the U.S. semiconductor industry could be eroded by its shrinking share of the world market and its inability to raise capital as cheaply as Japanese competitors.[82]

This phenomenon is in fact due to several factors:

- Government "targeting" policy: As noted in Part I, "targeting" of the semiconductor industry by the Japanese government reduces the risk to Japanese lenders and makes it unusually easy for Japanese semiconductor firms to raise debt capital.

- Government loans: The government has made low interest loans to Japanese firms for investment in production equipment, and has made grants and low interest loans for semiconductor R&D (the latter repayable only if resulting products are profitable).

- Industrial affiliation: The Japanese semiconductor firms belong to "keiretsus," large industrial groupings linked by cross-ownership of equity shares and interlocking directorates--each of which includes a major bank. "Keiretsu" banks maintain a close relationship with the semiconductor firms, and, in some cases, bank officers and directors hold positions in those firms. Such banks are frequently also major equity shareholders in the semiconductor firms. Such affiliations further facilitate loans and reduce the risk to lenders.

80/ Japan Economic Journal, June 6, 1982.

81/ Electronic News, October 11, 1982.

82/ Chase Study, p. 2.1.

- Favorable interest rates: Japanese government maintains financial policies (such as exchange controls) which result in interest rates in Japan that are lower than in most of the rest of the world. U.S. firms' ability to participate in the Japanese debt capital market is limited by exchange controls—a problem not faced by Japanese firms. Although Japan is relaxing these controls, access by foreign firms to yen loans is still restricted.83/ Favorable interest rates naturally enhance Japanese firms' cost of capital advantage.

All of these factors combine to diminish the pressure on Japanese firms to earn an immediate return on their investment. Their risks are lower because a period of loss operations does not jeopardize their future investment capability in the same manner as would be the case for a U.S. firm. That fact itself increases the risk of investment for U.S. firms, since it means that Japanese firms can invest and price very aggressively for a sustained period.84/

83/ The Japan Economic Journal reported on July 6, 1982 that Japanese banks had been "deluged" with requests for yen currency loans from foreign firms, a fact attributable to "Japan's interest rate which is the lowest among major economies." The Journal noted that because the Ministry of Finance limited the total of loans allowed to foreign firms, the banks "fear that they are going to be charged with foreign complaints." Similarly, on October 9, 1981, the Japan Economic Institute reported that

> if Japanese Corporations have any advantage, it is likely to lie in the overall lower interest rates that prevail in Japan. Since American firms are effectively blocked from raising money in Japanese capital markets, they cannot take advantage of these lower interest rates.

JEI Report No. 8, p. 6.

84/ Japanese banks clearly are prepared to underwrite competition by "targeted" firms beyond the point dictated by self-interest. On May 6, 1980, the Japan Economic Journal observed that

> Despite the record levels of bankruptcy experienced since 1974, Japanese banks have typically continued financing even deficit-ridden borrowers with which strong managerial ties have been established... the pattern of support which has been evidenced to this date indicates a willingness of banks to continue financial (sic) select firms in financial crisis beyond the point where their self-interest, strictly defined, would dictate demand for repayment of outstanding loans.... Should the responsible governmental authorities allow the marketplace to unduly buffet important Japanese business without its moderative influence or fail to identify and nurture new growth industries, a critical element would be lost in an economic system built on consensus decision-making.

Until very recently, U.S. semiconductor firms have been able to offset the Japanese advantage in access to capital because they have led Japanese firms in innovation.[85] The profits from each generation of semiconductor innovation have provided investors with a return, generated funds for investment by U.S. firms for the next round of innovation, and encouraged investors once again to commit funds to the industry.

The recent Japanese high-density RAM success thus threatens to break the cycle of "investment/marketplace success/profits/reinvestment" that has propelled the U.S. industry to world leadership. Withdrawal of an increasing number of U.S. firms from the high density memory race would concede the "entering wedge"--one of the fastest-growing, technologically critical semiconductor product lines--to the Japanese. Should this occur, a downward spiral may begin from which it will be difficult to recover. A commanding Japanese market share in dynamic RAMs will be translated quickly into higher production volume, corresponding cost advantages, and an increasing technological edge as Japanese firms, building on this advantage, move on to take over other semiconductor product lines. At that point, U.S. firms will be in second place, and falling further behind. As the Chase Bank concluded:

> (D)eclining market share may adversely affect the U.S. companies' productivity and efficiency, thereby placing added pressure on profit margins and exacerbating the industry's ability to raise capital. A shrinkage in profit margins could threaten the viability of those companies within the industry that fail to earn their cost of capital over an extended period of time.[86]

85/ Late entrants into a product line have higher costs because they are behind the innovator in cumulative volume of output. They can "catch up" by making extremely large investments in order to build volume quickly. This strategy can be employed only by firms with very large capital resources, such as Japanese firms. See Boston Consulting Group, op. cit., pp. 56-57.

86/ Chase Study, p. 2.1.

III. The Protected Japanese Domestic Market

> Protection has been provided those industries that are in need of protection because of their newness and their fragility as emerging industries. Thus protection is negotiated for the semiconductor and computer industries, and telecommunications.... The impact on technology level is again direct. Sectors of high value-added, and high technology, with high growth potential, are afforded as much protection as can be arranged. This allows a nurturing of technology in the domestic market until competitive scale and sophistication are achieved.
>
> - J. C. Abegglen and A. Atori, in "Japanese Technology Today", an advertisement placed by 16 Japanese firms (including Toshiba, Matsushita, Sony, TDK) in Scientific American, October 1980

> The Japanese IC industry has recorded a spectacular growth in the recent few years owing to the following two factors: 1) active demands from manufacturers of desktop electronic calculators and 2) import controls exercised by the Ministry of International Trade and Industry.
>
> - Japan Economic Journal, October 22, 1974

The Japanese semiconductor industry has developed in a carefully protected home market. The Japanese market is large—26 percent of world semiconductor consumption—and affords a strong and stable base for Japanese industrial development. Deliberate protectionism has been a key element of Japanese semiconductor policy.

Until 1974 the Japanese semiconductor market was officially closed. Japan maintained quotas, never sanctioned under the General Agreement on Tariffs and Trade (GATT) on imports of semiconductors. NEC's Executive Director Hattori was emphatic about the importance of market protection for the semiconductor industry when he said in 1974,

> The general problem is that makers cannot operate if there is no demand. Thus large capital investment for process and other manufacturing technologies which is backed by demand is necessary. So my point is that you cannot make large investments if the demand is not stabilized.... And if (American) ICs for minicomputers were not placed on the negative list, capital investment would not have been possible by Japanese makers. This meant that since MITI put up the negative list and gave administrative guidance, it was possible for us for the first time to stand on our own feet.87/

87/ Nikkon Kogyo, Dec. 12, 1974. (SIA translation)

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Over a period of years, U.S. firms made repeated efforts to penetrate the Japanese semiconductor market. With limited exceptions, these efforts were not successful. MITI permitted some imports of U.S. semiconductors which its own firms could not make and which its own end-products firms needed to remain competitive—for example, ICs for pocket calculators and digital watches. Japanese firms also imported U.S. semiconductor technology to enable Japan's own semiconductor sector to grow.[88/]

Until "liberalization" of Japan's domestic market in 1974-76, U.S. firms were barred, in all but one case, from operating local manufacturing and sales subsidiaries,[89/] and attempts by U.S. firms to overcome this obstacle encountered Japanese resistance.[90/] This was a particularly severe obstacle. Foreign subsidiaries are absolutely essential to any sustained U.S. export effort. Buyers have more confidence in service, product reliability, and delivery when dealing with a local facility.[91/]

"Liberalization" of the computer and related industries in 1974-76 supposedly ended the barriers to semiconductor imports and to direct foreign investment in

---

88/ Japan Economic Journal, September 29, 1970; January 5, 1971.

89/ Pursuant to the "Law Concerning Foreign Investment", foreign firms prior to 1975 were barred from majority equity ownership in Japanese firms and could not establish local subsidiaries.

90/ "U.S. IC Maker Wishes to Invest", Japan Economic Journal, September 8, 1970; "Tension Mounts from Planned U.S. Entry into IC Industry", Japan Economic Journal, April 27, 1971; "Motorola's Attempt to Crack Semiconductor Market Hits Snag", Japan Economic Journal, December 2, 1975. "American IC Manufacturers Express Intention to Advance into Homeland from Okinawa after Reversion", Asahi, April 6, 1971.

91/ An important exception was Texas Instruments (TI), which was able to establish a local subsidiary in the late 1960s in return for agreeing to license its patents to Japanese firms. By the terms of the agreement TI was limited to no more than 10 percent of the Japanese market. It has never achieved even this limited market share. Nihon Keizai, March 27, 1971; J. Tilton, The International Diffusion of Semiconductor Technology (1971), pp. 49-63. Significantly, TI still re-exports a high percentage of its locally-made products despite the fact that it has been in the market well over a decade and has more than tripled its capacity in the past 3-4 years. Most of TI's 64K chips are exported "for assembly to be sold mainly in the American market." Japan Economic Journal, May 11, 1982.

Japan.[92] Today, however, six years after "liberalization," U.S. semiconductor firms do not hold a larger share of the retail merchant market than they held when imports were controlled by quotas.[93]

As Figure V indicates, the U.S. "share" (as that term is there defined) has been chronically low and has not exceeded twelve percent for any sustained period despite a substantial yen appreciation against the dollar since the early 1970s.[94] The U.S. share is actually lower now than before "liberalization" was completed. These percentages may vary somewhat depending on the assumptions used, but the net conclusion—that the market is unresponsive to yen appreciation, increased local activities by U.S. merchant firms, or other factors—does not vary.[95] Nothing has occurred which has changed that basic fact. (Figure W summarizes various "liberalization" measures and U.S. investment attempts undertaken since 1973.)

Given the success of U.S. semiconductor firms in Europe, where they hold roughly 56 percent of the merchant market as "U.S. share" is defined in Figure X, and given the magnitude of the effort which U.S. firms have devoted to attempting to market in Japan, the U.S. share appears unusually low (Figure X). This low share, coupled with Japan's history of import restrictions, suggests that barriers to sales of foreign semiconductors remain.

92/ Import of ICs with 100-200 elements was liberalized on April 19, 1973. Import of ICs with over 200 elements, excluding ICs for computers, was liberalized on December 1, 1974. Import of ICs for computers and foreign investment was liberalized on December 1, 1975. JIPDEC, Computer White Paper, 1977, p. 4, p. 12.

93/ Precisely what the U.S. "share" of the Japanese market has been and is depends on how the "semiconductor market" is defined and how the U.S. "share" is calculated. "Semiconductor", for example, is a generic term that embraces a wide and changing variety of devices that perform diverse functions, some of which are interchangeable, some of which are not.

94/ The European Community nations have recently complained of the same phenomenon. In a joint filing pursuant to Article XXIII of the GATT, the EEC nations complained on April 7, 1982, that

> When the yen's international value has fallen, this has been effective in favoring Japanese exports, but when the yen's international value has risen, this has not led to an increase in Japanese imports of manufactured goods on a scale comparable with what would have been expected in the case of other economies. (p. 7)

95/ The U.S. share calculated here (based on Dataquest and SIA figures) does not vary significantly from the estimates of the Bank of America. BA Asia, The Japanese Semiconductor Industry 1981/82, p. 205.

Figure V

U.S. COMMERCIAL MERCHANT SEMICONDUCTOR SALES IN JAPAN AS A PERCENTAGE OF JAPANESE DOMESTIC SEMICONDUCTOR CONSUMPTION

Year	Yen/ Dollar	U.S. Share Integrated Circuits (%)	U.S. Share Discrete/ Optical (%)	U.S. Share Total Semiconductors (%)
1973	268.7	16.9	3.8	8.9
1974	291.8	17.3	4.1	10.0
1975	296.9	17.1	3.8	10.5
1976	296.2	15.7	5.2	10.5
1977	265.9	14.6	3.7	9.1
1978	205.9	15.5	3.6	10.4
1979	221.3	19.8	5.4	14.5
1980	224.8	15.8	5.1	12.2
1981	221.3	11.8	4.5	9.3

Notes: Japanese Consumption = Merchant and Captive

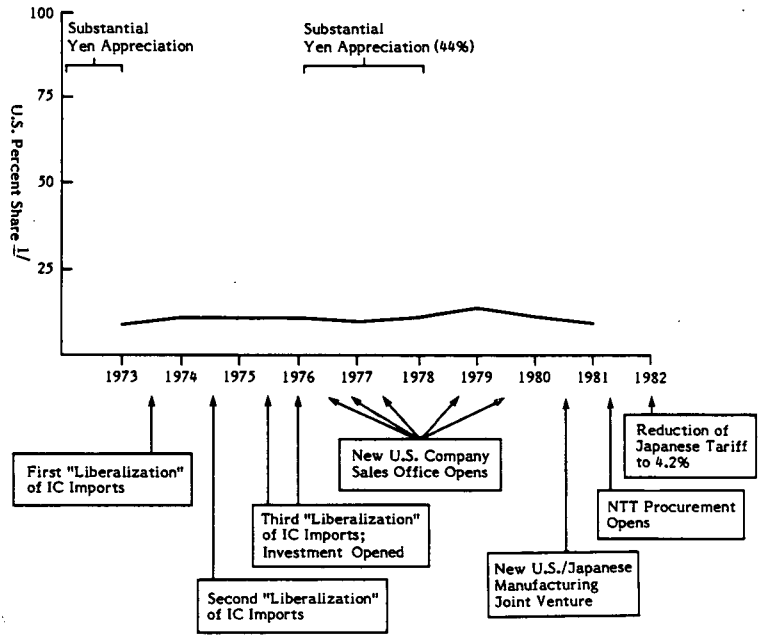
U.S. Sales = Merchant Only

U.S. sales include totals for U.S. firms wherever located, estimated TI total sales in Japan (imports and local manufacture).

Source: Dataquest, SIA Estimates

Figure W

"LIBERALIZATION" MEASURES, U.S. INVESTMENT ATTEMPTS, AND YEN APPRECIATION HAVE HAD LITTLE EFFECT ON U.S. MERCHANT FIRMS' PENETRATION OF THE JAPANESE MARKET



1/ Source: Figure V

Figure X

COMPARISON OF U.S. SEMICONDUCTOR SALES, EUROPE AND JAPAN

	Europe			Japan			
	1980 European Consumption 1/ ($ Million)	1980 U.S. Sales to Europe 2/ ($ Million)	U.S. Sales as % of European Consumption	1980 Japanese Consumption 3/ ($ Million)	1980 U.S. Sales to Japan 4/ ($ Million)	U.S. Sales as % of European Consumption	U.S. Sales in Japan if 1980 European Sales Percentage Achieved ($ Million)
Integrated Circuits	2,408	1,530	64	2,282	360	16	1,460
Discretes	1,366	570	42	1,148	59	5	482
Total Semiconductor	3,774	2,100	56	3,430	419	12	1,942

Sources:

1/ Nomura Research Institute

2/ SIA Reports. "U.S. sales" counts as "U.S. firms" those which a) are incorporated in the U.S., and b) conduct a substantial portion of their production and R&D in the U.S. The European subsidiaries of such firms are also counted as "U.S. firms".

3/ Dataquest, includes merchant and captive (Conversion 224.8:1)

4/ SIA Reports (includes sales by U.S. firms wherever located) (Conversion 224.8:1)

There is substantial additional evidence that the Japanese semiconductor market remains protected. It may be summarized as follows:

1) The U.S. share of the merchant semiconductor market in Japan has never exceeded 12% for a sustained period, despite "liberalization," more favorable exchange rates, and repeated U.S. company efforts to expand their sales to Japan;

2) Domestic semiconductor supply and demand is controlled by an oligopoly of Japan's leading semiconductor producers, who have both the incentive and the ability to adhere to "buy Japan" practices;

3) Marketplace developments show a pattern of abrupt displacement of U.S. semiconductor imports when comparable Japanese-made products become available;

4) In the past the government overtly encouraged a "buy Japan" attitude toward semiconductors, and there is evidence that this attitude was still encouraged after "liberalization";

5) The Japanese government has continued "buy Japan" procurement practices.

A. Japanese Semiconductor Firms Control Most Domestic Demand

> The fact that many Japanese firms that are large consumers are also large producers makes the Japanese market more difficult to penetrate.
>
> - J. C. Abegglen and A. Atori, in "Japanese Technology Today," (1982 edition) an advertisement placed by 15 Japanese firms (including Toshiba, Matsushita, and Sony) in Scientific American, October, 1982

> The question is, how the partnership cultivated among the companies in the VLSI Association can be maintained to produce fruit....
>
> - Nihon Keizai, February 28, 1980 (SIA translation)

An important factor in the inability of U.S. firms to penetrate the Japanese market is the simple fact that the same firms that produce most of Japan's integrated circuit also account for a majority of Japan's semiconductor consumption. Figure Y depicts an estimate of total semiconductor consumption in the Japanese market. As can be seen, consumer electronics products (TV sets, watches, calculators) account for 56% of the total; the information industry (computers, word processors, telecommunications) and other industrial uses account for the rest. Figure Z depicts the leading Japanese producers of consumer electronics and information industry products in 1980. In most cases, at least two-thirds of the total production of these products is attributable to the same firms that produce most of Japan's semiconductors.[96/] In some end-product lines, such as electronic telephone exchanges and word processors, all domestic production is accounted for by Japanese semiconductor producers.[97/]

96/ This phenomenon is analyzed in Borrus, Millstein, and Zysman, op. cit., pp. 63-70.

97/ BA Asia, Ltd. The Japanese Semiconductor Industry 1981/82. The Japanese market is not simply "captive," with vertically integrated firms consuming their own semiconductors. In 1980, the top four Japanese semiconductor manufacturers consumed only 18% of their output internally and only 15% of their MOS output. During the same period, exports accounted for less than 25% of Japanese (footnote continues)

Figure Y

CONSUMPTION OF INTEGRATED CIRCUITS IN JAPAN

Market Segment	1980 Percentage of Total Usage 1/
TV Sets, VTRs	14.1
Audio Equipment	16.9
Calculators/Watches	16.9
Other Consumer Products	8.5
Computers	15.5
Communications	8.5
Other Information Industry and Industrial Use	19.7
TOTAL	100.1 2/

1/ Usage of ICs as a percent of the value of consumption

2/ Shares exceed 100% due to rounding

Source: BA Asia Ltd., The Japanese Semiconductor Industry 1981/82

At present, Japanese semiconductor firms are tending toward specialization in narrower product lines, and selling the bulk of their production to each other. For example, the Japan Economic Journal reported on December 30, 1980 that Hitachi was increasingly concentrating on integrated circuits (particularly 64K RAMs) and reducing

semiconductor output. BA Asia, Ltd., The Japanese Semiconductor Industry 1981/82, pp. 299, 318, 328. The Japanese "producer/consumers" are specializing in fewer particular device types, and buying the remainder of their semiconductor needs from outside producers. This improves economies of scale, since it avoids duplicative effort by individual producers. Nihon Keizai reported on March 30, 1981 that smaller electronics firms such as Alps, Pioneer, and TDK were largely giving up in-house production of semiconductors and procuring from specialized large producers such as Hitachi, Fujitsu, and NEC. This was because the large-scale production of the big producers gave them a tremendous cost advantage. See also BA Asia 1980, p. 133; Japan Economic Journal, April 14, 1981.

Figure Z

LEADING JAPANESE PRODUCERS OF PRODUCTS UTILIZING SEMICONDUCTORS

(CY 1980 except where noted)

Information Industry

Computers (FY 1981)

Firm	Total Sales
*Fujitsu	26
*Hitachi	17
*NEC	16
*Toshiba	6
*Oki	5
Nippon Univac	5
Semiconductor Producers % Share	70

Electronic Telephone Exchanges

Firm	Domestic Production
*NEC	47.0
*Fujitsu	39.5
*Oki	8.5
*Hitachi	5.0
Semiconductor Producers % Share	100.0

Word Processors (Japanese Language)

Firm	Domestic Production
*Toshiba	48.0
*Sharp	37.0
*Oki	10.0
*Fujitsu	5.0
Semiconductor Producers % Share	100.0

Personal Computers

Firm	Domestic Production
*NEC	41.1
*Sharp	37.0
*Oki	10.0
*Fujitsu	5.0
Semiconductor Producers % Share	93.1

Consumer Products

Color TV

Firm	Production
*Matsushita	27.9
JVC	21.0
*Sony	20.9
*Hitachi	7.4
*Sanyo	7.4
Semiconductor Producers % Share	63.6

Radio/Cassette Tape Recorders (FY 1980)

Firm	Production
*Matsushita	18.0
*Sony	17.5
*Sanyo	12.5
*Sharp	11.0
*Toshiba	9.0
Semiconductor Producers % Share	68.0

Stereos (FY 1980)

Firm	Production
*Pioneer	19.0
*Matsushita	17.0
*Sony	12.5
JVC	8.0
*Hitachi	6.0
Semiconductor Producers % Share	54.5

Microwave Ovens

Firm	Production
*Matsushita	30.0
*Sharp	18.0
*Toshiba	14.5
*Sanyo	12.0
*Hitachi	9.0
Semiconductor Producers % Share	83.5

Home VTR

Firm	Production
*Matsushita	27.9
JVC	21.0
*Sony	20.9
*Hitachi	7.4
*Sanyo	7.4
Semiconductor Producers % Share	63.6

* Producer of Semiconductors

Source: BA Asia Ltd., The Japanese Semiconductor Industry 1981/82, p. 46

production of discretes, while Toshiba and Mitsubishi were concentrating on transistors, Fujitsu on memory chips, and NEC on discretes, LSI chips for calculators, EPROMs and microprocessors.[98/] These firms' control over both supply and demand gives them the ability to resist imports collectively, and they have a past history of doing so.[99/] In this connection it should be recalled that MITI is authorized by Public Law 84 to organize these firms into cartels, that it has long pressured them to rationalize production and divide labor, and that it has promoted and supervised their collective formulation of strategic goals, R&D efforts, and exchange of information and ideas. Moreover, the Japanese firms have obvious present incentives to resist imports collectively. It would be naive to believe that in light of the continued small market share enjoyed by the U.S. firms that some form of collusion on the part of these firms to exclude imports does not exist today. The experience of American firms attempting to sell in Japan corroborates this conclusion.

U.S. semiconductor executives have repeatedly found that despite "liberalization," it is not possible for foreign semiconductor firms to effect a significant penetration of the Japanese market today—a phenomenon at least partly attributable to the perpetuation of a de facto "buy Japan" policy.[100/] Significantly, other countries have drawn the same conclusion about Japan.[101/]

98/ Japanese firms tend to produce a narrower range of device types than U.S. counterparts. The Bank of America observed in 1980 that

> Another way to view the large Japanese manufacturers is in terms of their product strengths.... (U)nlike the major U.S. producers, Motorola and T.I., no single Japanese producer offers the total spectrum of semiconductor components to fill most user requirements. Motorola, for example, can be expected to sell catalog items that cover as much as 80 percent of all semiconductors that a customer could require, from discretes to ICs on a "per device" basis. In contrast, Hitachi, with perhaps the broadest line in Japan, might offer under 50 percent of all possible requirements.

BA Asia Ltd., The Japanese Semiconductor Industry 1980, p. 133.

99/ Denshi Buhin, December 12, 1971; Nihon Kogyo Shimbun, February 19, 1974.

100/ See, e.g., evidence in the 1979 U.S.I.T.C. Investigation No. 332-102, including statement of Robert Noyce (May 30, 1979), pp. 6-13; Statements in Second Composite Supplemental Submission (Business Confidential, June 15, 1979); Transcript of hearing, pp. 74-80. See also Testimony before House Ways & Means Committee of C. E. Sporck (May 24, 1982), p. 3; George Scalise (July 26, 1982), pp. 10-12; Floyd Kvamme (January 26, 1981); Al Kelsch (June 10, 1981); Testimony of W. J. Sanders before the Senate Finance Committee (May 26, 1982), p. 3; Statement of Robert W. Galvin before the Senate Foreign Relations Committee (September 14, 1982), pp. 5-7.

101/ See, e.g., the complaint filed by the EEC nations pursuant to Article XXIII of the GATT on April 7, 1982.

B. Import Displacement

> In the past, the import of overseas ICs was checked when similar ICs were domestically manufactured.
>
> - JEI, Journal of the Electronics Industry of Japan, March 1975

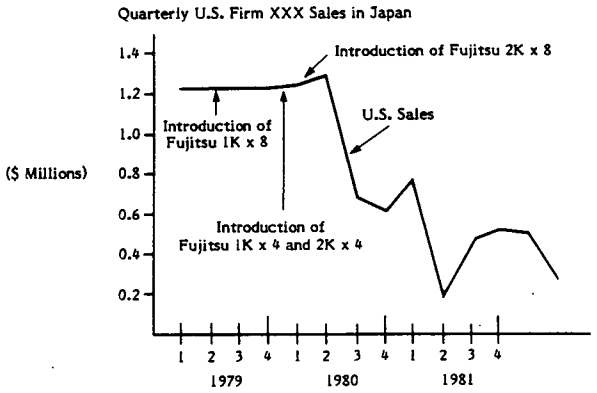
While the Japanese market was supposedly "liberalized" six years ago, U.S. semiconductor firms continue to encounter the phenomenon of "import displacement"--that is, they are able to achieve some penetration of the Japanese market with a particular product so long as sufficient quantities of a competing Japanese product are not available, but as soon as Japanese firms can supply the product in sufficient volume, U.S. firms' sales drop sharply, sometimes almost to zero. This happens even though U.S. firms have been producing longer, and thus should enjoy lower costs than the Japanese.

Import displacement was once MITI policy,[102/] but supposedly the policy has ended as a result of "liberalization." The recent experience of U.S. semiconductor firms in Japan with respect to several product lines suggests, however, that this is not the case. Figure AA depicts sales in Japan of bipolar PROMs by a major U.S. producer ("Firm XX") between calendar 1979 and 1981. In 1979, Firm XX enjoyed relatively stable sales of slightly over $1.2 million per quarter in this product line. However, in late 1979 and early 1980 Fujitsu introduced its own line of bipolar PROMs. Following a brief 3-6 month interval, during which Japanese designers analyzed and converted to the Fujitsu PROM, the U.S. firm's sales began to fall off sharply as Japanese buyers converted to the Fujitsu PROM on an as-available basis. In the 12 months between the second quarter of 1980 and the second quarter of 1981, quarterly sales dropped from just under $1.3 million to approximately $0.2 million.

102/ On May 4, 1971, the Japan Economic Journal reported that

> (T)he Ministry of International Trade and Industry was opposed to such imports of LSIs and was now studying ways for restricting them, such as by limiting their quantity or shortening their import time. This is because though it so far has been allowing virtually all imports, it hopes to clamp strong restrictions on them when the Japanese makers become fully capable of producing their own LSIs.

Figure AA
BIPOLAR PROM SALES IN JAPAN BY U.S. SEMICONDUCTOR FIRM XXX



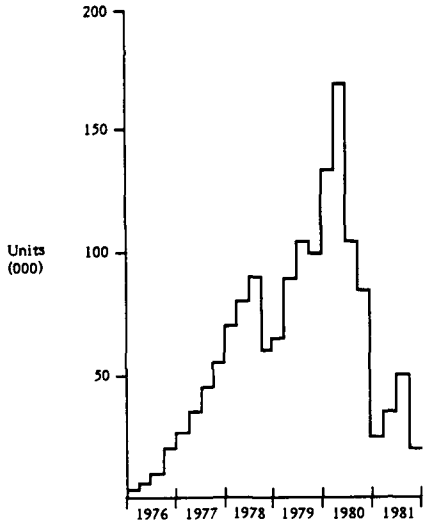
Source: Company Estimates

Figures BB, CC, and DD depict the experience of three U.S. firms with respect to the 8080 microprocessor. U.S. firms began selling this product in Japan in the early 1970s. NEC began producing small numbers of 8080s in 1975, but in 1978-79, it increased its output substantially (Figure BB). In mid-1979, the market for U.S.-made 8080 microprocessors in Japan virtually disappeared. As Figure CC indicates, net bookings for this product dropped suddenly to negative figures, reflecting cancellation of earlier orders as well as a loss of new bookings. Subsequent bookings and a reduction in backlog have been virtually nil. Meanwhile, in 1980, at the same time that the Japanese market for the U.S. 8080 had disappeared, NEC substantially increased its own production—in effect, taking over the market from the U.S. firms. (See Figure BB.) The U.S. firms' 8080 experience in Japan should be contrasted with the same three firms' experience in the world market, where sales tapered off gradually as the life cycle of the product came to an end and a new generation of microprocessors reached significant volume in the world marketplace (Figure DD).

It is not clear what actually caused the sudden disappearance of U.S. firms' 8080 market. If Japanese 8080 quality were superior, seemingly some significant displacement of U.S. firms by the Japanese should have occurred sooner, since the Japanese 8080 was on the market several years prior to the 1979 displacement. Japanese firms should not have been able to underprice U.S. firms because they had been in the market for a shorter time and had produced lower volumes, so that U.S. firms' costs were presumably lower than those of Japanese firms. The evidence strongly suggests that "buy Japan" propensities on the part of Japanese users were at least partly responsible for the disappearance of the U.S. 8080 market. It appears that when NEC was capable of supplying the entire market, Japanese users quickly switched to the Japanese product.

Figure BB

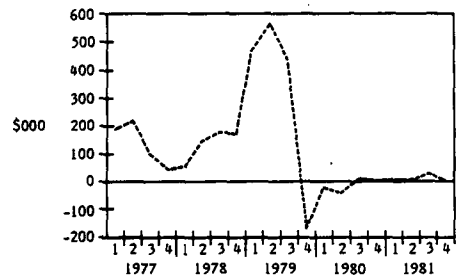
JAPANESE PRODUCTION OF 8080 MICROPROCESSORS BY QUARTER



Source: Dataquest

Figure CC

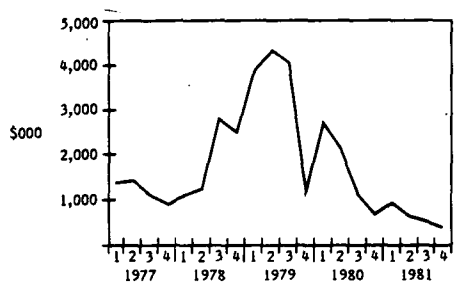
ESTIMATED UNITED STATES BOOKINGS OF
8080-TYPE MICROPROCESSORS TO JAPANESE MARKETS



Source: Company Estimates

Figure DD:

ESTIMATED UNITED STATES BOOKINGS OF
8080-TYPE MICROPROCESSORS TO WORLD MARKETS



Source: Company Estimates

While the charge is sometimes leveled, it is unlikely that the response of the market to U.S. and Japanese products can be explained by material differences in the products as sold--performance, quality, or timeliness of delivery.[103/] U.S. devices are quality-competitive with those of the Japanese.[104/] The Japanese devices which are displacing U.S. devices are imitations of U.S.-designed products. They "fit the same socket" as the U.S. products and, where applicable, use U.S. software. There is no difference between Japanese "import substitutes" and U.S. products as to physical and functional characteristics.[105/]

The historical monthly pattern of integrated circuit imports as a percent of Japanese consumption tends to corroborate the picture of import displacement in Japan. In Figure EE, the jagged line depicts, on a monthly basis, total imports of ICs (all countries, not just the U.S.) as a percent of Japanese domestic consumption. As can be seen, there are a number of sharp "peaks" in import share, where the import percentage approaches or exceeds 30 percent, followed by subsequent sharp drops. The first two "peaks" (1976 and 1979) were led by a surge in Japanese demand for components for CB

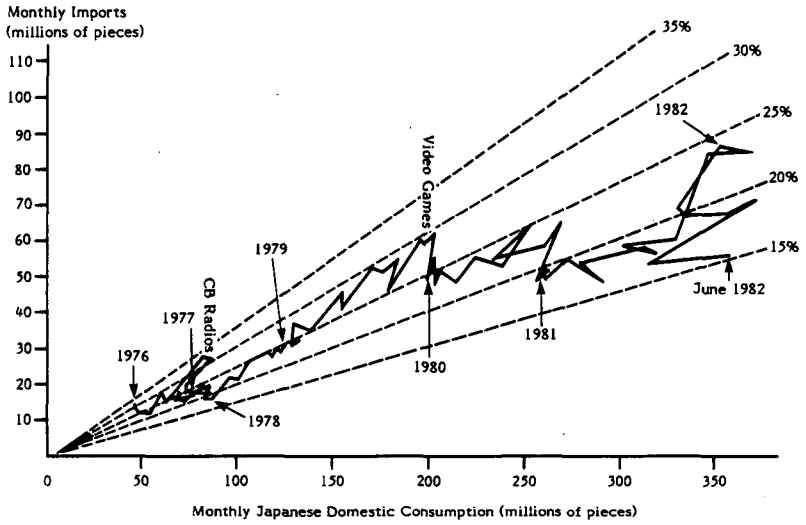
103/ One U.S. firm reported that it had utilized every distribution channel available in an effort to improve sales of its products. This included direct sales, selling through distribution system, and, finally, utilizing marketing representatives and trading companies.

104/ In January 1982, an official at the Integrated Circuit Engineering Corp. (ICE) concluded that there was no significant difference in quality between U.S. and Japanese made semiconductors. Electronics, January 13, 1982. Similarly, R. W. Anderson of Hewlett-Packard (a major consumer of RAMs) recently concluded that no statistically significant quality difference exists between U.S. and Japanese devices. Philadelphia Inquirer, February 14, 1982.

105/ In some instances the primary cause of displacement has been price. Japanese firms have brought a new product on line at a price so low that U.S. firms cannot possibly match it economically, despite the fact that U.S. firms enjoy a lead in cumulative output and corresponding cost advantages. For reasons already noted, targeting gives Japanese firms the incentive and the ability to price in this fashion, domestically as well as internationally. However, given the apparent price insensitivity of the Japanese market to imports, it is unclear that even if U.S. firms matched these price reductions, the result would be any different.

Figure EE

MONTHLY JAPANESE INTEGRATED CIRCUIT IMPORTS AS A PERCENTAGE OF DOMESTIC CONSUMPTION, 1976-82



Source: U.S. Industry Source, Compiled from MITI and JETRO Figures

radios (1976) and video games (1980). Imports appear to have met this demand—but only temporarily. As can be seen, the demand for imports declined quickly after an initial surge, not only in percentage terms but in an absolute sense.[106/]

106/ It is not yet clear what caused the surge in import demand in late 1981 (which has fallen off sharply in 1982). The import IC "share" depicted in this figure is frequently somewhat higher than the U.S. share depicted in Figure S. Figure V, however, embraces all imports of ICs (U.S., European, etc.), whereas Figure S is limited to U.S. imports. Furthermore, Figure Z reflects month-by-month share, whereas Figure S depicts annualized shares, and Figure V reflects volume (number of devices sold) whereas Figure EE reflects sales revenue.

C. Japanese Government Policies

> The Ministry of International Trade and Industry recognizes that it is essential for the self reliance and development of the electronic computer industry of our country that the national computers get a reasonable share of the market in our country. The Ministry has made it known that it will watch the trends of importation and installation of the electronic computer in our country, and powerfully deploy various promotional measures such as promoting development of super LSI for the next generation of the electronic computers and securing rental funds for the national computers. It is even more important after the liberalization that the national electronic computers receive proper understanding and get utilized. I would like to ask everybody concerned for sufficient cooperation in this regard.
>
> - MITI Minister Komoto, reported in Monthly Report of the Electronics Industry, January 1976

"Buy Japanese semiconductors" was official national policy until well into the 1970s, and the tactic of import displacement was openly practiced by MITI. There is reason to believe that Japan is practicing covertly today what it practiced overtly a few years ago. For example, pronouncements issued by the Japanese government at the time "liberalization" was implemented in 1975-76 indicate that at that time, the intention was simply to move the "buy Japan" policy underground, encouraging a less overt continuation of that policy. The government instructed its various organs that

> (I)f a Japanese model is on an equal level as a foreign model, the Japanese model should be selected.107/

107/ Denki, March 11, 1976, reproduced in Gresser, High Technology. A number of comparable "buy national" directives from the Japanese government are reproduced in Appendices to Gresser's work. They include an article from the Monthly Report of the Electronics Industry (Jan. 1, 1976) reporting an informal talk by the MITI Minister outlining countermeasures to be taken in the wake of liberalization, including exhortation of "local governments, industrial and financial businesses" to buy national; an article from the same publication reporting a decision by the Japanese Cabinet to keep "watching" Japanese firms' market share so that liberalization "may not affect the national manufacturers adversely"; and a series of Recommendations by the Industrial Structure Council, urging, among other things, that trends be monitored "so that proper countermeasures can be taken when significant harms to the national industries, such as rapid decrease in the market share of computers, are anticipated."

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This continuation of a covert "buy Japan" policy following liberalization has been manifested in a variety of formal and informal actions (including pressure on potential Japanese buyers to "buy national")[108] which have the net effect of restricting U.S. semiconductor imports--even when such imports are price- and quality-competitive with comparable Japanese products.

Furthermore, while foreign investment has officially been "liberalized," Japanese law still bars foreign acquisition of a Japanese company unless 100% of the firm's board of directors and the Ministry of Finance approve the acquisition. In fact, Japanese companies' boards typically do not give this consent. Thus the fastest method of market entry into a country--a method used by Japanese firms in entering the U.S.[109]--is usually not available to U.S. firms in Japan. This substantially impairs U.S. access to the Japanese market.

108/ One U.S. semiconductor executive testified before the U.S. International Trade Commission in 1979 in a confidential submission that

> There were numerous instances where we would obtain orders from Japanese customers who, on our applying for import licenses against those specific orders, would mysteriously cancel the orders. On investigation of this matter, we learned that the prospective customers had received direct calls from individuals we believe to have been with MITI asking them why they were buying foreign made products when locally made products of approximately the same capability were available. As a result of MITI pressure, our orders would disappear.

USITC Investigation No. 332-102, Second Composite Supplemental Submission, June 15, 1979, p. 2.

109/ For example, in 1978 NEC acquired Electronic Arrays, Inc., a California corporation, which now produces ROMs and RAMs, and Toshiba acquired Maruman Integrated Circuits in Sunnyvale, California., This firm now produces ICs from the wafer fabrication stage forward. Japan Economic Journal, May 11, 1982; Wall Street Journal, September 23, 1982.

Another serious problem has been the restricted ability of U.S. firms to secure yen loans from Japanese banks. Japan's interest rates are among the lowest in the world, and Japanese firm's access to local bank loans gives them an advantage—lower cost of capital.[110] Japan's Ministry of Finance limits the total amount of yen loans that can be made to foreign firms.[111] As a result of such restrictions, "American corporations are effectively blocked from raising money in Japanese capital markets."[112]

110/ In early July 1982 the long-term prime rate for yen loans in Japan was reportedly 8.4 percent. The rate for Eurodollar loans, by contrast, was around 16 percent. Japan Economic Journal, July 6, 1982.

111/ The Japan Economic Journal reported on July 6, 1982 that

> Although the Finance Ministry does not admit publicly, it imposes de facto limitation on the amount of offshore yen loans through administrative guidances directed at individual banks in an attempt to curb capital outflows that add to the weakening of the yen.

Until May, 1982, the MOF limited offshore yen loans to those tied to energy development and international organizations. Under foreign pressure, the MOF agreed to allow loans to foreign corporations provided that the loans were guaranteed by a foreign government. Japan Economic Journal, August 24, 1982. In October 1982, the Ministry of Finance announced that it would limit the volume of offshore yen loans in the second half of fiscal 1982 to the same level as in the first half of the year. Japan Economic Journal, October 12, 1982. In addition, the Ministry of Finance restricts the issuance of yen-denominated foreign bonds—a serious source of complaints by foreign governments and international agencies. Japan Economic Journal, September 7, October 5, and October 12, 1982.

112/ Japan Economic Institute, JEI Report No. 38 (October 9, 1981), p. 6.

D. Procurement

> NTT officials said those U.S. firms are somewhat arrogant in their reasoning that since their products are well accepted in the U.S. NTT should accept them according to U.S. standards. An increasing number of foreign firms have visited the NTT head office in Tokyo to sell their products, but President Shinto told them, "If you like to sell to NTT, you should change your products suited to specifications of NTT. Without such efforts, you just cannot blame us for not opening up our market enough."
>
> - Japan Economic Journal, January 12, 1982

An important segment of the Japanese domestic semiconductor market consists of communications equipment, which accounts for approximately nine percent of domestic semiconductor consumption. This market has been virtually completely closed to U.S. semiconductor firms by the strict "buy Japan" policies of the government public telephone/telegraph monopoly, NTT,[113/] which consumes most of the products in this market area.[114/] NTT guarantees its suppliers a "reasonable" profit percentage on sales (reportedly a minimum of 10 percent), so that its suppliers enjoy a steady flow of remunerative orders. As Figure FF, indicates, sales to NTT by its four largest suppliers—all of whom are major semiconductor producers—exceed $1.1 billion per year. One of these firms, Oki, garners over 20 percent of its annual revenues through NTT procurement sales.

113/ NTT is a public corporation owned, controlled, and funded by the Japanese government Ministry of Post and Telecommunications (PTT).

114/ Until 1980 NTT largely limited its procurement to four domestic firms—Oki, NEC, Hitachi, and Fujitsu (the "Big Four")—who are also large producers of semiconductors. During trade negotiations in the late 1970s NTT's former President Tokuji Akikusa reportedly told U.S. trade negotiators that "the only thing we could consider buying overseas would be (telephone) poles and mops." Business Week, August 9, 1982, p. 42.

NTT purportedly opened procurement to foreign bidders three years ago. However, NTT has not, to date, made significant semiconductors purchases from U.S. merchant suppliers.[115] NTT contends that its comparative dearth of foreign purchases is attributable to the failure of non-Japanese firms to submit bids. Business Week reported, however, that this lack of bids may be attributable to the fact that NTT had opened the market to outsiders only for "lot ticket items."[116] MITI Minister Shintaro Abe recently acknowledged "that there are still 'elements' within NTT that oppose importing American equipment."[117]

Figure FF

IMPACT OF NTT PROCUREMENT ON ITS FOUR LEADING SUPPLIERS

	Total Company Revenues	Sales to NTT	Percent of Annual Revenues
NEC	$ 6,160	$ 505	8.2 %
Fujitsu	2,684	328	12.2
Oki	857	179	20.9
Hitachi	14,795	164	1.1

Conversion: 250:1

Source: Business Week, August 9, 1982

115/ Semiconductor products which NTT purchases frequently must pass standards which are based on design, rather than performance. Outside suppliers unfamiliar with or unable to comply with the design specifications are thus "designed out" of the market. This problem is exacerbated by the fact that much of NTT's equipment development takes place in the laboratories of the local Japanese suppliers, making some designs proprietary information--effectively closing the contracts to all other suppliers. USITC Publication No. 1013, November 1979, p. 61; Electronic News, October 11, 1982, p. C.

116/ Business Week, August 9, 1982, p. 42.

117/ Fortune, October 4, 1982, p. 92.

E. Harm to U.S. Firms from Exclusion

> Japanese protectionism in semiconductors has fundamentally altered the conditions of competition on the world semiconductor market for the foreseeable future—to the disadvantage of American companies—and the worst effects may be yet to come.
>
> - Robert Galvin, Chairman and Chief Executive Officer, Motorola, Inc.

While the Japanese export drive in high density RAMs has had a dramatic and visible adverse impact on a number of U.S. semiconductor firms, a less visible but equally serious threat to U.S. firms is posed by the continuing inaccessibility of Japan's domestic semiconductor market. The problem here is not only denied opportunities, but an increasing threat to U.S. firms in all world markets because of their continuing inability to penetrate the Japanese market.

1. Effect of Past Denied Opportunity

While the harm resulting from Japan's exclusionary policies can only be approximated, it has nonetheless been real. For example, by contrast to Japan, U.S. firms and their subsidiaries in Europe now hold roughly 60 percent of that semiconductor market despite the existence of a 17 percent tariff. If U.S. merchant firms had been able to capture 60 percent of the Japanese market in the 1973-81 period, they would have generated at least $10 billion in additional sales.[118/] A comparable market share prior to 1973 would have brought $4-5 billion in additional revenues. While there is no accurate way to determine revenues which U.S. firms would have actually earned, these numbers at least give some idea of the size of the potential market which was denied.[119/]

118/ Dataquest's estimate of total consumption in Japan during this period was $20.1 billion.

119/ Furthermore, under such circumstances, it is very unlikely that Japanese companies would have achieved the degree of success they have in export markets, and it is very likely that U.S. companies would have enjoyed greater success in U.S. and third country markets. Additional U.S. sales during this period would have generated several billion dollars more for U.S. firms (even excluding consideration of the suppression effects of Japanese pricing in a number of product areas).

The phenomenon of import displacement is also damaging. When a U.S. firm's Japanese sales suddenly disappear, it not only suffers a sharp curtailment of earnings, but is deterred from further investments for production for the Japanese market.[120/] In this context, the remarks of NEC's Hattori should be recalled--that IC investment is not possible if demand is not stable.[121/]

In aggregate, it is quite plausible to speculate that the closing of the Japanese market during the late 1960s and early 1970s has cost U.S. companies billions, and perhaps tens of billions of dollars in foregone revenues.[122/]

2. Effects of Continuing Japanese Protectionism

Japanese protectionism means more than lost revenue opportunities in Japan for U.S. semiconductor firms. Japanese protectionism constitutes an increasingly serious threat to U.S. firms in world markets, not just Japan. This is for several reasons.

To begin with, protectionism is integral to the process through which MITI encourages and directs the build-up of Japanese capability in key product lines in the targeted industries. Protection of the domestic market assures Japanese firms a source of demand in the early stages of the product life cycle enabling them to build volume, and thus reduce unit costs of production without fear of significant foreign competition. If U.S. firms could compete on an equal basis in the Japanese market at all stages of the product life cycle, this outcome would not be nearly so certain, and the prospect of periodic, sudden export drives by Japanese firms which have built up capacity in a protected environment would be less likely.

120/ USITC Investigation No. 332-102, Second Composite Supplemental Submission, p. 2.

121/ Nikkon Kogyo, Dec. 12, 1974.

122/ The losses from the residual effect of Japanese protection will continue, and will accumulate at a faster rate as the Japanese industry brings more production capacity on line. Using the above analysis applied to 1981 alone, the annual loss to U.S. companies of exclusion from the Japanese market was on the order of $3 billion. Motorola head Robert Galvin testified before the Senate Foreign Relations Committee on September 14, 1982, that

> It is reasonable to conclude that U.S. semiconductor companies have lost at least $15 billion in revenues as a direct result of Japanese protectionism in the late 1960s and early 1970s. And those losses (of revenue) are continuing to accrue, amounting to roughly $3 billion in 1981 alone.

Even more fundamentally, however, continued Japanese protection of the Japanese market hurts U.S. firms because Japan represents an important segment of the world semiconductor market as a whole. Figure GG indicates that while Japanese consumption of merchant semiconductors has remained constant relative to total world consumption, the U.S. and European shares have declined and the rest of the world has grown.[123/] Continued exclusion of U.S. firms from the Japanese market at the same time that Japanese firms are penetrating other markets threatens to give Japanese firms a decisive advantage in the competition to achieve the highest total volume of sales—with the corresponding cost advantages which flow from superior volume.

Figure GG

ESTIMATED WORLD SEMICONDUCTOR CONSUMPTION 1973-1982

(Percent Share of World Consumption)

Year	Japan	North America	Europe	Rest of World	Total
1973	25 %	43 %	29 %	3 %	100 %
1974	24	42	30	4	100
1975	23	42	30	5	100
1976	27	41	26	6	100
1977	26	42	26	6	100
1978	25	43	26	6	100
1979	25	42	26	7	100
1980	26	41	25	8	100
1981	26	40	25	9	100
1982	26	39	25	10	100

Source: Dataquest

123/ The Japan Economic Journal predicted on February 23, 1982 that the Japanese semiconductor market would continue to increase by an annual 20 percent in the first half of the 1980s, compared with only one-digit growth in the U.S.

In the past, U.S. semiconductor firms were able to offset the effect of their inability to penetrate Japan by maintaining superior sales volumes in the U.S. and Europe. That basic competitive fact of life is now changing. U.S. firms are being challenged by Japanese firms in Europe and the U.S.,[124] and the Japanese market, still heavily dominated by Japanese firms, is growing faster than Europe and the U.S. In part this reflects the erosion of the U.S. consumer electronics market, and the corresponding growth of the Japanese consumer electronics industry. U.S. consumer electronics production has declined relative to that of Japan, and U.S. semiconductor firms have lost part of their traditional customer base, while Japanese firms have gained a secure source of demand. As the Japanese domestic demand for semiconductors continues to grow, U.S. firms will be required to maintain unrealistically large shares of the U.S. and European markets to maintain production volume which will offset their continuing inability to penetrate Japan.

The Japanese challenge is global in scope, and to the extent Japanese firms are able to protect, even partially, their home market while they penetrate world markets, they will enjoy what may well prove to be a decisive edge--the ability to produce in superior volume--over the long run.

124/ Japanese firms began exporting ICs in 1974-75. They began to achieve significant market penetration in 1977-78, and ultimately captured a leading share of the 64K RAM market in 1981. Japanese firms began establishing semiconductor sales subsidiaries in the U.S. and Europe in the late 1970s. They are now establishing semiconductor assembly plants in the U.S., Scotland, Ireland, and other parts of Europe. These will be "integrated backward" by 1983-84 to permit complex manufacturing processes such as wafer fabrication. Japan Economic Journal, July 7, 1981; Wall Street Journal, March 2, 1982, p. 35; SIA, The International Microelectronic Challenge, p 37.

IV. JAPANESE SEMICONDUCTOR POLICIES AND THE RULES OF THE INTERNATIONAL TRADING SYSTEM

There is nothing in the General Agreement of Tariffs and Trade (GATT) or any of the agreements entered into under the auspices of the GATT that prohibits a country from developing an industrial policy designed to foster a particular industry. However, if the effects of that policy are (1) to "nullify or impair" obligations assumed, or the benefits to other contracting parties, under the GATT, or (2) to cause "serious prejudice" to the interests of other countries because of the subsidy programs involved, the adversely affected parties have a clear right to seek remedies under the applicable provisions of international trade law.

It is clear from the foregoing evidence that Japan's semiconductor policies have nullified or impaired GATT concessions granted by Japan to the United States and/or GATT obligations assumed by Japan (such as the obligation not to impose quotas, formally or otherwise). Similarly, a strong case can be made that Japan's success in semiconductors rests in large part upon a deliberate and extensive program of subsidization of the Japanese industry and that this subsidization has caused serious prejudice through (1) displacement of U.S. semiconductor exports to Japan, (2) displacement of U.S. semiconductor exports to third countries, and (3) injury to the U.S. semiconductor industry as a result of unfair Japanese competition in the U.S. market.

A. Nullification or Impairment of GATT Concessions/Obligations

The drafters of the General Agreement on Tariffs and Trade envisioned a trading system where quotas would be virtually eliminated[125/] and tariffs—the only "permitted" barriers to trade—would be gradually reduced through negotiation.[126/] However, the original contracting parties also realized that the basic obligations of the GATT could be undercut, or, in the language of GATT Article XXIII, "nullified or impaired" through a wide variety of government, or even private sector, actions. Accordingly, Article XXIII provides a basis under which any GATT contracting party can complain about the actions of any other country which nullify or impair benefits under the General Agreement.

Article XXIII is broadly drafted. It sets out a procedure whereby any contracting party can seek redress if any benefit accruing to it, either directly or indirectly, under the General Agreement is being nullified or impaired, or that the attainment of any objective of the GATT is being impeded as a result of:

(a) the failure of another contracting party to carry out its obligations under the GATT, or

(b) the application by another contracting party of any measure, whether or not it conflicts with GATT, or

(c) the existence of any other situation.

Among the objectives of the draftsmen was to provide any contracting party with a means to ensure "continued reciprocity and balance of concessions in light of changing circumstances."[127/] The concern was to ensure that any country could claim nullification or impairment in the event that its basic expectations as to the operation of the General Agreement were defeated by action of another party or by other "situations."[128/]

In discussing what was to become GATT Article XXIII, some delegates to the preparatory conferences objected to its sweep. The majority, however, recognized that it would be inadvisable to limit in advance the types of measures to which a country would take action under the GATT to maintain a fair balance of concessions. Among the

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125/ GATT Article XI.

126/ GATT Article II.

127/ U.N. Doc. EPCT/C.II/PV,12, at 13 (1946).

128/ See R. Hudec, The GATT Legal System and World Trade Diplomacy (Praeger, 1975) ("Hudec").

possible causes for Article XXIII action which were discussed by the drafters of the GATT (or the Havana Charter, where the language of Article XXIII was first drafted) or which have provided the basis for an actual Article XXIII proceeding were (1) anticompetitive behavior by an industry in a contracting party[129/] and (2) subsidization of an industry.[130/]

Japanese policies on semiconductors provide a solid basis for an Article XXIII complaint by the United States.

First, the quotas imposed by Japan semiconductor imports until 1975 were never GATT-legal. They were maintained in direct violation of GATT Article XI. The effects of these quotas continue today. In contrast to U.S. access to the European market, they prevented the U.S. industry from establishing a presence in the Japanese semiconductor market early on and the U.S. industry has never been able to recover from this early denial of market access.

Second, the Japanese government has encouraged industry cartels and fostered a strong "buy-Japan" predisposition through careful and considered "administrative guidance." Government cartelization and guidance of the industry was explicitly authorized by statute (Public Laws 17 and 84). Japanese industry organization effectively prevented the U.S. semiconductor industry from establishing a strong market position even after Japan lifted its import quotas.

Third, the government of Japan has, in the past, deliberately and directly limited U.S. investment opportunities in Japan. The inability of the U.S. industry to establish a strong presence in Japan has been extremely important in limiting U.S. trade opportunities. Effective exclusion of U.S. subsidiaries from a significant role in Japan has inhibited the major U.S. firms from establishing as strong a relationship as possible with Japanese purchasers, and, in so doing, sharply inhibited the U.S. industry's trade opportunities.

129/ The preparatory work on the Havana Charter (or ITO), which was to provide the basis for the GATT, leaves no doubt as to the broad scope of what later became Article XXIII of the GATT. As cited in Hudec's study of the GATT legal system, the Australian delegate to the drafting session proposed that the obligations of the Commercial Policy Chapter of the ITO be expressly conditioned on the achievement of the ITO Charter's broader objectives, so that a government might be excused, in whole or in part, of commercial policy obligations if these objectives did not materialize. The proposed ITO charter included provisions on restrictive business practices. The drafting conference agreed to accommodate Australia's concern in the nullification and impairment section of the Commercial Policy Chapter of the draft charter. See Hudec at 34.

130/ See Chilean complaint against Australia; GATT, 2 BISD 192 (153).

Fourth, the Japanese industry has been heavily subsidized for over fifteen years by the Japanese government. The dollar value of the subsidies does not come close to stating their commercial value. In the very successful VLSI program, for example, the government organization of a commercial research and development effort on a joint industry basis and the "guidance" given to the effort were far more significant than the approximately $132 million over four years (at 220:1) of government funding involved. As already noted, one Japanese semiconductor executive estimated that without the VLSI program, Japanese firms could have spent five times as much on semiconductor R&D.

Without this concerted government-organized and government-financed effort, it is highly unlikely Japanese semiconductor producers could have made such great commercial and technical strides. It is extremely doubtful that six major Japanese semiconductor producers would have been in a position to develop and produce the 64K RAM, the most advanced form of computer memory device commercially available, within a very short period of time. Similarly, it is extremely unlikely that without (a) favored access to capital and (b) special depreciation of semiconductor manufacturing equipment, the Japanese companies could, or would, have installed the enormous increases in 16K and 64K RAM production capacity between 1978 and 1982.

The effects of Japanese semiconductor policies have, in a very real sense, impaired the benefits given the U.S. under the GATT in as far as semiconductor trade is concerned. In the face of Japanese policies, tariff concessions by Japan on semiconductors have been virtually meaningless. More importantly, the GATT prohibition on quotas has, as a practical matter, been undermined. Japanese policies have prevented U.S. producers from obtaining a share of the Japanese market that is even close to the U.S. industry share of the European market, or of the U.S. market, which is open. It is impossible to say in any precise way what the U.S. share should be and would be but for Japanese semiconductor policy. It is, however, possible to say that the U.S. industry's market share in Japan, currently about nine percent, is artificially low, and, absent a basic change in Japanese policies, will not rise significantly.

B. The Subsidies Code

The Subsidies Code negotiated in the Tokyo Round of the multilateral trade negotiations[131] was crafted with the express intent of providing a code signatory with a remedy against subsidies causing (a) serious prejudice, (b) nullification or impairment, or (c) injury to the interests of that signatory, even though the subsidy practice might not, itself, be prohibited. The concept behind this provision of the Subsidies Code is much the same as the rationale underlying the nullification or impairment provision of GATT Article XXIII: while a Code signatory might not be able to prohibit another country from pursuing certain subsidies (e.g., research and development grants to industry), that signatory must have a recognized right to challenge, and get redress for, the adverse effects of the subsidy program on its interests.

The relevant provisions of the Subsidies Code are as follows:

(1) If the Committee of the Subsidies Code finds that a "subsidy is being granted or maintained in such a manner as to cause injury, nullification or impairment or serious prejudice" to the interests of another signatory, it can authorize countermeasures.[132]

(2) The adverse effects required to demonstrate nullification or impairment or serious prejudice may arise through:

(a) the effects of the subsidized imports in the domestic market of the importing signatory, or

(b) the effects of the subsidy in displacing or impeding the imports of like products into the market of the subsidizing country, or

(c) the effects of the subsidized exports in displacing the exports of like products of another signatory from a third country market.[133]

(3) Among the "subsidies" identified under the Code are government financing of commercial enterprises, including grants, loans, or guarantees; and government financing of research and development programs.[134] Moreover, the list of possible subsidies set out in the Code is deliberately "illustrative and non-exhaustive." The intent is to provide relief for the broad range of subsidies "granted with the aim of giving an advantage to

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131/ Formally, the Agreement on the Interpretation and Implementation of Article VI, XVI, and XXIII of the General Agreement on Tariffs and Trade.

132/ Article 13:4 of the Subsidies Code.

133/ Article 8:4 of the Subsidies Code.

134/ Article 11:3 of the Subsidies Code.

certain enterprises."135/

(4) In determining the effects of subsidies on international trade, the Code does not restrict a signatory to a calculation based on the ad valorem amount of the subsidy per unit of export (in this respect, it is unlike the countervailing duty law). Rather, where the Committee finds that serious prejudice, injury, or nullification or impairment has occurred as a result of a subsidy, the Committee may authorize "such countermeasures as may be appropriate, taking into account the degree and nature of the adverse effects found to exist."136/

(5) In addition to liability for countermeasures, signatories to the Code are under an affirmative obligation to consider the "conditions of world trade, production (e.g., capacity utilization, etc.) and supply" in the product concerned when drawing up their subsidy practices.137/

A case could be brought under the subsidies code against the Japanese on several grounds. There is no doubt that the Japanese government has given "subsidies," as that term is used in the Subsidies Code, to its leading semiconductor firms. These include, but are not limited to:

- "Hojokin" R&D loans (repayable only if profitable technologies are forthcoming) made to five Japanese semiconductor firms for VLSI development, totaling approximately $132 million (at 220:1) between 1976 and 1979;

- "Itakuhi" R&D grants to Japanese semiconductor firms for the New Function Elements, Optoelectronics, and Supercomputer Projects, amounting to an estimated $300 million (at 220:1) between 1979 and 1990;

- R&D grants to individual companies for "important technologies";

- Loans at special interest rates from the Japan Development Bank to the Japanese semiconductor/computer firms for "restructuring" and modernization of production equipment, and loans to these firms' joint venture, JECC, totaling approximately $1.9 billion, at 220:1, between 1976 and 1982;

- Special tax depreciation for semiconductor production equipment, and other special tax advantages;

135/ Ibid.

136/ Article 13:4 of the Subsidies Code.

137/ Article 11:2 of the Subsidies Code.

- Closed procurement by government agencies and NTT, with profitable procurement rates for Japanese firms.

These subsidies have been granted and maintained in a manner which has caused, and is causing, injury to U.S. semiconductor firms:

(1) These funds helped the Japanese semiconductor industry to develop to the point where Japanese firms have become a significant factor in U.S. and third country markets, reducing the share of U.S. firms in a number of key semiconductor product lines;

(2) These funds enabled Japanese semiconductor producers to invest and price extremely aggressively by substantially reducing R&D capital cost and business risk for Japanese firms;

(3) These funds played a key role in limiting U.S. exports to Japan by enabling Japanese firms to develop, produce, and sell semiconductor products which displaced U.S. products in the Japanese market.

Furthermore, the effects of the subsidies are far greater than the dollar amounts involved suggest, since they were accompanied by a program of industry rationalization designed to eliminate duplicative R&D and production by Japanese firms, and to encourage economies of scale.

Finally, the government of Japan has developed its program with the express purpose of encouraging an industry with significant export capacity. This was done in complete disregard for the condition of export markets.

CONCLUSION

> Growing government intervention abroad undermines the balance of our past trade agreements. That erosion must be halted.... We must build upon the GATT framework, not tear it down. But we must now make an independent assessment of our national commercial interests, set priorities, seek new negotiations, and utilize existing rights aggressively, if the GATT framework is to be respected and is to endure.
>
> - Charles E. Sporck, President, National Semiconductor, before the House Ways & Means Committee's Subcommittee on Trade, May 24, 1982

The net effect of Japan's "targeting" of its semiconductor sector has already been substantial, and, from the viewpoint of U.S. firms, its implications are serious. Despite the extreme degree of competitiveness, adaptability, and ability to innovate of the U.S. semiconductor industry, there has been erosion of the industry's international competitive position in key product areas. As Japanese capital investment in semiconductors is increasing, U.S. investment prospects are uncertain. As Japan expands its share of world semiconductor markets, traditionally competitive U.S. industry is becoming less able to compete.

U.S. firms' setbacks have not been a result of free market competition, but of the Japanese government's targeting policy, implemented through:

- Financial support. The Japanese government has funneled various forms of direct and indirect aid to leading semiconductor firms. This has made possible large capital investments and aggressive pricing.

- Cartelization. MITI has presided over the formation of research cartels, encouraged product specialization by firm, rewarded selected firms through government contracts and subsidies, and supervised the industry structure to ensure that each firm moves in a direction consistent with overall goals.

- Domestic market protection. The Japanese government has promoted and condoned practices which have made it impossible for U.S. semiconductor firms to achieve a significant penetration of the Japanese domestic market.

These Japanese government policies—not any inherent weakness on the part of U.S. firms—threaten the loss of U.S. leadership in semiconductors. Furthermore, other

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nations--France, Germany, Taiwan, Korea--are now beginning to emulate Japan and are implementing their own government-backed versions of the Japanese targeting program to promote the growth of their high technology industries.

The Japanese challenge in semiconductors comes at a time when trade relations between the U.S. and Japan are under serious strain. Pressure is building in the U.S. for the implementation of protectionist measures, such as "local content" legislation for automobiles, which would not only further damage U.S.-Japan trade relations, but would seriously harm the economies of both nations. The U.S. Department of Justice allegations of price-fixing on the part of Japanese semiconductor firms, and other recent prosecutions of Japanese firms in the U.S., have further strained trade relations. The challenge facing U.S. policymakers, therefore, is to respond effectively to the Japanese high technology effort without crude or self-defeating measures that simply worsen trade relations without addressing root problems.

The Japanese semiconductor challenge calls for measures by the U.S. government within the context of this nation's bilateral trade relations with Japan. Such measures are necessary because U.S. firms cannot, by themselves, counter the measures taken by the Japanese government to promote the interests of its firms through targeting.

First, the U.S. government should announce as U.S. policy that foreign industrial targeting practices will not be allowed to undermine U.S. technological and economic leadership in this critical industrial sector. The future growth of the U.S. economy depends on the continued vitality of this industry.

Second, the U.S. government must identify, analyze, and counter the distorting effects of foreign industrial targeting practices. The U.S. government should establish, in cooperation with industry, a monitoring system (excluding firms which produce solely for their own use) with respect to major commercial merchant semiconductor product lines. Such monitoring will give "early warning" of export drives, and will be available to alert the U.S. government to possible predatory export trends by Japanese firms as well as the continuing existence of barriers to market access to Japan. The U.S. government should provide assurances that it will take appropriate action under the U.S. trade laws if monitoring reveals the existence of unfair trade practices.

Third, the U.S. government should insist that U.S. semiconductor firms receive commercial opportunities in Japan that are fully equivalent to those enjoyed by Japanese firms--including those favored by MITI. Such "national treatment" is asking no more than Japanese firms already enjoy in the U.S. today. U.S. firms must receive real, not "cosmetic" market access, reflected in significantly greater participation by U.S. firms in the Japanese market. This will require an affirmative action program to normalize competition in Japan. The Japanese government should establish necessary programs to see that this result is achieved.

- Japan must abandon its "buy Japan" policies, whether overt or covert;
- U.S. subsidiaries in Japan should enjoy access to local Japanese capital markets on the same terms as those enjoyed by MITI-favored Japanese firms;
- U.S. companies should be able to consummate acquisitions and enter into joint ventures in Japan on the same basis as MITI-favored firms;
- U.S. companies should be permitted to establish development, manufacturing, and research facilities, and to participate in joint research projects on the same basis as MITI-favored Japanese firms;
- Japan should be required to demonstrate, through detailed accounting cost comparisons, that their firms are not pricing below costs.

Fourth, in order to establish free market competitive conditions internationally, the U.S. government should promptly seek enforcement of Japan's obligations in multilateral forums (through consultations and other procedures available under the GATT and the MTN Subsidies Code) and should be prepared to exercise U.S. rights under such agreements, if necessary.

Fifth, the implementation of these policies with respect to Japan should form a model for dealing with targeted industries practices in other countries.

Sixth, the U.S. Congress should enact legislation that provides the authority and means necessary to ensure that the U.S. government can carry out the policies and measures outlined above effectively.

SIA believes that true access to the Japanese domestic market is one key to meeting the challenge posed by the Japanese "targeting" policy. The Japanese policy creates a "pressure vessel" in which surplus capacity is built up in a protected environment. Active participation by U.S. firms in local Japanese markets will "decompress" the pressure vessel. The competition which they can mount at the early stages of a product cycle can offset the buildup of Japanese capacity and diminish the prospect of sudden export drives which inflict unanticipated losses on U.S. firms, and ultimately discourage investors.

Securing access to the Japanese market will clearly require serious and difficult negotiations with Japan. For harmony in our trading relations to be assured, Japan must commit itself to a "true liberalization" of its domestic market, and the U.S. and Japan must continually monitor semiconductor merchant trade flows to ensure that the Japanese market really becomes and remains open.

U.S. government monitoring of merchant imports and exports of key semiconductor types is essential to any long-term effort to meet the Japanese challenge, for it will give "early warning" of sudden export offensives and of abrupt "import substitution" of

Japanese for U.S. products in the Japanese market. It will enable the U.S. to verify on an ongoing basis that the Japanese market remains open, that export prices are reasonable, and that the Japanese are adhering to the rules of the international trading system.

The international competitive problem faced by the U.S. semiconductor industry is an urgent one. While U.S. semiconductor firms are attempting to recover from the damage caused in 1980-82, the Japanese electronics industry—under the sponsorship of its government—is making a concerted bid for world dominance of information technology products. The competitive dynamics of the industry ultimately reward the firms that can out-invest, out-produce, and out-innovate their rivals, and in all of those areas the Japanese industry has a government-induced advantage not present in our market economy. The U.S. government and industry must take steps to meet this challenge, and quickly, if the U.S. industry is not to suffer erosion of its high technology advantage, with consequent damage to our economy, our employment, and our future growth potential.

GLOSSARY

Bipolar - One of two types of monolithic integrated circuits (the other is MOS). Bipolar is an older, faster technology formed with p- and n-type silicon which consumes less electricity than MOS.

Bit - Binary digit. A unit of information equal to one binary decision ("yes" or "no", or "1" or "0").

Captive - In the context of this paper, production of semiconductors by a firm for its own internal consumption.

Diffusion - A manufacturing process in which heat is used to cause one material to penetrate another material. In silicon wafer fabrication, desired impurities are diffused into silicon in furnaces.

Dynamic RAM - A semiconductor memory device in which presence or absence of a capacitative charge represents the state of a binary storage element.

EEPROM - An Electrically Eraseable PROM.

EPROM - Eraseable Programmable Read Only Memory. A memory device which permanently stores information used repeatedly, which may be programmed after manufacture, and erased and reprogrammed with new information if necessary (usually by exposure to ultraviolet light).

Gate - A logic element in a digital circuit that has two or more inputs and one output.

Hanagataban - Literally, Japanese for "star edition," a reference to the most popular model or product line in an industry.

Hojokin - In the context of this paper, an interest-free long-term loan which need be repaid only if the technology developed pursuant to the loan generates a commercial profit.

Integrated Circuit - A semiconductor chip containing multiple electronic elements that act together to form a complete device circuit.

Itakuhi - In the context of this paper, a Japanese government grant for R&D.

Keiretsu - An industrial grouping of Japanese firms (usually including a major bank, a trading company, and large manufacturing companies), characterized by interlocking officer-director relationships and cross-ownership of equity.

Japan Development Bank (JDB)	-	A Japanese public corporation charged with promoting prospective "growth" industries in Japan which are regarded as important to national economic policy.
Japan Electronic Computer Co., Ltd. (JECC)	-	A joint venture formed by Japan's leading computer firms. JECC purchases computers from Japanese firms (with public and private funds), and leases them to consumers on favorable terms.
Japan Information Processing Development Center (JIPDEC)	-	A non-profit industry-government association established to promote the advancement of information processing and the information processing industry. JIPDEC conducts surveys, software R&D, and extensive public relations and educational activities.
LSI	-	Large Scale Integration. An integrated circuit containing 100 or more gate equivalents or other circuitry of similar complexity.
Merchant	-	In the context of this paper, a semiconductor firm which produces for sale to outside buyers (not merely for internal use).
Microcomputer	-	A microprocessor complete with stored program memory, random access memory (RAM), and input/output logic.
Microprocessor	-	A single chip large-scale integrated circuit which is the central processing unit of a small computer. It performs all logic and arithmetic operations and controls the operation of other parts of the system (input/output, memory storage).
Ministry of International Trade and Industry (MITI)	-	The Japanese government ministry charged with overseeing Japan's industrial development, foreign trade, and technological development.
MOS	-	Metal Oxide Semiconductor. A transistor or semiconductor that uses silicon dioxide to separate layers of p- and n-type semiconductor material.
PROM	-	Programmable Read Only Memory. A read-only memory which can be programmed after manufacture by external equipment.
RAM	-	Random Access Memory. The basic memory storage element in a computer; stores digital information temporarily and can be changed by use.
ROM	-	Read Only Memory. A device which permanently stores information used repeatedly.
Semiconductor	-	A material such as germanium or silicon that is neither a good conductor nor a good insulator. The basic solid-state device used to amplify or switch electrical current.

VLSI - Very Large Scale Integration. Integrated circuits which contain at least 5,000 logic gates or more than 16,000 memory bits.

Wafer - A thin disk of semiconducting material (usually silicon) on which many separate chips can be fabricated and cut into individual integrated circuits.

Sources: Most of these definitions were derived from FTC Bureau of Economics, The Semiconductor Industry, A Survey of Structure, Conduct, and Performance; and Borrus, Millstein, and Zysman, International Competition in Advanced Industrial Sectors.

APPENDIX A

CHRONOLOGY OF JAPANESE GOVERNMENT ORGANIZATION AND GUIDANCE OF THE SEMICONDUCTOR INDUSTRY

1. Growth of Japan's Semiconductor Industry Under MITI Guidance, 1950-1975

The Japanese semiconductor industry did not emerge as a key focal point for promotional measures until the mid-1970s. Japan's major semiconductor producing firms were also its leading computer and consumer electronics products producers, and semiconductor promotion tended largely to be viewed, at first, as a secondary aspect of the promotion of computer and consumer electronics development. While it is not the intention here to document government policies affecting Japan's computer industry, to the extent those policies are addressed here it is a reflection of the tendency of the Japanese themselves to blur the distinction between the two industries.

The framework for MITI's promotion of the semiconductor industry was laid with the passage of Public Law 117, the Electronics Industry Provisional Development Act of 1957, which formally established MITI's legitimacy as the electronics industry's leader, authorized MITI to exempt computer firms from the antimonopoly laws, and provided for funding of the industry's growth through a variety of special programs.[1/]

In 1970 mounting public indignation against industrial pollution gave rise to the "anti-pollution Diet," which resulted in passage of numerous environmental protection laws and measures designed to improve the quality of life. MITI responded by calling for a structural change in the economy in the direction of more knowledge-intensive industries, including computers and semiconductors—industries which polluted less, reduced

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1/ The 1957 Act's passage coincided with the completion of MITI's transistor computer logic research project begun in 1954. MITI disseminated technology from this project to all interested domestic firms, and in 1957 several firms began producing components. At this point, while rendering various forms of assistance to the computer industry, MITI did not regard its development as an urgent national priority. Its primary "targets" were still growth industries like heavy machinery and automobiles. MITI's concern over promoting its computer industry increased, however, in the 1960s, when a Report (1956) by the Electronics Industry Deliberation Council identified the computer industry as highly important for Japan's future. This report noted the looming importance of certain key technologies, including semiconductors. The report proposed a number of programs (virtually all of which were implemented) including a joint industry/government effort to build a large computer, strengthening of the Japan Electronic Computer Company (JECC), and rationalizing production of peripheral equipment.

Figure A-1

TIMETABLE FOR LIBERALIZATION OF THE JAPANESE INFORMATION INDUSTRY

Product	% of Liberalization		Liberalization of Imports	Liberalization of Technology Imports
	50%	100%		
Electronic Accounting Machines, High-Performance Calculators, etc.	Aug. 4, 1974	Dec. 1, 1975	Apr. 19, 1973	July 1, 1974
Computers				
Main Units	Aug. 4, 1974 1/	Dec. 1, 1975 1/	1975	July 1, 1974
Peripheral Equipment				
Memory Units, Terminal Devices	Aug. 4, 1974 1/	Dec. 1, 1975 1/	1975	July 1, 1974
Other	Aug. 4, 1974 1/	Dec. 1, 1975 1/	Feb. 1, 1972	July 1, 1974
Parts	Aug. 4, 1974 1/	Dec. 1, 1975 1/	1975	July 1, 1974
Software	Dec. 1, 1974	Apr. 1, 1976		July 1, 1974
ICs				
Under 100 Elements	Liberalized 2/	Dec. 1, 1974 2/	Liberalized	Liberalized
Under 200 Elements	Liberalized 2/	Dec. 1, 1974 2/	Apr. 19, 1973	Liberalized
200 or More Elements	Liberalized 2/	Dec. 1, 1974 2/	Dec. 25, 1974	Liberalized

1/ Including ICs for Computers

2/ Excluding ICs for Computers

Source: JIPDEC Computer White Paper, 1977

Japan's dependence on imported raw materials, and strengthened other industrial sectors.[2/]

The same year, Japan bowed to U.S. pressure and committed itself to liberalize access to its domestic computer market—and to permit foreign investment—by 1975. This change in policy inevitably affected semiconductors, which were included in the schedule for liberalization. (The schedule ultimately adopted is depicted in Figure A-1.) MITI's response was to press for rationalization and restructuring of the computer industry to prepare it for liberalization. Its hand was strengthened in this regard by the passage in early 1971 of Public Law 17, the Law for Provisional Measures to Promote Specific Electronic and Machinery Industries,[3/] a statute primarily designed to encourage the development of certain designated industries by improving production techniques, forming cartels, and rationalizing production.[4/]

During this period the Japanese firms were becoming alarmed by the increasing sales inroads in Japan being made by U.S. firms' integrated circuits, particularly large scale integrated circuits (LSIs). The U.S. ICs were cheaper and of better quality than those made by the Japanese firms, and while Japan could place restrictions on imports of such devices, the superior U.S. devices were needed to maintain the competitiveness of Japanese end-products, such as electronic calculators.[5/] Accordingly, MITI warned U.S.

2/ These views are expressed in an interim report by the Industrial Structure Council of MITI, "Trade and Industrial Policy for the 1970s", issued in May, 1971, a document sometimes referred to as the first MITI "Vision"; See J. Gresser, High Technology and Japanese Industrial Policy: A Strategy for U.S. Policymakers (October 1, 1980), p. 26, notes 51-52.

3/ The law was formed by combining the prior 1957 Law Concerning Special Measures for the Promotion of Specific Electronic Industries with the 1956 Law Concerning Special Measures for the Machinery Industry.

4/ The law authorized MITI to adopt a rationalization plan for each designated strategic industry and to issue instructions to industry members, directing them to take concerted (anti-competitive) action if MITI found that this was necessary to achieve its rationalization plans. Such instructions regarding concerted action carried an automatic exemption from the antimonopoly laws, although participation was within certain constraints and was subject to reporting requirements. Three categories of computer and other electronic products were designated by MITI as strategically important: (1) technologies requiring special R&D investment, including those in which Japan was behind, such as integrated circuits; (2) those requiring high volume production because of economies of scale; and (3) those requiring modernization of production systems.

5/ The Japan Economic Journal reported on January 5, 1971 that Japanese IC and LSI firms "doubled as manufacturers of computers and communications equipment" and were themselves dependent on imported American ICs. The inferior quality of Japanese LSIs meant that "stoppage of cheap U.S. imports by any means may invite opposition from Japanese calculator firms." It went on to note that MITI "says
(footnote continues)

semiconductor firms that it was considering leveling dumping charges against them.[6/] It did not, however, restrict imports, but instead pressured the six leading Japanese semiconductor firms (the "Big Six") to work together to minimize duplicative production and to allocate IC specialties among themselves. Thus, in late-1971, the Electronics Industry Association announced the formation of a cartel among its members, governing the production of integrated circuit products.[7/]

By the end of 1971, the Big Six had reorganized themselves into three paired groupings of "tie-ups"—NEC-Toshiba, Oki-Mitsubishi, and Fujitsu-Hitachi.[8/] Within each paired grouping, the partners agreed to avoid duplicative production, and to divide up responsiblity for production of specific product types.[9/]

One of MITI's primary goals in encouraging these paired groupings was a joint effort by the Big Six to develop a computer system based on large scale integrated circuit (LSI) technology[10/] superior to the then-dominant IBM-370, which used IC but not LSI technology. Significantly, the emphasis of this program was still on the development of a complete computer system, rather than new semiconductor technologies. It was hoped

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domestic production of LSI is still too small for controlling imports." See also Japan Economic Journal, September 29, 1970.

6/ Ibid.

7/ The Japan Economic Journal reported on December 14, 1971 that

> The cartel is aimed at sharing production of certain types of products, raising productivity and lowering costs owing to the aggressive competition of U.S. makers lately in the IC field.... The association hopes to clarify the reason for Japanese makers being judged to be about one year behind their American counterparts in this field and the common troubles being experienced by them. After this, the association intends to probe how makers are handling production and sales and find out the products in which they individually excel, particularly as the scope of the planned cartel is due to be wide ranging from linear ICs used for electric appliances to MOS LSIs for desktop calculator use. On the basis of such survey, the association intends to work a cartel which will have a maker producing a type of IC product at the lowest cost undertake commissioned production for others.

Japan Economic Journal, January 5, 1971; See also Denshi Buhin, December 12, 1971; Nihon Kogyo, January 8, 1972.

8/ Japan Economic Review, December 15, 1971.

9/ See, e.g., Nihon Kogyo Shimbun, February 19, 1974.

10/ LSI refers to ICs containing 100 or more logic gates or circuitry of similar complexity.

that the latter would be developed subsequently as a by-product of the new computer system.[11] However, this program was ultimately undercut by U.S. firms' unanticipated introduction of low-cost, efficient, high performance LSI-based mainframes in the mid-1970s.[12]

The oil crisis of the mid-1970s shook Japan and led to a further reevaluation of its industrial policies and priorities. In 1975 MITI released Japan's Industrial Structure: A Long Range Vision, in which it indicated that the "knowledge-intensive" industries were now the key to Japan's economic future. Development of these industries would reduce Japan's dangerous dependency on imported raw materials, ensure continued high economic growth, produce an improved quality of life, and strengthen all other sectors of Japan's economy.[13]

The year 1975 saw an intensive effort by MITI to regroup the computer/semiconductor industry in preparation for liberalization. In the wake of the frustration of the joint effort to develop a computer superior to the IBM-370, the Japanese for the first time placed unprecedented emphasis on the development of new semiconductor technologies, particularly Very Large Scale Integrated Circuits (VLSI).[14] The LSI computer failure had clearly convinced MITI of the central role of semiconductors in the competitive struggle for international superiority in computers, and throughout 1975 the government struggled to reorganize the industry to permit a coordinated drive to develop VLSI technology. This would mean pooled resources, division of tasks among the various firms, and sharing of information—i.e., the same techniques that had been employed, under government pressure, prior to liberalization. In April 1975, NTT formed a governmental corporation comprised of three "super-large" producers—Hitachi, Fujitsu, and NEC—to

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11/ M. Borrus, J. Millstein, and J. Zysman, International Competition in Advanced Industrial Sectors: Trade and Development in the Semiconductor Industry (February 18, 1982), pp. 86-87; Gresser, op. cit. pp. 12-13; Japan Economic Review, May 15, 1973, p. 12.

12/ This innovative U.S. technology secured for the U.S. a dominant world market position in LSI-based computers—the market at which the Japanese program had been aimed—and thus thwarted the goals of the Japanese program. See JIPDEC Report, Summer 1978, p. 34; Borrus, Millstein, and Zysman, loc. cit.; JIPDEC, Computer White Paper 1980, p. 5.

13/ Gresser, op. cit., p. 19.

14/ The Japan Economic Journal reported on September 23, 1975 that

> For this period (1976-83) the five computer makers will invest a total of Y250 billion, including the cost for development of ultra-large scale integrations. Of the total fund, Y45 billion will be met with a governmental subsidy.

Fully one-third of this total fund was to be committed to VLSI development.

undertake development of LSIs for a computer system designed to be competitive with IBM's Future System.[15/]

During the spring of 1975, MITI pressured NTT to consolidate its VLSI developmental efforts with its own VLSI program, which was then being conducted at MITI's Electro-Technical Laboratory. At the same time MITI encouraged talks among the producer firms concerning joint research and development of VLSI technology.[16/]

At length, in July 1975, MITI and NTT agreed to consolidate part of their ongoing efforts, joining with five semiconductor producers in the creation of the VLSI Association.[17/] This Association placed the Japanese industry in a position to pool their VLSI

15/ The Japan Economic Journal reported on April 15, 1975, that

> Up to now, the three have been trying to develop such an LSI individually. This means that they are now going to unify their activities.... The corporation will offer technological assistance and promote exchange of know-how among the computer makers on the basis of results attained by the joint research machinery to be set up. The corporation will offer joint facilities for the use of the makers.... In the long range, MITI is known to be intending to go on further to achieve a fresh revamping of the industry structure.

16/ On July 1, 1975 the Japan Economic Journal reported that Hitachi and Fujitsu had agreed on a joint R&D effort, and were negotiating with Mitsubishi concerning possible participation:

> Possible points of their agreement are:
>
> - Concentrating both firms' researchers at one place to have them conduct intensive research.
>
> - Jointly manufacturing a prototype next generation computer on the basis of the ultra-large scale integrations to be developed.
>
> - Equally sharing development funds, rights and tasks relative to joint research projects.... They now intend to form a joint research organization and enter into official talks with Mitsubishi Electric Corp., their possible research partner, on the project after the Ministry of International Trade & Industry and Nippon Telephone Telegraph Public Corporation jointly determine the gist of their proposed ultra-large scale integration development program.... The tri-company move is being closely watched as it falls in line with the International Trade & Industry Ministry's plan to unify domestic computer makers into two groups: Hitachi-Fujitsu-Mitsubishi and Nippon Electric-Toshiba.

17/ Japan Economic Journal, July 1, 1975 & July 29, 1975; Gresser, op. cit., pp. 15-16.

R&D efforts against the U.S. in the "liberalized" late 1970s--sharing information, dividing developmental tasks, and reducing R&D costs.[18/]

2. The VLSI Project, 1976-79

The VLSI research and development program, which began in 1976 and was completed in 1979, was central to Japan's post-liberalization competitive strategy. The VLSI program's methods were similar to those employed during the pre-liberalization period: division and allocation of specific developmental tasks between and among the various firms under government supervision, thus eliminating the inefficiencies associated with competition and duplicative research.

a. Organization

MITI, NTT, and the five major semiconductor firms (Toshiba, Hitachi, NEC, Mitsubishi, and Fujitsu) jointly formed the VLSI Development Association ("VLSI Association"), headed by Hitachi President Yoshiyama.[19/] The VLSI Association was the vehicle for the allocation of funds (public and private) to individual VLSI projects, and served as the coordinating body for the whole effort.[20/] Operationally, the project was

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18/ On the eve of liberalization, on November 18, 1975, the Japan Economic Journal reported that

> Key domestic computer makers, however, do not seem to be feeling much of a tangible threat from (liberalization) although some concede they have some misgivings about what might happen. Behind their self confidence is the fact that they successfully have prepared themselves for the total exposure to international competition through efforts of their own and heavy government financial assistance aimed at fostering a domestic computer industry.... Another encouraging thing to domestic makers is the program for development of ultra LSI to be launched next fiscal year with subsidy from the Ministry of International & Trade Industry.... Under the guidance of the Ministry of International Trade & Industry, two groups of makers have been formed for the development of such LSI.

19/ Nihon Keizai, May 9, 1977.

20/ The program's stated goals were

1) development of micro-fabrication methods to handle sub-micron lithography, especially electron beam and x-ray techniques, rather than traditional photo lithography methods;

2) development of low-defect large diameter silicon wafer substrates;
(footnote continues)

divided among three cooperating laboratory groups, a central research laboratory responsible for developing the basic VLSI component and manufacturing technology and two computer applications laboratories responsible for developing applications for the new technologies in two independently developed lines of computers.

The central research, or "Cooperative Laboratory," located at NEC's facilities in the Tokyo suburb of Kawasaki, focused on basic research. It was staffed by representatives of all five participating chip manufacturers and members of MITI's Electrotechnical Lab ("MITI Lab").[21/]

Two other VLSI "laboratories" conducted applications research intended to develop marketable products and systems from the technologies developed by the Cooperative Lab. These "labs" were actually independent, jointly-owned companies which were organized to coordinate the applications research efforts under way in the laboratories of the five participating chip manufacturers. Staff was drawn from the respective participating companies.[22/]

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3). development of improved computer-aided design technology;

4) development of improved, LSI micro-fabrication processing techniques and equipment;

5) development of VLSI evaluation and testing techniques and equipment; and

6) definition of logic and memory devices that could utilize all of the above elements.

BA Asia Ltd. The Japanese Semiconducter Industry; An Overview (1979), p. 122; Nihon Keizai, February 28, 1980.

21/ Yasuo Tarui, former director of the semiconductor device section of the MITI Lab, ran the Cooperative Laboratory with a staff of about 100 personnel. The lab conducted research into every aspect of basic semiconductor technology -- microfabrication, crystal technology, semiconductor design, process technology, test and evaluation techniques, and device design. Director Tarui felt he was able to select from the cream of Japan's research talent in staffing the Cooperative Lab, and that all participating companies benefited greatly by having their top researchers exposed to the Cooperative Lab's advanced technology. Electronics, June 9, 1977, p. 61.

22/ Significantly, the two groups developed different (i.e., non-duplicative) technologies in their respective efforts, reflecting a planned "division of labor" by the collaborating firms. Thus, one applications lab, the Computer Development Laboratory, was set up to coordinate the activities of Fujitsu, Hitachi, and Mitsubishi in developing techologies for IBM-compatible computers in three corporate laboratories. The second, NEC-Toshiba Information Systems, Inc. (NTIS), coordinated the efforts of NEC and Toshiba in developing technologies for non-IBM compatible computers in six separate corporate laboratories. Electronics, June 9,
(footnote continues)

3. Acquisition of U.S. Technology

A major portion of the VLSI program was aimed at helping Japanese firms catch up to the U.S. industry in terms of production capability for advanced integrated circuits. Pursuant to this objective, the Japanese sought access to advanced U.S. equipment types and technological knowledge. According to one source one-third to one-half of the VLSI program's entire budget was spent on the acquisition of the most advanced semiconductor manufacturing and test equipment from U.S. equipment manufacturers. In 1976, soon after the program was launched, U.S. suppliers of virtually all types of state-of-the-art LSI production equipment reported a surge of Japanese orders for

> automatic direct digital control furnaces, tape carrier gang bonders, LSI testers, mask alignment systems and related equipment, plasma strippers and etchers, implantation equipment, CVD equipment, and practically everything needed for new generation devices.23/

U.S. equipment suppliers noted that the Japanese firms participating in the VLSI program were placing orders for production/test equipment at double the rate of non-participating firms, and that the demand for such equipment resulting from the VLSI program was much heavier than anticipated.24/ Heavy production/test equipment purchases continued for the duration of the VLSI program.25/

1977; Magaziner and Hout, Japanese Industrial Policy, p. 104. NTIS was originally a joint NEC-Toshiba marketing venture launched in 1974. Its articles of incorporation were amended in 1975 to stress VLSI development.

23/ Borrus, Millstein, and Zysman, op. cit., p. 55; Electronics News, September 27, 1976, p. 1; See also Electronics News, July 19, 1976. Nihon Keizai reported on May 9, 1977 that with the acquisition by the Association of equipment such as a new electron beam device, a "diffusion furnace," and process equipment, work could begin in earnest.

24/ In addition to the items cited above, Japanese equipment purchases included advanced pattern generators, photo-repeaters, wafer processing equipment, automatic in-line wafer fabricating systems, microetching systems, leak detectors, automatic wafer probes, probe cards, and implantation equipment. Electronics News, July 19, 1976.

25/ Electronics News, October 9, 1979.

4. Results

The VLSI program ended in 1979.[26] By the end of that year the VLSI Development Association had succeeded in developing 1000 patentable technologies.[27] The primary technical achievements of the program included numerous significant advances in electron beam lithography, a critically important technique which utilizes variable shaped electron beams to etch microscopic circuit lines on chips.[28]

The program benefited the Japanese semiconductor industry above and beyond the specific technologies developed. Most importantly, the program freed up company funds which would otherwise have been required for R&D and for production capacity expansion. Major R&D savings were possible not only because the government subsidized much of the research, but because government coordination eliminated duplicative research by individual firms, permitting more efficient use of research personnel and more rapid and widespread diffusion of basic research findings.[29]

26/ The VLSI Association remained in existence to focus on software development. Administrative offices were transferred from NEC's facilities to the "OS Association," Mita International Building, Tokyo. Nihon Keizai, February 28, 1980.

27/ Japan Economic Journal, September 2, 1980.

28/ Use of these beams makes possible much finer circuitry than is feasible under conventional methods utilizing light beams on photosensitive silicon. This technology will be essential to the development of chips of higher density than the 64K RAM--i.e., the next generation of VLSI technology, the 256K dynamic RAM. See Nihon Keizei, February 28, 1980. Hitachi designed a machine for tracing circuits with magnetically focused electron beams capable of drawing circuit lines as thin as 0.75 microns, a substantial reduction from the then-current average line width of 2.5 to 3.0 microns. Fujitsu designed a machine capable of focusing an electron beam capable of drawing a line a mere 0.5 microns across, while Toshiba produced a similar machine with a variable beam for drawing the masks used for printing chips, and managed to reduce the width of beams even further to 0.3 microns using super conducting magnetics. At the time (1980), IBM scientists were saying that lines so fine probably represented the physical limit of miniaturization. The Economist, April 5, 1980, p. 75.

29/ This is a significant advantage. In 1977 a Texas Instruments executive calculated that his firm alone would probably spend as much R&D money on VLSI and VLSI-related programs as the combined Japanese industry and government during the same period. Electronics, June 9, 1977, p. 100.

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5. Sharing Of VLSI Technology

Japan has been recalcitrant in sharing technologies developed through the VLSI program, particularly with foreign firms. Until 1978 American firms, including wholly-owned subsidiaries in Japan as well as U.S.-Japanese joint ventures, were flatly prohibited from licensing patents developed under the VLSI program. In 1979 a limited exception to this prohibition was introduced: the VLSI Association would license those patents which had been developed by researchers on loan from the five Japanese chip manufacturers. However, it is not clear that this measure will significantly enhance the availability of VLSI Association patents to U.S. firms.[30/]

6. Current Programs

The VLSI Program has been succeeded by a series of new joint industry-government semiconductor R&D programs. These programs are comparable to the VLSI Project in that they are government-funded and supervised, and feature "division of labor" among the participating firms. However, the projects are also of a longer duration and are open to "second-tier" firms, not merely the traditional industry leaders. As with earlier semiconductor R&D projects, some of the new joint efforts are being undertaken pursuant to efforts to design more advanced computers.[31/]

a. Supercomputer (high speed logic/memory subprogram)

The purpose of this program is to develop high speed computer elements capable of extensive parallel processing. One subproject is the development of high speed logic and memory elements, considering alternatives to silicon semiconductor technology, including Josephson Junction elements, high electron mobility transistors (HEMT), and

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30/ Under the terms of 1980 amendments to the Foreign Exchange Control Act, no single Japanese company can grant a license for a patent flowing from the VLSI program without prior government approval. Thus far, only Texas Instruments and IBM have received licenses for VLSI patents. It took from 1978 until 1980 for these firms to negotiate licensing agreements, and the final agreements tied the VLSI patent licenses to cross-licenses in other areas. Thus, the VLSI program may well become the prototype for future Japanese government actions restricting the outward flow of Japanese technology. Furthermore, it is not known whether patents developed by governmental researchers, or jointly by government and private sector personnel, can be licensed to U.S. firms. See Gresser, op. cit., p. 30; W. F. Finan, "The Exchange of Semiconductor Technology between Japan and the United States", p. 70.

31/ Much of the information set forth below is derived from a cable sent by the U. S. Embassy in Tokyo in May 1982.

gallium-arsenide field-effect transistors.[32]

b. Optoelectronic Integrated Circuits (OEIC)

This project seeks to integrate both optical and electronic elements monolithically on an IC--a goal which will require a new technology of integration. While the official goal of this project is technologies that permit improved data transmission and monitoring and control of industrial processes, MITI reportedly seeks to use the project to help it build a "dream computer," using light, rather than electricity, as a medium of information transfer.[33]

Nine private companies are participating directly in R&D;[34] five others are members of a "Research Association," the Optoelectronics Joint Research Laboratory (OEJRL) that is part of the project's administration. The nine leading firms plus MITI scientists are participating in joint research at Fujitsu's laboratories in Kawasaki.[35]

c. New Function Elements

The purpose of this program is to advance basic semiconductor technology, specifically, (1) development of extremely fine lattice-structured elements capable of very high computation speeds at room temperature; (2) development of devices with a three-dimensional structure which increases greatly the number of elements on one chip; and (3) the development of devices capable of functioning in extremely hostile environments (inside atomic reactors, in space, in automobile engines).

32/ Nikkei Sangyo Shimbun, November 5, 1981, predicted:

> The moves for carrying out the super-computer development project through virtual cooperation between the government and private circles will probably come to irritate concerned manufacturers in the U.S. and other countries.

33/ Japan Economic Review, September 19, 1981.

34/ NEC, Toshiba, Mitsubishi, Matsushita, Fujitsu, Hitachi, Oki, Sumitomo, and Furukawa.

35/ MITI hires the OEJRL on a contract basis to do research on its behalf, covering all expenses with non-refundable government consignment payments ("itakuhi"). Results will be made available to "related industries." Patents will be government property, which MITI will license upon application. U.S. Embassy, Tokyo.

The ten participating companies have formed the "Research and Development Association for Future Electron Devices." MITI has contracted with this group to conduct R&D (fully funded by the government) in the same fashion as it did with the OEIC--i.e., via "itakuhi" payments. The project has been divided into three subprojects, with the participating firms dividing the R&D tasks among themselves.

Subproject	Firms	
1. Develop laminating techniques capable of building multi-layered devices in which each layer is about one atom thick; reduce cathode-to-anode distance to within 5000 Angstroms.	Fujitsu Hitachi Sumitomo	
2. Develop methods of incorporating IC elements onto a chip in layers	NEC Oki Toshiba Mitsubishi	Sanyo Sharp Matsushita
3. Design ICs capable of withstanding extremes of heat and radiation.	Toshiba Mitsubishi Hitachi	

7. Current Legal and Policy Framework for Industry Organization

Shortly after the VLSI Project was launched, Japan extended the legal framework that had sustained the growth of its computer/semiconductor industry in the pre-liberalization era. Public Law 17, the 1971 Extraordinary Measures Law for the Promotion of Specific Electronic and Machinery Industries ("Kidenho") expired in 1978. It was immediately replaced by the Public Law 84, the Law for Provisional Measures for the Promotion of Specific Machinery and Information Industries ("Kijoho") which will remain in effect until 1985. For the most part, the 1978 Kijoho simply extended MITI's authorities originally delegated under the 1971 Kidenho, and maintained the same basic goals, except that increased emphasis was placed on developing "leading edge" technologies, and the software industry was included with the electronics and machinery industries. The law made provision for specifying technologies to be developed. The 1978 Cabinet order implementing this law designated computers and integrated circuits as among the leading edge products to be developed.[36/]

The Kijiho provides the government with a panoply of powers for the promotion of advanced electronic industries in Japan. It continues the traditional three-pronged approach of Japanese industrial policy.

36/ GAO, Industrial Policy: Japan's Flexible Approach (June 23, 1982), pp. 50-51.

First, the Kijiho emphasizes an "aggressive promotion of technological development"[37/] in electronics through heavy subsidization of commercial research and development. "Elevation" plans have been promulgated for research and development of electronic digital computers, semiconductor elements, and ICs.[38/]

Second, the 1978 law provides for Japan Development Bank and other government financing for the targeted industries in order to promote industrial production ("strengthening the manufacturing base").[39/]

Third, the 1978 law designates specific industries for "rationalization". These are industries in which technology and production are already established. The objective of the rationalization plans is to set performance and efficiency targets, ensure that the industry is structured to meet these targets, promote standardization of production, and attempt to gauge the needs "in each demand field through establishment of a cooperative regime with users and other purposes." Production of both semiconductor ICs and hybrid ICs are targeted for "rationalization," with projected expenditures through 1984 of 250 billion yen and 30 billion yen, respectively.

In addition to providing funding for R&D, industrial production, and rationalization of targeted sectors, the Kijiho, like the 1971 law, gives MITI the authority to exempt industry cartels from the antimonopoly law and, in certain instances, to force individual producers to comply with the rationalization plan worked out for particular sectors. The Kijiho also continues tax benefits for the use of specific Japanese electronic devices.

37/ This synopsis of the Kijoho is derived primarily from the Commentary on the Temporary Measures Law for Promotion of Designated Machinery and Information Industries by MITI's Machinery and Information Industry Bureau.

38/ In each case, the plan sets out detailed objectives (general computer to package LSIs with more than one million bit memory elements, larger than 10,000 gate logic elements etc.), a target completion date, and funding requirements. Four hundred fifty billion yen were earmarked to develop a general digital computer, 50 billion yen for minicomputer development, 100 billion yen for office computers, 1.5 billion yen for certain high performance silicon semiconductor elements, 400 million yen for certain high performance compound semiconductor elements, and 9.2 billion yen for certain ICs. The target dates for completion range from 1982 (silicon and hybrid semiconductor elements) to 1984 (computers and ICs).

39/ Digital computers and semiconductor ICs are designated as eligible industries for government aid and, in fact, are among the handful of "top priority" areas. As a result, these sectors are eligible for loans at the most favorable interest rates. The "industrialization" plans for digital computers and semiconductor ICs project expenditures of 15 billion yen and 25 billion yen, respectively, with specific output targets established for 1984.

Beyond the formal measures set out in the 1978 law, the law provides a general framework (e.g., through industry-government councils) for continued close cooperation between the government and industry and within the industry. As before, the industry is instrumental in shaping government policy, and "administrative guidance" by MITI is instrumental in shaping industry actions.

The Kijoho directs MITI to prepare an "advancement plan" for electronics technologies requiring accelerated R&D. To enable MITI to implement such plans,

1) MITI is given authority to procure the necessary funds to implement the plan;

2) MITI is authorized to direct firms to cartelize R&D efforts ("practice concerted acts with respect to the restriction of standards or the restriction of technology") as necessary to accomplish the target set for rationalization;

3) MITI is authorized to compel reluctant firms to participate in a cartel if nonparticipation would interfere with industry rationalization;

4) Such cartels are exempted from the antimonopoly laws;

5) MITI may order companies planning to enter a particular field to change their plans.

In July 1979 MITI released its Draft Trade and Industrial Vision for the 1980s. The ultimate goal of MITI was now seen to be economic and energy security for Japan, and the key to such security was seen as the computer industry, including semiconductors, components and manufacturing equipment. This was so for a number of reasons:[40/]

1) Growth. The computer/semiconductor industry was one of established excellence. It was projected to expand rapidly, generating jobs and revenue.

2) Pervasive impact on growth industries. Semiconductors and computers are becoming essential to many new growth industries—robotics, telecommunications, aerospace, biological engineering, machine tools, nuclear energy. Synergy of these industries and their dependence upon semiconductors and computers will create vast economies of scale that will generate manifold benefits for the economy.

3) Revitalization of depressed industries. Computers and semiconductors can strengthen and revitalize depressed industries, replacing excess labor with automated devices, reducing costs, improving fuel efficiency, and systematizing operations.

40/ Gresser, op. cit., pp. 20-21.

4) Improved quality of life. MITI sees the computer as the key to a much higher quality of life, helping reduce pollution, conserve energy, and improve health services.

Thus by the late 1970s, Japan had staked its future on the computer, and was implementing policies that were designed to ensure that its computer/semiconductor industry would achieve a position of international competitive pre-eminence, if not dominance, in the 1980s.

APPENDIX B

ASPECTS OF JAPANESE GOVERNMENT FINANCIAL ASSISTANCE

The Japanese government's financial assistance to its semiconductor firms has been described in the foregoing paper. This Appendix provides additional information with respect to some of these forms of assistance.

1. Role of Japan Development Bank (JDB) Loans

The Japan Development Bank (JDB) is a public corporation which is generally regarded as having a central role in assisting prospective growth industries. It is the instrument for direct government loans for "industrial development and economic and social progress," and operates under a "basic policy for employing government funds for investment in industrial equipment and facilities" laid down at the beginning of each fiscal year by the cabinet.[1/] In the bank's words, it:

> (w)as expected to...(supply) long-term funds from time to time to the areas considered important by the national policy standard.2/

As Philip H. Trezise of the Brookings Institution recently noted:

> Beyond its immediate role as a long-term lender, the JDB was seen by the MITI as a 'catalyst encouraging the types of industrial development aimed at by government policy.' A JDB loan, that is, would be a signal to the commercial banks that the government favored the expansion of this or that industry.3/

The JDB draws money from the government's postal savings scheme, the Fiscal Loan and Investment Program, which is a major repository of individual "household" type savings deposits.[4/] The JDB loans these funds to "favored" industries and enterprises at

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1/ JDB International Department, "Functions and Activities of the Japan Development Bank" in Trezise and Suzuki, "Politics, Government, and Economic Growth in Japan", in Asia's New Giant (Brookings, 1976), p. 795.

2/ Ibid.

3/ Trezise and Suzuki, loc. cit.

4/ Through its tax policies and limits on branch banking, the government has made it more remunerative and convenient for small savers to deposit their savings with the postal savings system—with 20,000 post office branches—than with banks. GAO, Industrial Policy: Japan's Flexible Approach (June 23, 1982), pp. 10-12; Sakakibara, Feldman, and Harada, The Japanese Financial System in Comparative Perspective (1982), pp. 40-41.

below-market rates of interest, usually through a public corporation. Thus, it serves to funnel private savings to favored industries at discounted rates. These funds are significant for their own sake, and as a symbol of MITI's "favor" to the recipient.

As noted in the preceding paper, JDB has made numerous low-interest loans to promote the development of the computer/semiconductor industry. The JDB continues to make such loans. In February 1982, MITI's Machine and Information Industries Bureau reported that 51.5 billion yen in JDB loans would be made available to the industry in 1982:

> (B)ecause it was decided to implement two years' portion of the gradual tariff reduction agreed on at the Tokyo Round, which included tariff on computers, a harsher market situation for fragile domestic producers can be expected. Under this circumstance, in order to secure a long-range developmental base for the computer industry of our country, it is decided to continue the Development Bank loan with most favored customer interest rate for the JECC which is a joint rental company. In addition, for the purpose of improving industrial structure, the Development Bank loan will be continued for computer producers.5/

JDB loans have helped Japanese firms raise additional private capital in the form of bank loans at attractive interest rates. Because of government-imposed controls, stocks and bonds did not develop as a significant source of capital for Japanese firms. However, until well into the 1970s, the government was able to hold interest rates at an artifically low level, reducing the cost of raising capital through bank loans. Access to low-interest loans encouraged investment, made long-term investment less risky, and resulted in a very high leverage ratio in most Japanese firms. Inevitably too, artificially low interest rates generated an excess demand for loans, and made possible a system of credit rationing directed by the government.6/

The rationing mechanism was exercised primarily through Japan's 13 city banks, which have a national branch system and are the primary lenders to Japan's industrial corporations, including the leading Japanese semiconductor firms. These banks, facing strong demand for loans at low rates, "overloaned" to industry; that is, they allowed their external liabilities to exceed their total deposits. This forced them to turn to the Bank of Japan to cover their commitments. The Bank of Japan is under the guidance of Japan's Ministry of Finance, and its criterion for providing the extra funds sought by the city banks is that the loan policy of the city banks be in accordance with government

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5/ Machine & Information Industry Bureau, Points of Emphasis in Policy Implementation for FY 1981, pp. 1-5. (SIA translation)

6/ GAO 1982, op. cit., pp. 8-9; GAO, U.S.-Japan Trade, Issues and Problems (1979), p. 185. The dependence on bank loans, known as "overborrowing," has resulted in a proportion of debt financing roughly twice as great as that in other industrialized countries. GAO 1982, op. cit., p. 9.

priorities. Thus the monetary authorities had a great deal of influence over the allocation of credit--determining who received it and who did not--based on the government's industrial policy goals. A JDB loan was a particularly good indicator that the particular firm was "favored" by the government.[7/]

To be sure, other manifestations of government "favor" toward a particular sector were also significant--for example, the "targeting" of particular industries for growth by the government, MITI's "Visions" and "Extraordinary Measures" laws. These indicators of favor by the government were signals to the city banks that investments in these sectors were good long term risks.

2. Promotion of Computer Rentals and Sales

One of the Japanese government's major contributions to its semiconductor industry has been its major efforts to promote sales and rentals of computers. In the early 1960s MITI organized a consortium of Japan's seven leading computer manufacturers to overcome the problem of the high cost of computers as an obstacle to domestic sales. They formed the Japan Electronic Computer Company (JECC), a quasi-governmental joint venture which bought computers from Japanese producers and then leased them to end-users. JECC enjoyed substantial debt capacity because of its seven-firm backing and governmental affiliation; while it borrowed from private sources, its largest single creditor was the Japan Development Bank. JECC thus provided manufacturers with a ready-made market for their product (in 1970 it purchased $250 million

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7/ The banks thus naturally have tended to look for manifestations of governmental policy in determining their allocation of credit to particular customers. As the General Accounting Office noted in 1979, in describing one such manifestation,

> Commercial banks were able to get an explicit "reading" of the industries and companies which the government wished to favor from noting the companies to which the Japan Development Bank (JDB) made loans. The government made no attempt to supply all of the needs of companies in strategic industries through the JDB. In fact, the Bank's loans were typically but a fraction of the firms' credit needs, but the JDB loan meant that the large commercial banks would then give these firms priority for funds.

GAO 1979, loc. cit.; GAO 1982, loc. cit. JDB loans for investment in various computer/semiconductor projects must be made on the recommendation of MITI, which decides "whether or not their proposed plans are necessary to achieve appropriate production scales, work collaboration, specialization, and other items for rationalization, selects qualified corporations and makes recommendations for loans to Japan Development Bank." MITI, Implementation of the Temporary Measures Act for the Promotion of Certain Machine and Information Industries, Section 3(1)(4).

worth of computers), relieved them of excessive inventories and the need to assist in the financing of sales, and promoted the use of computers throughout Japanese society.[8/]

JECC was designed to provide an outlet for Japanese-built computers, but it served indirectly as an important source of demand for the semiconductor industry as well, because of a JECC rule that severely limited the value of foreign components that could be included in computers bought by JECC. In order to benefit fully from JECC, Japanese firms were required to utilize a high percentage of domestically produced components assuring a continued outlet for their production.[9/]

JECC served as a major conduit for financing of the industry, channeling small "household" savings deposits to favored firms under the direction of the Japan Development Bank. One-third of JECC's computers were bought with loans received from the JDB at rates about one percent below market rates. These funds, drawn largely from the Postal Savings deposits, were not only a form of indirect subsidy by the government, but were a "signal" to the city banks that loans to a corporation that had been so blessed by JDB were "safe." Accordingly, JECC was able to borrow most of the rest of its funds from the city banks. In 1978 the gross value of JECC's rented assets was approximately Y400 billion.[10/]

As a conduit through which the Japanese government could pump massive funding into its computer industry, JECC served as an instrument not only of promotion, but also of leverage and control. JECC was the only company leasing Japanese computers, and in order to gain access to JECC's funds, the Japanese producers had to accede to conditions fixed by MITI. MITI used this leverage to promote the advancement of the industry as a whole, notably through its "fixed prices" and "buyback" policies.[11/]

> Fixed prices. JECC's computer purchase and lease prices were fixed, in effect eliminating price competition between producers. Thus the only way firms could improve their profits was by increasing market share--and because of price controls, market share expansion could be achieved primarily by improving computer quality. As a result, Japanese computer firms battled to produce the highest quality, rather than the

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8/ E. J. Kaplan, Japan: The Government-Business Relationship (U.S. Commerce Dept., 1972), pp. 87-88; JIPDEC Report No. 27 (1976), p. 4.

9/ L. D. Helm, The Japanese Computer Industry: A Case Study in Industrial Policy (M.A. Thesis, University of California at Berkeley, 1978), p. 102. In 1966, MITI recommended that Japanese computer manufacturers make their computers at least "90 percent Japanese," and in 1968 the Electronics Industry Deliberation Council recommended that JECC purchase only those computers that were 90 percent Japanese. Industrial Japan, July 1968, pp. 33-34.

10/ Magaziner and Hout, Japanese Industrial Policy (1980), p. 105; Helm, op. cit., p. 102.

11/ Helm, loc. cit.

lowest priced computers. The producers were prevented from competing with each other through the use of high quality foreign-made components—a JECC rule limited the value of foreign components that could be included in computers bought by JECC.12/ This served to protect domestic semiconductor producers from competition from superior U.S. made devices.

"Buy-back." JECC had a requirement that computer manufacturers buy back at book value from JECC computers that were returned by customers.13/ Thus, JECC could continue to buy the producers' newest models and rent them to consumers at low prices. This measure eliminated the risk to customers of buying a computer that might quickly become obsolete—it could be returned at any time with no penalty.

JDB's funding of JECC has clearly been seen by the Japanese government as a competitive advantage in the struggle for market share with U.S. firms. Thus, following liberalization, JDB assistance to JECC was stepped up as a counter to the perceived threat of U.S. competition.14/

12/ Ibid.

13/ As technology advanced rapidly in the 1960s, the resale value of computer equipment fell well below book value, placing a financial burden on manufacturers. Accordingly, MITI and the Ministry of Finance developed a tax reserve in which a percentage (first 10, later 20) of the original selling price to JECC could be reserved from taxable income against future estimated trade-in losses. After five years, the reserve had to be put back into the company's income stream. The tax impact of this measure peaked in 1972, when Y10.3 billion yen was saved by Japanese firms. The drain on the budget was so great that the provision has been modified; in 1977, Y3 billion was saved. Magaziner and Hout, loc. cit.; p. 105; Kaplan, op. cit., p. 88; JIPDEC Report No. 27, p. 4.

14/ The Japan Information Processing Development Center (JIPDEC) reported in its 1977 edition of Computer White Paper that

> Now that capital investment in the computer industry and the import of computers were completely liberalized in 1975, these (JECC) loans are expected to take on even more significance since IBM and other foreign computer manufacturers are now expected to intensify their activities in Japan.
>
> Thus in order to insure the position of Japanese computer manufacturers in a market which is expected to expand along with the rapid advances in data processing, and to strengthen the foundation of the domestic manufacturers, the amount of loans from Japan Development Bank to JECC is being further increased.

3. Tax Advantages

The government of Japan has promoted development of its computer/semiconductor industry through a number of significant tax advantages for producers and consumers. Most of these advantages have been provided for in the Basic Electronics Industry Development Law, enacted in 1957 and reenacted every seven years. Some of the most important of these advantages include:

- accelerated depreciation for production equipment. Facilities used in the production of newly developed technologies may be depreciated in the first year by an amount equal to one-third of the initial book value of the facilities, in addition to normal depreciation. MITI must determine eligibility for this benefit; in doing so, it takes into account the international competitive position of the product.15/

- accelerated depreciation for computer purchase and use. Japanese firms which build new high-quality plants or equipment with which an electronic computer utilizing at least a 1 million bit memory is combined get a special 20 percent depreciation allowance in the first year, in addition to normal depreciation. This provision effectively reduces the computer's asset book value by 20 percent, lowering the user's tax base. This not only encourages computer use, but reduces the risk of investing in technologies that may quickly become obsolete—in effect encouraging plant modernization for higher productivity and quality sooner than the market would warrant. This provision enables purchasers to write off over 52 percent of investment costs in the first year.16/

- Deductions for R&D. 20 percent of the increase in expenditures on wages, materials, and other expenses incurred in the course of R&D may be deducted from corporate taxes. "R&D" includes work to manufacture new products, improve design, or devise new techniques.17/

- Export promoting tax measures The Japanese government has employed a variety of tax incentives to promote exports. These are summarized in Figure B-1.18/

15/ Gresser, op. cit., p. 24.

16/ Computer White Paper (JIPDEC) 1976; Helm, op. cit., pp. 93-94; Gresser, op. cit., pp. 24-25.

17/ Gresser, op. cit., p. 25.

18/ Magaziner and Hout, op. cit., p. 97.

Figure B-1

EXPORT PROMOTING TAX MEASURES

Dates When Measure Was in Operation	Measure
1953-1964	Export income deduction. This measure directly shielded export income from taxation.
1953-1959	Export loss reserve system. A reserve against the possibility of cancelled export contracts was non-taxable.
1953-1959	Special depreciation for overseas offices of trading companies. All depreciable assets in a new office overseas were subject to a 50 percent write-off the first year.
1959 to present	Technology export income deduction. Companies are allowed to deduct a portion of royalties paid from abroad from their taxable income. The objective is to stimulate saleable technology development.
1964-1972	Overseas market development reserve. A small portion of the revenue from current exports can be put into reserves from taxable income. Like all Japanese reserves, this must later be returned to the income stream. This provision still applies for small businesses.
1964 to present	Overseas investment loss reserve. A small percentage of current foreign investment expenditure each year can be put into reserve to insure against investment losses. This reserve fund is non-taxable.
1964-1972	Export accelerated depreciation. Accelerated depreciation was allowed on capital investment where the output was to be exported. The degree of acceleration depended on the proportion of plant and equipment devoted to export.
1968-1978	Export special depreciation. This is an overlay acceleration on the previous provision.
Early 1950s to present	Free trade zone investment loss reserve. This measure is a variation on the overseas investment loss reserve extended for free trade zones.

Source: Gresser, op. cit., p. 16, citing Magaziner and Hout, op. cit., p. 97

Attachment B-1

MITI SUBSIDY GRANTS FOR IMPORTANT TECHNOLOGIES R&D - 1982

Grant Number	MITI Bureau	Grant Type*	ELECTRICAL CATEGORY Description of Project	Grantee
8	Tokyo	Applied	Solid electro-chromium display element	Citizen Watch KK
9	Tokyo	Applied	Optical type attitude sensor for aircraft installation	NEC KK
10	Tokyo	Industrial	High performance optical fiber maintaining eccentric wave surface	Hitachi Electric Cable KK
11	Tokyo	Applied	Micro-computer educational system	Japan Business Automation KK
12	Tokyo	Applied	Diagnostic technology for malignant tumors	Technical Research Association, Medical Equipment Research Lab.
13	Tokyo	Applied	Space light modulator (incoherent-coherent conversion) tube	Hamamatsu Television KK
14	Tokyo	Applied	High sensitivity high time analysis flow sight meter	Showa Denko KK
15	Tokyo	Applied	High quality silicon single crystal upgrade technology	Toshiba Ceramics KK
16	Tokyo	Experimental	SAIRISTA valve for high voltage large capacity direct current transmission use	Toshiba Electric KK and Hitachi Seisabrusho KK
17	Tokyo	Experimental	LSI Applied intelligent compounded automatic measuring system	Automatic Measuring Technology Research Assn.
18	Tokyo	Applied	High performance position sensor using high density magnetic scale and magnetic head	Nahamura Seisabrusho KK
19	Osaka	Applied	Large capacity XY matrix type liquid crystal display using thin membrane transistors	Sharp Elec. KK
20	Osaka	Applied	SIC Electron Device	Sanyo Elec. KK
21	Osaka	Applied	Multicolor liquid crystal display	Hoshi Elec. Mnfg. KK
22	Osaka	Applied	High definition image processing high speed processor	Matsushita Elec. Industries KK
23	Osaka	Experimental	± 500 KY class gas-insulated direct flow switching device (switchgear)	Mitsubishi Elec. KK
24	Osaka	Applied	500 KYAC Filter for UHY direct current transmission	Nisshin Elec. KK
41	Tokyo	Future	Manufacture of group IV-V compound semiconductors using Ion Beam Epitaxy (IBE)	Nihon Shinku Gijutsu KK (Japan Vacuum Technology Inc.)
46	Tokyo	Future	Research on ultra-high frequency devices	Hitachi Seisakusho KK, Fujitsu KK, NEC KK, Mitsubishi Electric KK
47	Tokyo	Future	Research on optical memory materials	Oki Elec. Industries KK

* Applied = Applied research
Industrial = Testing for industrial use
Experimental = Experimental or pilot project manufacture

Source: MITI Machine and Information Industries Bureau (SIA translation)

Attachment B-1

MITI SUBSIDIES FOR IMPORTANT TECHNOLOGY R&D JAPANESE FISCAL YEAR 1982

June 1982

INDUSTRIAL TECHNOLOGY INSTITUTE, MITI

Table #1 - Subsidy Budget for Important Technology R&D - Japanese Fiscal Year 1982

Category	1982 Budget Amount	1981 Budget Amount
	(in thousands of yen)	
Important Technology R&D (includes electrical, machinery)	1,398,880	1,583,200
Housing Systems R&D	51,000	87,540
Future Technology R&D	319,593	355,103
Environmental Protection, Safety Technology R&D	522,900	581,000
Energy Conservation Technology R&D	623,944	391,493
TOTAL	2,916,317	2,998,336

Note: Budget amounts for commercialization of civilian-use energy conservation equipment not included in above.

Source: MITI Machine and Information Industries Bureau (SIA translation)

APPENDIX C

THE PRICE OF MARKET ACCESS: U.S. TECHNOLOGY

Japan developed its semiconductor industry from an initial position of relative technological inferiority. Accordingly, a major goal of the Japanese government's developmental strategy has been promotion of the acquisition of U.S. computer/semiconductor technology and its subsequent diffusion throughout Japanese industry. It has used its control over access to the Japanese market as leverage in these efforts, in effect permitting limited access to the domestic market by U.S. firms as a tradeoff for transfer of U.S. technology to Japan.

In the beginning, MITI carefully supervised licensing agreements and tie-ups between Japanese and U.S. firms.[1/] It required foreign firms to license all Japanese firms requesting access to a particular technology, limiting royalty payments by Japanese firms to a single rate on each transaction--effectively preventing competitive bidding-up of royalty rates among Japanese firms. MITI often linked the import of particular technologies with the acquiring firm's ability to develop export products using that technology. MITI also conditioned approval of some agreements on the requirement that the acquiring Japanese firm diffuse its own technical developments--through subsidiaries--to other Japanese firms. By the end of the 1960s, Japanese semiconductor firms were paying at least 10 percent of their semiconductor sales revenues as royalties to U.S. firms.[2/] In 1968 the Organization for Economic Cooperation and Development (OECD) criticized the role of the Japanese government's intervention in the technology import agreement process, complaining that under the agreements brokered by MITI,

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1/ Texas Instruments (TI) "traded" its possession of technology for limited access to the Japanese market in the late 1960s. At that time TI raised serious charges of patent infringement against NEC and threatened to seek an injunction against imports of infringing Japanese electronics products unless the government of Japan permitted TI to establish a plant in Japan. TI was permitted to establish a joint venture with Sony, which it bought out in 1972, but in return was required to license its patents to NEC, Hitachi, Toshiba, Sony, and Mitsubishi, and agreed to limit its share of the Japanese semiconductor market to no more than 10 percent. (TI's current share is below that limit.) Furthermore, the delays associated with these negotiations were sufficient to enable Japanese firms to develop their own semiconductor industry substantially in a protected environment. J. Gresser, High Technology and Japanese Industrial Policy: A Strategy for U.S. Policymakers (October 1, 1980), p. 12; J. E. Tilton, International Diffusion of Semiconductor Technology, pp. 146-47.

2/ Borrus, Millstein, and Zysman, International Competition in Advanced Industrial Sectors: Trade and Development in the Semiconductor Industry (February 18, 1982), pp. 82-83; Tilton, FTC Staff Report on the Semiconductor Industry, p. 148.

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> The scope of the technology is frequently changed; the royalties and initial payments are reduced; arrangements must be made for the Japanese partner to get privileged access to certain foreign markets; provisions are disallowed under which the Japanese partner renounces manufacture after the expiry of the contract or to make certain competitive products; sub-licensing is made subject to further government approval; undertakings are deleted under which the Japanese partner would hand over a list of his customers at the end of the contract; the renewal is excluded; etc.3/

MITI promoted technology transfer in other ways. For example, although U.S. firms were generally barred from establishing local subsidiaries in Japan, during the early 1970s MITI permitted the formation of a number of U.S.-Japanese joint ventures--virtually none of which survived. A primary motivating factor appears to have been the transfer of U.S. technological know-how to the Japanese "partner." As one U.S. semiconductor executive testified in 1979, the Japanese knew the prospects for failure were high; however, the joint ventures were seen as a mechanism by which medium-sized Japanese firms could acquire semiconductor experience. MITI, which had to approve all joint ventures, served as the "marriage broker," pairing up U.S. firms with selected Japanese firms.4/

The Japanese semiconductor industry has itself been candid in conceding both its debt to transferred American semiconductor technology and the fact that U.S. transfer of such technology has been the "price" for the entry--however short-lived--of U.S. products into the Japanese market. In 1979 the Electronic Industries Association of Japan (EIAJ) testified before the U.S. International Trade Commission that

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3/ "Liberalization of International Capital Movements: Japan", Paris, OECD, 1968, pp. 57-58.

4/ The U.S. executive testified that

> Japanese don't put their best people into these joint ventures. The attempt is to draw on the technology of the American partner, then eventually to go out on their own.

Second Composite Supplemental Submission, USITC, p. 6.

The same semiconductor executive indicated that in the 1960s his firm sought permission to do business in Japan and was told by the government that in order to do so it would have to be represented by a Japanese company. His firm assented because there was no other way to gain a local toehold in Japan. NEC's sales representation of the U.S. firm was an inexpensive way for it to do market research, to perform engineering analysis, to learn testing, to learn about the product itself, and to acquire much other knowledge that would otherwise have cost many millions of dollars. Ibid., p. 5.

The growth of the Japanese semiconductor industry has had a substantial boost from technical licensing agreements with foreign firms, mostly U.S. From 1950 until 1975, 711 technical licensing agreements covering electronic components were concluded with foreign firms. In 1975, of the 232 licensing agreements involving electric/electronic technologies, 150 were introduced from the U.S. The other 82 cases include licensing from subsidiary companies of U.S. firms.... There appear to be two principal reasons for these agreements. The first of these, according to our interviews, is that even in the absence of such agreements, the Japanese semiconductor industry can obtain all the required technological information (albeit at higher costs) using other technology transfer channels. The use of licensing agreements therefore legitimizes the process while assuring some benefit to U.S. manufacturers. The second reason is to assure the effective entry of U.S. semiconductor products in the Japanese market, as a benefit or price for U.S. licenses. Even under a short life cycle of these U.S. exports, the U.S. manufacturers stand to gain considerable sales in Japan.5/ (emphasis added)

5/ Statement of Ivar Gutmanis on behalf of EIAJ, May 29, 1979, USITC Investigation No. 332-102, pp. 22-23.

APPENDIX D

INNOVATION

Despite the rapid Japanese advances of the past decade, the U.S. semiconductor industry retains one important advantage--its innovative ability. Japanese firms' planning and careful concentration of resources on specific goals can, and at times has been, offset by unexpected U.S. technological breakthroughs. In the recent past, a very high proportion of those breakthroughs has been achieved by the smaller and medium-sized U.S. merchant semiconductor firms.

MITI and the Japanese firms have undertaken major measures, to improve their innovative capability. Those measures, coupled with the aggressive investment and pricing strategies of Japanese firms, constitute a serious technological challenge to the U.S. semiconductor industry, particularly to the merchant producers who in the past two decades have contributed substantially to the U.S. innovative edge.

1. The U.S. merchant semiconductor firms are a critical element of the U.S. innovative edge.

Competition in semiconductors is more than simply the sum of relative levels of capital investment, pricing strategies, and comparative share of the market. Were this not the case, a few large companies would probably predominate. In fact, to a degree unique in most industries, the development of new products and process technologies in semiconductors is a critical competitive factor. A firm's ability to develop and apply "breakthrough" technologies may offset other competitive disadvantages, such as small size. As Robert Noyce, Vice Chairman of Intel Corporation, has observed,

> A year's advantage in introducing a new product or new process can give a company a 25% cost advantage over competing companies; conversely, a year's lag puts a company at a significant disadvantage with respect to its competitors.1/

Moreover, if a firm has lost the "race" to bring a new product on line most quickly, it may regain its footing by introducing an even newer product which "leapfrogs" its rival's technology. As a result, U.S. semiconductor firms are locked in a constant, intensive race to bring new processes and device types on line quickly.

This innovative ferment was one of the primary factors in propelling the U.S. semiconductor industry to world leadership. A striking characteristic of that ferment has been the proliferation over time of large numbers of comparatively small "merchant"

1/ Charles River Associates, Innovation, Competition and Government Policy in the Semiconductor Industry, September 1980, pp. 4-1, 4-9, 4-10.

firms, a factor which has caused a progressive deconcentration of the U.S. industry:

- In 1948, a team under William Shockley at Bell Laboratories invented the transistor, the first semiconductor type, which was commercially introduced in 1951. During the 1950s, transistors were primarily manufactured by Western Electric and producers of vacuum tubes--firms such as RCA, Sylvania, and GE.

- In the early 1960s, at Texas Instruments (Kilby) and Fairchild (Noyce)--smaller "second generation" firms--the integrated circuit was developed, which ultimately rendered many uses of the transistor obsolete. Government military and space procurement fueled demand for ICs, and additional new firms such as Signetics and General Microelectronics entered the market to produce ICs. Older firms such as Motorola and Raytheon began to move into IC production.

- In the late 1960s and early 1970s, metal oxide semiconductor (MOS) technology was introduced, and over 30 new firms entered the semiconductor market, primarily to develop and exploit new MOS technologies. Many of these "third generation" firms emerged as offshoots of older firms--Intel, National, and AMD from Fairchild, Mostek from TI.

- Intel, one of the new firms, introduced the random access memory (RAM) in 1970 and the microprocessor in 1971. Both of these developments were technological breakthroughs which, taken together, caused a virtual explosion in demand for microelectronics devices.2/

Figure D-1 summarizes major semiconductor product and process innovations since 1969. As can be seen, in recent years a disproportionate number of these innovations have come from the small "merchant" sector firms. The reasons for this are not entirely clear, although semiconductor executives tend to attribute it to the small firms' management commitment to and emphasis on innovation, their organizational flexibility, ability to push profit and loss criteria "deep" into the organization, and ability to attract talented personnel.3/

Whatever the reasons, however, the simple fact is that the merchant producers have made a disproportionately large contribution to U.S. semiconductor innovation. That in turn has reinforced the U.S. industry's competitive position all over the world. U.S. firms were the first to introduce the 1K, 4K, and 16K Random Access Memory devices, first with microprocessors, and indeed first, until very recently, with virtually all major innovations in semiconductor device structure and process technology. That innovative edge has time and again contributed to U.S. firms' competitive advantages.

2/ For additional background on the history of the industry, see E. Braun and S. MacDonald, Revolution in Miniature (1978); M. Borrus, J. Millstein, and J. Zysman, International Competition in Advanced Industrial Sectors: Trade and Development in the Semiconductor Industry (February 19, 1982), pp. 13-43; J. Tilton, The International Diffusion of Semiconductor Technology (1971), pp. 49-63.

3/ Charles River Associates, op. cit., p. 3-15.

Figure D-1

MAJOR SEMICONDUCTOR INNOVATIONS SINCE 1969

Semiconductor Device Structures

Technology	Approx. Date	Originator/ Early Advocate
MOS Resistor	1965	Fairchild/GME
Deposited Metal Resistor	1965	Source varies
Depletion-Mode MOS Resistor	1969	Mostek
Bipolar-Junction Field Effect Combination	1970	National
Tripped Charge Storage	1972	Intel
Bipolar-MOS Combination	1972	RCA
Isoplanar, Coplamos, et al.	1974	Fairchild/ St. Micro-systems
Merged Transistor I2L	1975	IBM/Phillips
Vertical MOS (VMOS)	1977	Siliconix/AMI

Semiconductor Processes

Technology	Approx. Date	Originator/ Early Advocate
Gettering Processes	1965	Bell
Plastic Encapsu-lation	1965	Fairchild
Direct Bonding/ Bump	1966	IBM/ W. Electric
Nitride Chemical Vapor Deposi-tion (EVP)	1968	General Instrument
Glass Chemical Vapor Deposi-tion (CVD)	1969	Bell
Ion Implantation	1970	Mostek
Schottky Junction	1970	Texas Instruments
Dielectric Isolation	1970	Harris
	1973	Veeco
Polysilicon Deposition	1973	Intel
Silicon-on-Sapphire	1973	RCA
Plasma Etching	1974	Standard Telecommuni-cations (UK)
Ion Milling	1975	Veeco
Electron Beam Processing	1975	T.I./IBM
Photolithography Projection Alignment	1976	Perkin-Elmer
Deep Ultraviolet Photolithography	1977	Perkin-Elmer

Semiconductor Products

Technology	Approx. Date	Originator/ Early Advocate
C-MOS	1968	RCA
Schottky TTL	1970	T.I.
1K MOS RAMs	1970	AMS/Intel
Microprocessor	1971	Intel
Bipolar RAMs	1972	Fairchild
4K MOS RAMs	1973	Intel/Mostek T.I.
16K MOS RAMs	1976	Intel/Mostek

Source: Charles River Associates, Innovation, Competition and Government Policy in the Semiconductor Industry (1980), pp. 3-5, 3-6, 3-7.

2. Targeting has enabled Japan to challenge the U.S. technological lead in semiconductors.

Until very recently, Japanese semiconductor firms lagged behind the U.S. industry in technological capability and innovation. Recognizing this, MITI has over the years given a high priority to helping the Japanese industry catch up to the U.S. technologically, largely by promoting the transfer of U.S. semiconductor know-how to Japanese firms. "Technology transfer" was advantageous to Japanese firms at this time since it enabled them to acquire the successful results of U.S. R&D without the expense of conducting the R&D themselves. They did not waste resources on pursuing "blind alleys" or unsuccessful attempts to innovate, which are inherent in virtually all R&D efforts.

Prior to about 1970, the flow of semiconductor know-how was decidedly one-way—U.S. to Japan. Around 1970, however, while it still lagged behind the U.S., Japan began to generate a gradually-increasing counter-flow of technical knowledge,[4/] reflecting in part MITI's organization of Japanese semiconductor firms into "research associations" for semiconductor R&D. Japanese indigenous technological capability received a decisive boost when the industry was targeted for growth in the mid-1970s and the VLSI Project was launched. This project continued to draw heavily on U.S. semiconductor technology,[5/] and rather than generating new breakthroughs, resulted primarily in refinements and improvements on existing technologies, many if not most of which had been pioneered by U.S. firms.[6/] However, the VLSI Project enabled Japanese firms to pull roughly abreast of U.S. semiconductor firms in technological capability, and in some areas, MITI believes Japan is actually now ahead, notably in memory production technology and optical fibers.[7/]

Whether or not MITI is correct, the fact is that an important threshold was crossed as the 1970s came to an end—Japan pulled abreast of the U.S. in semiconductor

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4/ W. F. Finan, "The Exchange of Semiconductor Technology between Japan and the United States," October 21, 1981, p. 2.

5/ Business Week reported on December 14, 1981 that a substantial portion of the VLSI budget was spent on acquisition of U.S. technological know-how, and quoted one observer as estimating that information acquired from U.S. firms "provided at least 35% to 40% of the base-line data on which they were able to extrapolate and achieve what they did" by 1979.

6/ U.S. Embassy, Tokyo, May 1982.

7/ Japan Economic Journal, August 10, 1982, p. 15.

technology. Japanese firms are now able to cross-license with U.S. firms, reflecting the fact that they possess technology of considerable value to U.S. firms.[8/]

Furthermore, at present, Japan is embarking on an effort to take the innovative lead in semiconductors from the United States--to develop the ability to "forward engineer" its own major innovations rather than merely "reverse engineer" innovations of U.S. firms.[9/] As Nikkei Sangyo Shimbun reported on August 6, 1981, in describing the New Function Elements Project,

> Unlike the case of ultra high frequency computer or VLSI development projects of the past where there were some technological "textbooks" available overseas, this project is to explore a totally uncharted area of technology.

MITI and the Japanese firms are seeking to develop this capability in a number of ways.

- Government-funded cooperative research programs aimed at "basic" semiconductor research are proliferating;

- MITI is stressing the theme of "cooperative research." It is seeking to attract foreign "Watson Lab quality" scientists into its R&D projects;

8/ W. F. Finan observed in 1981 that since 1977, Japanese firms had filed for more patents than the five major U.S. semiconductor firms. Finan noted that even if Bell Labs and IBM patent filings were included, the Japanese filings were still more numerous. (Patent filings are, of course, only one rough measure of technological capability.) W. F. Finan, "The Exchange of Semiconductor Technology Between Japan and the United States", p. 11.

9/ The Japanese record with respect to the sharing of Japanese-developed technologies is mixed at best. On the one hand, Hitachi and Hewlett-Packard have entered into an agreement pursuant to which Hitachi will license technology to HP (Japan Economic Journal, March 9, 1982) and Japan has announced its intention to open VLSI program technologies to foreign bidders (Japan Economic Journal, September 2, 1980). On the other hand, MITI recently indicated that it would grant priority rights to domestic firms in licensing patented or patent-pending technologies developed in the "Fifth Generation Computer" project (Japan Economic Journal, June 16, 1981). Furthermore, under the terms of the 1980 amendments to the Foreign Exchange Control Act, no single Japanese company can grant a license for a patent flowing from the VLSI Project without prior government approval. Few such approvals have been granted to date. Finan, op. cit., p. 14.

- Intensive semiconductor research is under way in government laboratories, notably those of MITI and NTT (where development of 256K RAM technology is under way). The results of this R&D will inevitably be disseminated to Japanese firms.10/

These efforts are under way at the same time that U.S. firms, particularly the merchant firms that have made such major contributions to the U.S. innovative record, are confronting major problems in their innovative efforts. To begin with, semiconductor R&D is expensive: U.S. semiconductor firms invest, on the average, nearly 10 percent of their revenues in R&D--over three times the percentage invested by U.S. industry in general (see Figure D-2). As already noted, the current recession and the Japanese export challenge threaten many of these firms' continued ability to commit funds to R&D--at the same time that the Japanese government's involvement in R&D is increasing.

Furthermore, the Japanese government's commitment to semiconductor R&D comes at a time when U.S. firms do not enjoy the degree of R&D support from the U.S. government (particularly the military) which they received in the 1950s and 1960s. At that time, defense funding provided "seed money" for basic IC research and MOS technology. Government procurement for the Minuteman and space programs gave the merchant IC producers a large-scale production outlet for integrated circuit designs emerging from the R&D laboratories. However, U.S. government support of R&D subsided in the 1970s, and today few of the leading U.S. merchant semiconductor producers do significant amounts of government-funded research. The defense-related R&D assistance U.S. firms now receive is primarily targeted for custom-designed "mission-oriented" innovations which do not have significant commercial applications.

Finally, there is the problem of "basic" or "fundamental" research. Because of the shortness of product life cycles most of the U.S. firms' R&D effort is aimed at short-term projects that produce an immediate payoff--that is, technology that can be translated quickly into a marketable product. For the most part, these products therefore entail attempts to achieve incremental improvements in existing technologies.11/ Longer-term basic research—which can produce revolutionary technological advances but often promises little payoff to the sponsoring company--gets a relatively low priority

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10/ Nikkan Kogyo Shimbun reported on June 17, 1981 that MITI planned to establish an "IC Design Center" in 1982 to fulfill a wide range of custom IC needs of medium and small enterprises, to serve as a consulting center for the entire field of IC technology, and possibly to produce ICs. Nikkan Kogyo Shimbun reported on April 22, 1980 that NTT would establish the "Fourth Research Institute" by 1982 to "perform the research and development of a 1 megabit ultra-LSI, Josephson element, and new function element"--all forms of advanced semiconductor technology.

11/ Paradoxically, R&D contributes to this problem since the shortness of product life cycles is due to the high degree of competitive innovation in the industry--a product of the heavy commitment to R&D.

Figure D-2

INTEGRATED CIRCUIT R&D EXPENDITURES

Fiscal Year

	1976		1977		1978		1979		1980		1981	
	Jpn 1/	USA 2/	Jpn	USA	Jpn	USA	Jpn	USA	Jpn	USA	Jpn	USA
R&D ($ millions)	82	160	92	235	185	316	248	387	319	507	394	573
IC Sales ($ millions)	557	2,033	585	2,464	1,223	3,261	1,694	4,671	2,416	6,360	2,956	5,843
Percent of Sales (%)	14.7	7.8	15.7	9.5	15.1	9.7	14.6	8.3	13.2	8.0	13.3	9.8
Exchange Rate (Y/US $)	296.2		265.9		205.9		221.3		224.8		221.3	

1/ Japanese fiscal year is 4/1 - 3/31.

2/ Estimated for U.S.-based merchant semiconductor manufacturers.

Sources: Japan Economic Journal
The Japanese Semiconductor Industry 1981/1982, BA Asia Ltd.
SIA Annual Financial Survey
SIA Semiconductor Trade Statistics Program

from merchant producers.[12] Only a few very large, diversified firms conduct significant basic research in-house.

The Japanese R&D programs are designed to deal with the need for a major, ongoing basic semiconductor research effort and commercial applications. These programs not only encourage basic research, but establish mechanisms by which the results of such research can be rapidly disseminated to Japanese firms for rapid conversion into commercial applications. At present, most U.S. firms do not enjoy access to a comparable source of ongoing basic research.

In response to this problem, U.S. semiconductor firms have established the Semiconductor Research Cooperative (SRC) to contract for and finance higher priority fundamental research in several of the nation's leading universities. The SRC's member firms will ultimately contribute $20 million to the project.[13] The purpose of the SRC is to explore those areas of semiconductor technology that will probably not generate an immediate commercial return, or as Robert Noyce put it,

> To support those areas of research that we all feel guilty about not doing.[14]

The SRC will benefit by the recent legislation making R&D tax credits available to participating firms. In addition, because of the shortage of trained engineers and other necessary personnel, U.S. firms have established advanced research centers in foreign countries (Israel, Japan) where additional qualified research personnel are available.[15]

These efforts should be bearing fruit by the end of the decade, and the benefits of this research will be of considerable use to U.S. firms. In the interim, however, the U.S. industry is vulnerable. The immediate threat faced by U.S. firms is that some—and perhaps many—of the merchant semiconductor firms which have given the U.S. much of its innovative lead will succumb to Japanese competition, and, at the same time, that Japan will achieve the major breakthroughs in fundamental semiconductor technology at which it is now taking aim. Should this occur, the U.S. may lose much of its "innovative edge"—its most important remaining advantage in world semiconductor competition.

12/ Basic research results are widely publicized and benefit the industry as a whole — but do not bring the sponsor a significant financial reward.

13/ New York Times, April 13, 1982.

14/ Electronic News, December 21, 1981.

15/ The number of U. S. electrical engineering graduates with bachelors' degrees actually declined between 1969 and 1979, from 16,282 to 16,093. During the same period, Japan's total of electrical engineering graduates nearly doubled, from 11,848 in 1969 to 21,435 in 1979—a number that substantially exceeds the U.S. total in absolute numbers. In 1979, relative to actual employment, U.S. semiconductor firms had approximately 20,000 positions for which they could not find qualified personnel. SIA, The International Microelectronic Challenge (1981), p. 29.

APPENDIX E

THE U.S.-JAPAN BALANCE OF TRADE

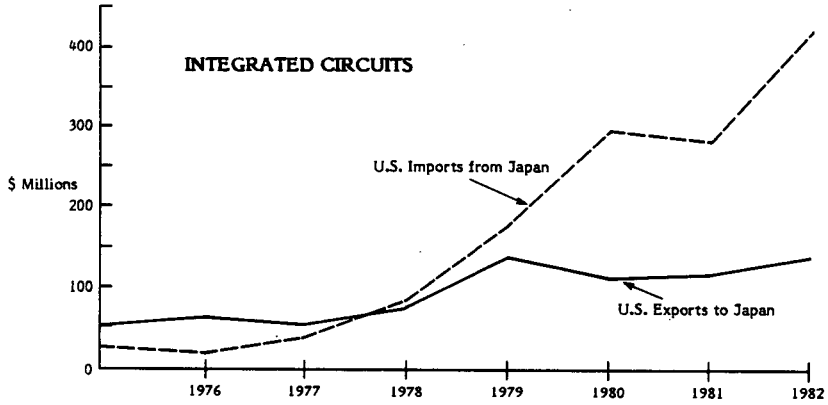
> Because of growing apprehension about the possibility that semiconductors, integrated circuits in particular, may be singled out as a hot subject at Japan-U.S. trade negotiations, MITI has started working on theoretical armament, in the capacity of policy officials.... The trade with the U.S. shows 4,489 million yen in exports and 2,865 million in imports, with a 1,604 million yen trade surplus. Thus Japan has a trade surplus with both the world and the U.S.... In light of the past trends of the industry and moves of the world market, MITI's view on these statistics is that the trade surplus is not only limited to the one month of August but will also remain constant (Machinery and Information Industries Bureau). Consequently, MITI needs to construct a new theory because one of the reasons which Japan gave in relation to the problem of semiconductors that "Japan is an import nation" in the field of ICs which involve higher technology.
>
> - Nihon Kogyo, November 9, 1979 (Translation by U.S. Embassy, Tokyo)

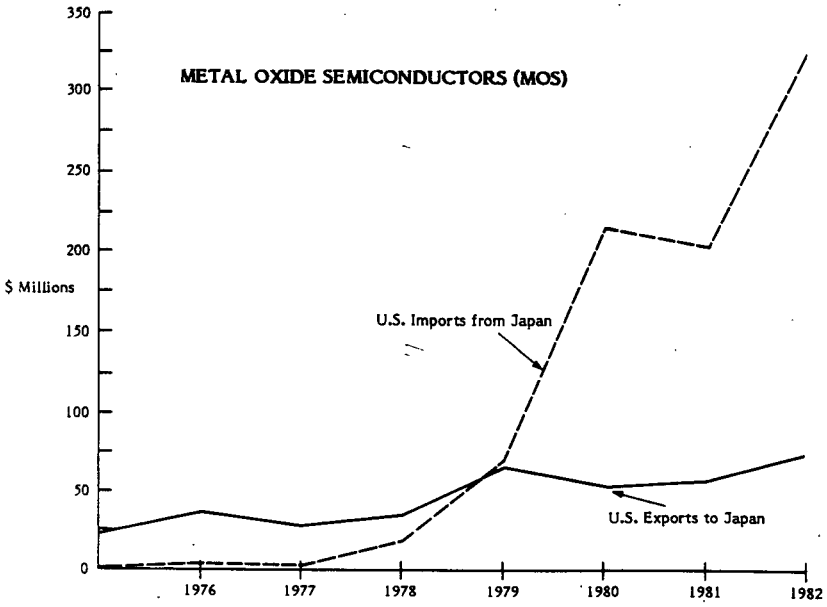
It is difficult, if not impossible, to obtain a completely accurate view of the U.S.-Japan balance of trade in semiconductors. For example, the U.S. Department of Commerce trade data reproduced in Figure E-1 shows that the semiconductor balance of trade favors Japan and that the balance is even more pronounced in Japan's favor in the most rapidly growing semiconductor sectors--MOS and integrated circuits (categories which overlap). Moreover, according to these figures the balance of trade has tilted more heavily in Japan's favor during the last 12 months. However, figures released by Japan's Ministry of Finance indicate that while Japan enjoyed a small surplus balance in ICs with the U.S. in 1980 (Figure E-2), it slipped into a deficit again in 1981.[1/] The Dataquest figures reproduced in Figure E-3 show a semiconductor trade balance favoring Japan, but by a smaller margin than shown by the Commerce Department figures. This disparity in figures reflects the many factors which can distort virtually any semiconductor balance of trade calculation. These include:

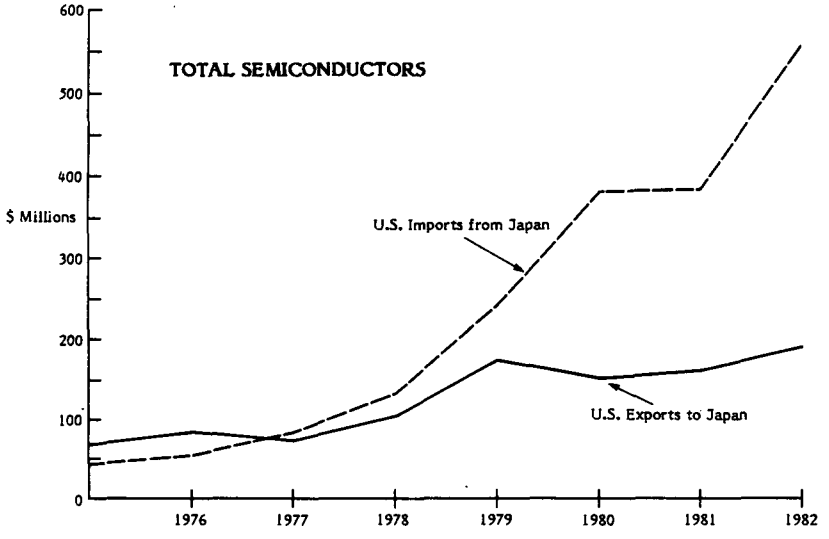
1/ The Electronics Industries Association of Japan likewise contends that the U.S.-Japan IC trade is in balance. Japan Economic Journal, March 2, 1982.

Figure E-1

U.S.-JAPAN SEMICONDUCTOR BALANCE OF TRADE
(based on U.S. Department of Commerce Figures)







- U.S. and Japanese third country activities. Many U.S. firms ship semiconductor sub-assemblies (which account for about 75% of value) to third countries for final assembly and sale. Final products may then be reimported from the third country to the U.S., or shipped from the third country to Japan. These foreign-assembled devices can distort trade data. Reimports of such devices to the U.S. show up, for example, as imports in U.S. Department of Commerce data. Similarly, shipments to Japan from third countries are not reported as exports in U.S. Department of Commerce data.

- U.S. production in Japan. Some U.S. firms, notably TI, operate manufacturing subsidiaries in Japan which export semiconductors made in Japan to the U.S. These may show up in trade data as "Japanese exports."2/

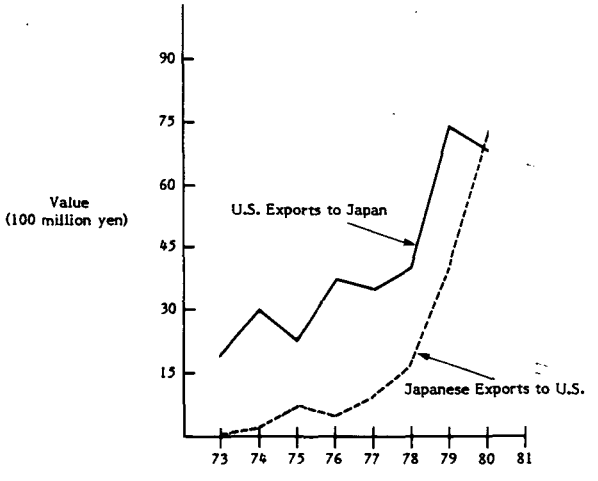
2/ TI's total semiconductor sales in Japan were estimated at Y24.5 billion in 1980 and Y27 billion in 1981. Of these, an estimated Y10 billion and Y11 billion, respectively, were imported—the rest produced locally. BA Asia, The Japanese Semiconductor Industry 1981/82, p. 209.

- Currency conversion. Trade data is usually expressed in terms of value rather than unit volume, and the fluctuation of the yen against the dollar--and use of either yen or dollars to reflect trade balances--can distort trade data, depending on conversion rates.

- Hidden imports. Most U.S. imports of Japanese semiconductors are "hidden"--the devices are incorporated in imported Japanese consumer electronics and information industry products. One U.S. semiconductor firm estimates that the 1981 value of such "hidden" imports is approximately $675 million, or about 19% of U.S. semiconductor production. On the other hand, U.S. exports to Japan of computers and other information industry products likewise contain "hidden" semiconductor exports. Finally, in both cases, some of the "hidden" devices may have been obtained by the end-product maker from the semiconductor firms of the other country.

Figure E-2

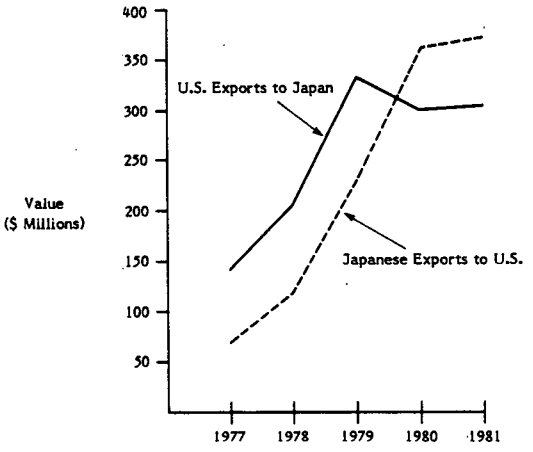
U.S.-JAPAN INTEGRATED CIRCUIT BALANCE OF TRADE
(according to Japan Ministry of Finance figures)



Source: Japan Electronics Almanac 1982, p. 191

Figure E-3

U.S.-JAPAN SEMICONDUCTOR BALANCE OF TRADE
(according to Dataquest figures)



Despite all of these potentially distorting factors, certain broad trends are apparent. First, whether or not the current balance favors Japan, Japan enjoys an improving balance of trade in semiconductors with the U.S., as all three sets of the preceding figures indicate. Second, with respect to ICs, one of the major product growth areas in the semiconductor field, the balance of trade has likewise been moving in Japan's favor. Third, regardless of whose figures are consulted, the sharpest shift in Japan's favor appears to have occurred in 1979-1981, when the world entered a recession, when Japan completed the VLSI Project, and shortly after Japanese semiconductor firms began expanding semiconductor production capacity.

Taken together, the figures suggest that at the very least, the Japanese semiconductor industry has been able to improve its position in the world market relative to the U.S. industry, particularly during the current world recession. To the extent this shift in Japan's favor may not be a reflection of superior Japanese management, productivity, efficiency, or other competitive factors, but of government support, the shift should be a matter of serious concern to U.S. policymakers.

Mr. FLORIO. Thank you.
Mr. Wolff.

STATEMENT OF ALAN WILLIAM WOLFF

Mr. WOLFF. Thank you, Mr. Chairman.

I am Alan Wolff, a partner in the law firm of Verner, Liipfert, Bernhard and McPherson, Chartered, and counsel to the Semiconductor Industry Association. SIA represents the majority of U.S. merchant and captive producers of semiconductors in matters of trade and Government policy.

You have asked me to address the broader implications of targeting problems, drawing on my experience as a Deputy Special Trade Representative in the Carter administration.

I conclude, that U.S. trade laws are currently inadequate to the challenges faced due to foreign industrial policies. It comes as a surprise to American business when they come to the Government to discover the depth of ignorance that exists about their industries and their problems and international competition.

When there are problems there is not a great deal of sectoral analytical capability in the U.S. Government.

One would expect to find it in the Department of Commerce. I can tell you that when we dealt with steel problems or other major trade questions, color televisions, things of that kind, we certainly did not have at USTR the capability to understand those industries, nor elsewhere within the government, although there is some commodity expertise at the USITC.

It is something that is developed on an ad hoc basis. I think that has to be changed if we are going to understand the nature of the challenges faced.

Our role as a Government in agriculture is very different. We work with the agricultural community to induce planting decisions because of uncertainties over weather and world supply and demand. I am not suggesting we do that in industry, but there are some lessons to be learned.

We aid in export promotion through the establishment of facilities abroad. It is funded by the USDA and a lot of the research is backed by the U.S. Department of Agriculture.

There is a striking difference between the attitude of government toward industrial R&D and agricultural R&D. With respect to industrial R&D, if there are likely to be commerical applications, we are not very interested. In agricultural R&D, if there are market implications, that is what we go after, and the result is the United States feeds one heck of a lot of the world today.

A third of our acreage is planted for export. We don't understand well the importance of trade. We are only coming to this understanding. You have been very helpful to this process by scheduling these hearings, which is a step forward in understanding how other governments act effecting their commerce, and how the United States does not.

This gap in industrial policy is important to understand. In semiconductors, the problem is principally Japan, because they have succeeded. It is not that others are not trying and not having some

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effect, the French, the Germans, British, and others are putting a lot of money into semiconductor development and related areas.

But the Japanese are succeeding, so Japan tends to be the focus of the semiconductor industry remarks. It should not, however, be the sole focus of U.S. Government policy because France, Germany, even Mexico, Brazil, South Korea, are active in a number of sectors, particularly now in small computers and other electronics.

The semiconductor industry study, The Effect of Government Targeting on World Semiconductor Competition, describes what one industry has gone through. The results show a decreasing number of American firms able to stay in the marketplace.

Our remedies are not adequate to deal with this problem of industrial targeting. Import relief is designed to give a breathing space, a period of adjustment for a domestic industry, but no adjustment is really possible if foreign governments are intervening heavily on the other side of the equation. The competition will remain unequal when the import relief expires.

Countervailing duties are not adequate. A countervailing duty is designed to offset the amount of a subsidy. In the case of semiconductors, the direct Government aid was only about $132 million in terms of direct grants for one project. There is about ½ billion to $2 million on top of that in other Government aid. The real benefit of the subsidies was to move the Japanese industry ahead one product generation. That is an incalculable benefit, it is enormous.

Our law is designed to only put an offsetting duty on for the amount of the subsidies involved. The effect is far greater than the actual direct subsidies.

Our antidumping laws are also inadequate. We have provisions in the 1979 act which allow the Government to go after below-cost sales, but what is the cost of a product when there is a dramatic price decline over a product life? How does one you know what the cost of the product is at any point?

How much does one allocate R&D to one product as opposed to another? Another problem derives from the fact that product life generations are very short. By the time one has suffered the injury, indeed, it is too late to get relief. The manufacturers are going on to the next generation of product.

Section 301, administered by the U.S. Trade Representative's Office, is broad enough to deal with problems of targeting, but it has not been effective. The action taken would have to be the result of interagency deliberation and frankly, there are a lot of people in the U.S. Government who do not understand the realities of international competition.

They take an academic approach, quite different than the one Professor Lodge described and exemplified this morning. They hold as an article of faith, that the targeting of specific industries by foreign governments doesn't exist, and if it did exist, it couldn't really be effective, and if it is effective, then in any event, it doesn't matter; and finally, if we tried to do anything about it in the United States, we would only make matters worse.

That is the firmly held belief of the several agencies of the U.S. Government who make up the interagency process. I am not referring to the Department of Commerce and the USTR offices, because I think that Mac Baldrige and Bill Brock are well aware of

the kinds of problems that are faced, but taking action is another thing.

What I would recommend, Mr. Chairman, as initial steps would be the following: Increase our knowledge and analytical capability in the Government on a sectoral basis. This is something that this committee certainly, I would hope, would address in terms of organizing the resources of the Department of Commerce, or if any reorganization takes place, in the Department of Commerce and Trade.

That in terms of remedies, the burden of proceeding ought not to be to the extent it is today on the domestic industry. We have and should have some national priorities and national interests in our commerce, in our trade position. It is an odd thing, but our Government considers itself an impartial judge in trade matters. Foreign governments consider themselves a participant, an advocate of their industry's position. We should have more resources in Government dedicated to conducting investigations and countering foreign trade practices where they are undermining our industrial strength.

It will not be possible to design an automatic remedy to deal with targeting, because unlike countervailing duties or antidumping duties, there are no specific ways of setting forth in advance what the remedy ought to be.

I think that what one would have to do is describe what the Congress believes the problem is, and insist that there be some action, but give the executive branch flexibility in the type of relief provided, which may have to include domestic measures.

Import restrictions will not always be the best approach. They are not practical in semiconductors because it is a world market. If we shut our market to semiconductors, then circuit boards, computers, other products downstream would feel the competitive pressures, at the same time receiving much less competitive prices on their supplies. They would be in a poorer position to compete.

There are several bills pending before Congress now, Representative Shannon's Technology Act of 1983; the Jones bill, which was the H.R. 1571, the reciprocity bill, which would go a substantial part of the way in at least recognizing the problems that exist.

They do not, however, address trade remedies as fully as they might.

In conclusion, Mr. Chairman, fundamentally what we need is not just a change in trade laws, but a change in the attitude of our Government. I think we are moving in that direction. Increasingly, in a number of sectors, it is becoming clear that international competition is being shaped by governments, and that our firms are competing on an unequal basis.

It is not going to be a solution to solve our problems simply through trade litigation. We do need a change in attitude in the executive branch. Since that is not going to be easily forthcoming in the near future, we will need some changes in law to give U.S. businesses faced with major research and investment decisions greater assurances of an adequate American response.

Thank you, Mr. Chairman.

[Testimony resumes on p. 514.]

[Mr. Wolff's prepared statement follows:]

STATEMENT OF ALAN WM. WOLFF
ON BEHALF OF THE
SEMICONDUCTOR INDUSTRY ASSOCIATION

Mr. Chairman, I am Alan Wm. Wolff, a partner in the law firm of Verner, Liipfert, Bernhard and McPherson, Chartered, and counsel to the Semiconductor Industry Association (SIA). SIA represents the majority of U.S. merchant and captive producers of semiconductors in matters of trade and government policy.

As one who has been involved in the administration and writing of U.S. trade laws for a number of years, and observed the difficulties inherent in applying those laws to the increasingly serious trade problems faced by U.S. industries, I believe that there is a need for reform of those laws. Current U.S. trade laws are inadequate to the challenges now being posed to U.S. industries by foreign industrial policies. This is becoming a particularly serious problem for the high technology industries.

AMERICA'S INDUSTRIAL POLICY

Corporate executives rarely discuss their businesses with trade policy officials -- unless they are losing sales to foreign competition. On these occasions, government officials are sympathetic but skeptical. They try to identify practices clearly designated as actionable under our trade laws. Very little interest is taken in restoring or enhancing the international competitiveness of the American industry.

It surprises American businessmen that U.S. officials do not as a matter of official policy care whether their industries continue to exist. The government is largely ignorant about their industries and their competitive problems. Often, even

after the problems are clearly identified, getting the government to effectuate a remedy is an uphill battle.

The U.S. government has a very different role in agriculture, where it plans production levels, subsidizes exports and works with farmers to develop markets at home and abroad. Agricultural production and trade are rarely free of government involvement in any country. This cooperation of government and agribusiness is essential for success in world markets.

The contrast between agriculture and industry is the more remarkable when one considers that the major breakthroughs in agricultural research have been funded by our government. When it comes to industry, however, federal agencies appear reluctant to fund research if it is likely to lead to immediate commercial applications.

The degree of government-industry cooperation in other countries has not been adequately recognized in America. For high technology industries, a laissez faire policy is becoming the exception rather than the rule abroad, much as has been the case with respect to major basic industries. While Japan is often cited as a prime example of a country driven by an industrial strategy, this is also the direction being chosen by many nations, including France, Germany, and a series of developing countries -- most notably Brazil, Mexico and Korea. Individual firms may not be equal to the competitive challenge posed by these foreign government-industry combinations.

THE NATURE OF INDUSTRIAL TARGETING

Japanese producers are now succeeding against their American competitors in key semiconductor product areas -- despite the fact that the Americans were there first, and are credited with almost all of the major innovations in semiconductor technology over the past two decades. SIA has submitted to your Committee its study of international competition in semiconductors entitled The Effect of Government Targeting on World Semiconductor Competition. The study examines the causes of this reversal of position. Japan's success was not due to commercial competition operating in a free market. It was largely a result of Japan's industrial policy.

The Japanese strategy of industrial targeting has been experienced to varying degrees in several industries -- steel, shipbuilding, heavy machinery, petrochemicals, and consumer electronics. During the mid-1970s, the Japanese government established as a national economic goal the attainment of preeminence in the knowledge-intensive industries-computers, data processing, communications, robotics, and electrical machinery.

The general pattern of the strategy is to (1) establish an industry in a protected home market, (2) identify a few high volume product lines in which to specialize, (3) make large investments in advanced production equipment, (4) launch an "entering wedge" export drive characterized by extremely aggressive pricing to dominate a particular commodity, and, (5) once this beachhead is established, expand the range of products offered to obtain a commanding position in the market.

This is a sound strategy. It is not explicitly prohibited under either international trade agreements or domestic U.S. law. It is this target industry strategy which was applied to semiconductors. The experience in the area of semiconductors has been explored in detail with you this morning by Mr. Scalise.

CURRENT REMEDIES

There are three basic categories of American trade remedies. The first -- import relief -- is designed to deal with temporary but serious dislocations caused by imports. Import relief is unlikely to be an effective response to foreign industrial strategies because it is assumed that the domestic industry can respond effectively given a short respite from foreign competition. With targeting, however, this self-adjustment process cannot succeed, individual firms being unequal to their foreign government-backed competitors. Moreover, an industry must be immediately threatened with serious injury. In a high growth industry, this test is hard to apply in traditional terms of unemployment and closed plants. What is being lost are the jobs never created.

The next category of remedies consists of highly specialized devices tailored to offset specific foreign practices. Countervailing duties can be imposed to offset foreign subsidies paid on the manufacture or export of particular goods if the industry can show that it has been "materially injured." By and large the countervailing duty law is not an effective means of countering foreign industrial strategies. The amount of the countervailing duty imposed bears no necessary relationship to

the real-world business effects of a subsidy. Direct government aid is only part of the financial benefit accorded by the targeting process.

SIA believes that the imposition of a higher duty is not a particularly effective response to targeting -- and in fact, is seeking the elimination of all semiconductor duties in the U.S. and other nations. Rep. Stark is sponsoring a bill, H.R. 1953, which would suspend the U.S. duty on semiconductors. SIA supports this legislation. Japan has unilaterally suspended its duty on a number of commodities in the recent past. This legislation, if enacted, should serve as an inducement for Japan to take similar action with respect to semiconductors. If Japan really believes in free trade -- as it professes -- it is difficult to see how it can justify a failure to implement a reciprocal duty suspension.

The major benefit of a government-supported joint R&D effort like the VLSI Project may be to make possible a new generation of products. A countervailing duty calculated to offset the seed money needed to establish an industry-wide project might amount to only a few percent of an individual memory chip's value. Furthermore, because of the collaborative nature of these programs, the value of government subsidies (and industry matching funds) is multiplied. Participating firms receive technology for which they would have to pay many times as much if they proceeded on their own -- as U.S. firms must do. Imposition of a countervailing duty pegged to the actual amount of the

subsidy would clearly be an ineffective means of restoring market conditions of competition.

The antidumping law offers relief where material injury is caused by "sales at less than fair value." Where a product is sold for export at the same price as it is sold for domestic consumption, as a general matter no "dumping margin" exists. The major exception to this rule is where sales in the foreign home market are at less than the cost of production. In these circumstances, the dumping margin is determined by reference to a constructed value (costs, general expenses and a required profit margin).

Given the fact that American producers of semiconductors are highly efficient, and Japanese companies have in the past relied on American production equipment, it should be relatively easy to show that when the Japanese sell high density memory devices well below the U.S. cost of production, they are dumping. This is not the case, however. It is very difficult to establish the appropriate allocation of research and development costs to a particular product line. Moreover since costs of production decline as learning curve efficiencies are obtained, the average cost of a product can be very difficult to estimate before the product life cycle has run its course.

The third category is of remedies generally linked to international agreements, particularly the General Agreements on Tariffs and Trade (GATT). The principal means of gaining access to these remedies is through section 301 of the Trade Act of 1974. Petitions may be filed requesting the President to enforce

the rights of the United States under any trade agreement; or to respond to any act, policy or practice of a foreign country that (a) is inconsistent with any trade agreement, or (b) is unjustifiable, unreasonable or discriminatory and burdens or restricts United States commerce.

Under the GATT, a signatory can seek a remedy if it considers that any benefit accruing to it directly or indirectly under the agreement is being nullified or impaired. Under the GATT Subsidies Code, countermeasures may be authorized if "a subsidy is being granted or maintained in such a manner as to cause injury, nullification or impairment, or serious prejudice" to another Code signatory.

Clearly the possibility exists of obtaining at least some form of relief under these agreements. Whether they will serve to curb excesses of national industrial strategy remains to be seen, however. One cannot predict with certainty whether a GATT panel of nationals of other countries would view GATT or Subsidies Code obligations in the same light as we would.

The President need not invoke international agreements to respond to foreign industrial policies. He would merely have to conclude that the foreign governmental practices complained of are unreasonable and constitute a burden on American commerce. He would then be authorized to impose duties or other import restrictions on the products of that country which enter the United States.

There is a very substantial difference, however, between the <u>possibility</u> of relief and the <u>probability</u> of relief. The statute

is discretionary. The President receives the advice of many agencies before he decides to grant relief. Here lies a substantial obstacle. It is an article of faith firmly held in some quarters of the United States government that the targeting of specific industries by foreign governments does not really exist; and that if it does exist, it cannot be effective; and if it is effective, then in any event, this does not really matter; and if, finally, the United States did intervene in order to provide some kind of a response, it would only worsen matters. Unfortunately, the current weight of opinion in the U.S. government is against any form of action.

CHANGES THE CONGRESS MIGHT MAKE

Knowledge: The government needs to be far more able to understand both the competitive strengths and weaknesses of American industries, as well as being able to understand the effects of foreign government intervention. A formal investigation must be launched if the U.S. International Trade Commission determines that there is "a reasonable indication" that the statutory criteria of material injury will be met. To do this the government will need a much stronger sectoral analytical capability. There must be adequate resources within the U.S. Government devoted to understanding both the competitive strengths and disadvantages of American industries as well as being able to understand the government intervention abroad which seriously affects trade and investment flows. Industry and labor will have to provide expert advice. To make this possible, there

must be a softening of the adversarial nature of industry-government relations.

The Burden of Proceeding: Under the antidumping and countervailing duty laws, the Secretary of Commerce must commence an investigation if the elements necessary for imposition of the duty are alleged and information is presented which is "reasonably available to the petitioner." Under a Section 301 proceeding, no standards are set as to when it is appropriate for the Trade Representative to initiate an investigation. Few resources are given to him with which to conduct the investigation. Thus the burden lies largely with the petitioner to document and prove his case. Where the complaint is based on a complicated web of foreign governmental policies and industrial behavior, this is no easy undertaking. Government resources must be created and made available to bear a large part of this effort.

Discretion: One defect of current law from the viewpoint of the petitioner is that whether any government action is forthcoming at all is largely a matter of discretion. Where the law is mandatory -- with respect to the imposition of countervailing duties and antidumping duties -- the definitions of what practices are actionable and the countermeasures provided are too limited to be of sufficient value. It would not be possible to devise a statute which was as automatic as countervail or antidumping for countering industrial targeting. One could not define in advance a specific remedy that would be appropriate for all cases. It would be possible, however, to

describe in a statute the process of foreign government industrial targeting and to require some form of reaction from the Executive Branch to offset or ameliorate its adverse effects.

It is the unpredictability created by targeting and the absence of any sure remedy that inhibits the investment of U.S. firms faced with this form of competition.

Relief Provided: Section 301 provides primarily that the President may increase import duties or impose quantitative restrictions. This remedy suffers from several defects. One of them is that it only affects imports into the United States market. Furthermore, import restrictions may not always be an appropriate response. While it may provide some leverage to negotiate obtaining access to the foreign market of the country practicing a particular industrial strategy, this is not necessarily the case. The ability to use threats of U.S. import restrictions to affect the behavior of foreign industries competing with U.S. firms in third country markets is even more limited. The present statute should therefore be amended to envision specifically the negotiation of settlements which would offset the adverse effects of a foreign industrial policy.

Another major defect of a narrow trade remedy approach is that no attention is either required or given to steps which the U.S. Government or industry might take to meet the challenge posed by foreign industrial policies. It may be that certain R&D projects will require some government funding. In the right circumstances, this could be a far more positive response than

trade restrictions. Problems of capital formation generally may have to be addressed.

We should learn from our trade cases and where shortcomings in other policies are revealed we should take appropriate remedial steps in those areas as well. The imposition of trade remedies alone will not suffice in the long run. Petitions for trade remedies should not be viewed in isolation from other actions which government and industry should consider to enhance U.S. international competitiveness although the existence of broader proposal should not be a necessary precondition for relief. The filing of a case will often point out broader problems that extend far beyond the bounds of an individual petition. Questions will be raised about our "infrastructure". For example, our educational system is growing weak in basic sciences at the secondary education level. At the graduate level we are not training enough electrical engineers. There may be shortcomings in our retraining of skilled workers and professionals as well as in relocation assistance for bringing the workers to areas where new employment is located.

CURRENT LEGISLATIVE INITIATIVES

Two bills are currently pending before the Congress which would effectuate needed improvements in our current trade laws. The High Technology Trade Act of 1983 (H.R. 1052), introduced by Rep. Shannon, is legislation designed specifically to address trade problems which are emerging in the high technology industries. This bill represents a package which would greatly strengthen this country's ability to maintain the competitiveness

of its high technology industries in the face of increasingly pervasive foreign government intervention in this sector. In addition, Rep. Jones is sponsoring a bill (H.R. 1571) which addresses the need for trade law reform across a wide range of industry sectors, including high technology and services. Because of its scope, it enjoys a wide backing. The Jones bill contains a distillation of the essential provisions of the Shannon High Technology bill.

The Shannon bill ("the bill") recognizes that the threat to the U.S. high technology industry from foreign competition is largely a result of restrictions on U.S. access to foreign markets and various forms of foreign government intervention. While the U.S. market is open to foreign high technology imports and investment, many foreign industries remain insulated and enjoy a substantial competitive advantage through Government policies and measures.

The bill authorizes the President to negotiate and enter into agreements and to take other action to obtain and preserve maximum openess with respect to international trade and investment in high technology. The degree of openness abroad is measured by looking at factors such as competition in more open markets, structural barriers facing U.S. companies, "national treatment", structural advantages enjoyed by foreign industries, mutual access to joint research, and the extent to which foreign-held U.S. market share was obtained through unfair advantages. (Sections 3 and 7).

International agreements would include commitments to reduce or eliminate tariff and nontariff barriers (including an acceleration of tariff reductions), a "national treatment" commitment, a commitment not to discourage procurement of U.S. high technology products, and other commitments ensuring access for U.S. companies to projects involving financial and scientific cooperation. In order to carry out these assignments, the President may modify tariff treatment, or submit to Congress proposed changes to U.S. laws. (Section 3).

The President is to determine on a continuing basis whether any major nation is not taking substantive action to provide national treatment for U.S. high technology exports and investment. If consultations with such countries fail to rectify the situation, the President is directed to utilize existing authority to obtain redress.

The bill contains a number of monitoring and reporting requirements. Any foreign government measures or industrial policies that distort trade and investment flows and adversely affect the U.S. high technology sector are to be reported to Congress annually by the Secretary of Commerce, working together with the Special Trade Representative and the High Technology Industry Advisory Committee -- a committee of industry representatives established by this legislation. (Section 5). This report is also to outline the steps the Administration is taking, or plans to take, to remedy the effects of sales at less than fair value, subsidization, or other unreasonable practices. If the President determines on the basis of such a

report that a foreign country has industrial policies or measures which significantly distort competition to the detriment of a U.S. high technology industry, result in sales below market value in the U.S., or involve subsidies which injure U.S. high technology industries, the President is directed to use his existing authority to obtain the elimination of such practices or to offset their adverse effects. Monitoring of the bill's implementation will be conducted by the Secretary of Commerce, who will report annually to the President, describing trade and investment levels and market conditions. (Section 6).

All of these measures would involve the U.S. government more actively and effectively on behalf of U.S. high technology firms. The bill's emphasis on the negotiation of bilateral agreements designed to mitigate the effects of foreign industrial practices represents a more sophisticated and effective approach than the imposition of trade remedies. The sectoral analytical capability of the government would be significantly enhanced as a result of the monitoring and reporting provisions. The government would be encouraged to address trade problems in the high technology area more comprehensively.

The Jones bill, H.R. 1571, incorporates a number of essential aspects of the High Technology Trade Act in addition to providing for more general improvements in existing U.S. trade laws. As in the Shannon bill, the U.S. government is given a negotiating mandate to seek the elimination of barriers to U.S. exports and investment in high technology sectors, and the amelioration of the market distorting effects of foreign industrial policies on

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U.S. high technology firms (Section 5). In addition, the United States Trade Representative is directed to report to Congress analyzing factors which significantly affect the competitiveness of U.S. high technology industries (Section 3). Furthermore, Section 301 of the Trade Act of 1974 is strengthened to give the President a more flexible range of tools with which to exert leverage against foreign countries engaging in market distorting practices, and to direct the President to take into account the impact of any action taken under Section 301 on the national economy, including employment, inflation, industry rationalization, and consumer costs. All of these measures will enhance the government's ability to undertake a more informed, comprehensive and effective response to market distorting foreign practices.

Legislation similar to the Jones bill is pending in the Senate, Senator Danforth's International Trade and Investment Act (S. 144).

I note that SIA does not seek to close or protect the U.S. market, but to open the Japanese market, and other foreign markets, and to mitigate the effects of foreign industrial policies. This legislation represents an important step toward securing this objective.

CONCLUSION

The improvement which these bills would make in our trade laws are needed -- and as I have suggested, additional changes are also needed.

Fundamentally, however, what is needed is not just a change in our trade laws, but a change in our national attitude. It has been said by foreign observers that we are a highly litigious people as a result in part of the limited role of government in the United States. This is how we wish it, but the time is ripe for making some changes.

The world economy functions somewhat as the authors of the Federalist Papers envisioned our democracy would. They felt that, given the right checks and balances, individual interest groups should pursue their conflicting objectives. The result would maximize freedom for all and obtain a balance of interests.

Increasingly in a number of sectors, international competition is being shaped by the participation of foreign governments in combination with their firms. This competition is unchecked by international rules. It will remain unbalanced as long as our government remains too embarrassed to promote the commercial interests of its industries.

For a relatively open international trading system to endure, the United States government cannot continue its indifference to the nature of international competition. In a broad sense our industries must compete from a position of equality, taking into account the support that foreign industries receive. This must be accomplished in a manner appropriate to our economic system. In any event, buffering trade measures may be required at the border in some cases. But if no other steps are taken to address the challenge of foreign industrial targeting, trade restrictions will be inevitable.

It would be too optimistic to assume that trade litigation -- the bringing of petitions to which a response must be given -- will soon be replaced by a U.S. government predisposed to trying to solve the problems of international competition posed by industrial targeting. A sweeping change in attitude is not likely to occur quickly within the Executive Branch. Therefore, new legislation will be required that puts less of a burden of proof on the petitioner and gives U.S. business executives faced with major research and investment decisions greater assurance of an adequate American response, both in terms of trade remedies and domestic measures.

H.R. 1571 & H.R. 1052: COMPARISON OF KEY PROVISIONS

Bill #/Title Date Intro.	Sponsor and Co-sponsor as of 3/9/82	Objectives	Negotiating Mandate	Amendment of § 301 Investigation	Monitoring/ Reporting Provisions	Services/ Investment/High Technology
H.R. 1571 Reciprocal Trade and Investment Act of 1983 February 22, 1983	Jones (OK), Conable, Vander Jagt, Schulze, Gibbons, Shannon, Downey, Frenzel	- To expand competitive U.S. exports by achieving substantially equivalent competitive opportunities. - To improve the ability of the President to identify barriers and obtain their elimination. - To encourage the expansion of international trade in services and to enhance the flow of foreign direct investment.	- Adds new negotiating objectives for Section 102 Agreements in the areas of services, investment and high technology. - H.R. 1571 does not include authority to proclaim elimination of duties on computers or semiconductors. (Companion bill — S. 144 in the Senate does include this authority.)	- Defines the terms unreasonable, unjustifiable and discriminatory. - Expands the range of responses to include proposing fast-track legislation as a 301 remedy. - Alters procedure: (1) Authorizes USTR to initiate an investigation; (2) allows USTR to delay consultations for up to 90 days.	- Directs the President to prepare national trade estimates which would identify barriers to U.S. trade and investment and estimate their impact. - President reports annually to Congress on the trade-distorting impact of those practices, and any action taken, or the reasons for no action, to eliminate such practices.	- Creates a new regime for the coordination and development of U.S. trade policy for services. - Negotiating objective in the high technology area incorporate principal concepts in H.R. 1052, including (1) obtain and preserve maximum openness, (2) reduce or eliminate all barriers to, and trade distorting effects of, foreign government acts, policies or practices, including foreign industrial policies, denial of national treatment, anticompetitive practices,
S. 144 Trade and Investment Act of 1983 January 26, 1983	Bentsen, Andrews Boren, Bradley, Chafee, Chiles, Cohen, Cranston, D'Amoto, DeConcini, Doyle, Glenn, Grassley, Hart, Heinz, Hollings, Inouye, Kasten, Mattingly, Melcher, Mitchell (ME), Moynihan, Pressler, Proxmire, Randolph, Riegle, Roth, Simpson, Symms, Tsongas, Percy, Cochran, Ford, Helms, Spector, Exon.					

H.R. 1571 & H.R. 1052: COMPARISON OF KEY PROVISIONS

Bill #/Title Date Intro.	Sponsor and Co-sponsor as of 3/9/82	Objectives	Negotiating Mandate	Amendment of § 301 Investigation	Monitoring/ Reporting Provisions	Services/ Investment/High Technology
						(3) obtain commitments not to discourage government or private procurement, (4) obtain commitments on access to joint research and (5) protect intellectual property rights.
H.R. 1052 High Technology Trade Act of 1983 January 27, 1983	Shannon, Gibbons, Lundine, Guarini, Beilenson, Edwards (CA), Dymally, Fazio, Matsui, Lantos, Mineta, Boland, Nelson (FL), Moakley, Patterson, Stark, Simon, Pritchard, Market, Jeffords Sunia, Corroda.	- To obtain and preserve maximum openness with respect to international trade in high technology, goods, services, and information and for investment in high technology industries. - To strengthen the international trading system as embodied in the GATT and related agreements.	- Provides new, independent authority for President to negotiate and conclude bilateral and multilateral agreements to achieve the purposes of the act. - Agreements may include commitments not to discourage public or private procurement and to eliminate tariffs, or other barriers, to high technology trade.	- Does not amend Section 301. - Requires President to determine when foreign countries deny national treatment to the detriment of U.S. high technology industries. President to consult and take action under agreements or U.S. law as appropriate.	- Secretary of Commerce analyzes and reports annually to Congress on foreign industrial policies or measures which distort trade and adversely affect U.S. high technology industries. President to take action under U.S. law to obtain elimination of such practices or offset their distorting effects.	- Services and investment covered as they relate to high technology.

Mr. FLORIO. Thank you very much.

One of the suggestions that has been made with respect to the question of targeting, specifically the area you have talked about, is that the United States should undertake policies, in the sense targeting policies as well, and yet though the targeting initiatives that you have made reference to today, particularly the Japanese targeting depend, in large measure upon closing the market for at least a period of time.

You just said that closing our market would not work, why does closing the Japanese market to outside competition, why is it a key component of their success and the feeling is yet that closing our market, particularly when we have a much bigger market than the Japanese market would be for their domestic consumption, why does targeting if pursued equally by nations, why is it we feel closing our market would not benefit our industries in the way that apparently closing overseas markets benefited our trading partners' industries?

Mr. WOLFF. In electronics the Japanese have structured a market in which the purchases of components are made substantially by a small group of vertically integrated very large companies.

In effect, we believe their market is substantially closed to competitive products already. It would also be closed to the next level of product, the circuit boards, for example. So, it is an effective process for the Japanese.

In the United States we have a highly diverse consumer base and it would really not be feasible to go after product after product, closing each market. It would also be an error in terms of our international competitiveness.

Mr. FLORIO. What would then be appropriate components of a targeting policy by the United States if the United States were to embark upon this type of policy, as we apparently have learned the Defense Department intends to do with respect to the super computers as they describe them?

Mr. WOLFF. Mr. Lidow may want to add to this. There are a number of things we can do. As he has mentioned, one of the things we want to do is deprive the Japanese of a protected home market base from which they compete.

Mr. FLORIO. But that is reacting to someone else's action.

Mr. WOLFF. On our side, there are two research cooperatives which have been founded, the Semiconductor Research Cooperative, and the Microelectronics and Computer Technology Cooperative.

They have already been faced with questions under our antitrust laws. The MCC has already received a 5-month review from the Department of Justice, the conclusion of which, as I understand it, was if you don't violate the laws you have no concerns. In other words they have been given no assurance by the Department of Justice that their activities will not be attacked by either the Department of Justice or private litigants.

That is a very unequal way of trying to compete with the Japanese.

I don't think there are any serious antitrust questions raised by the MCC but nevertheless they could be tied up in some very ex-

pensive litigation. We need changes in the law to deal with that. There are a number of bills before Congress now that would help in that regard. So joint R&D is one response.

Mr. FLORIO. How about capital allocation? You mentioned that the Japanese are generous in grants of credits and so on. Is this something we should consider in terms of targeting initiatives?

Mr. WOLFF. I think that Government support of some joint research endeavors might be useful. Direct capital allocation to individual firms, would however, be inappropriate. It would be very difficult for our system to take this approach efficiently.

Mr. FLORIO. On the point that you raised about keeping the Japanese—specifically talking about the Japanese market—open so as to in a sense keep competitive pressure on them, doesn't that argue for the concept of reciprocity, not on a sector-by-sector basis but in terms of the total trade balance between these two nations or any two nations? I conceive of someone arguing that in the leverage the United States has with respect to keeping the semiconductor industry in Japan open so as to avoid the consequences of that closed market, would probably come from our ability to impact upon the Japanese automobile market in this country. And that that concept of reciprocity probably makes sense and is the best leverage to keep markets open because in a sense the implicit threat is there that if you close your markets to products that you are developing we are going to close our markets or restrict our markets to products that you already are productive in, that you are effectively penetrating our markets in?

Do you feel comfortable with the concept of reciprocity used in the way that I have just described so as to induce markets to be kept open in our trading partners' economic arenas?

Mr. LIDOW. I don't feel comfort with reciprocity in that it appears to be a form of protection. In the first problem, it would be you know, soybeans versus cars, we don't want to import cars and in exchange they import soybeans. If we do it in a high technology product versus high technology product I think you come across a lot of problems in terms of definitions.

They can ship a product here that is state of the art and import from us something that is 10 years old but it is still categorized the same as high technology. But in broad brush we don't want protection from the Japanese. We want to have an open access to their marketplace.

In certain areas our market share in Japan should be greater than theirs in the United States.

Mr. FLORIO. But as a practical matter, they are not going to gratuitiously do those things when it is clear they perceive—and they are correct—it is in their interest to close that market, and to develop that industry and be able to do what they have done according to your charts which is develop that industry to such a degree in a protected context to be able to penetrate our markets at that point and steal away the capabilities of our productive industry to continue to earn appropriate rates of return to the point it is not as productive as it used to be.

What is it you will do, or advocate be done to induce the course of conduct that you are lamenting to change? Why would the Japanese in any way decide to open their markets, when they have

made the decision that the closed market is more protected unless we have the ability to say that in the overall trade relationships that it is in their interests to do that, to open their market, because failure to do that will result in some other activity or action being taken?

What is it you suggest if you don't agree with the reciprocity, one sector being used to induce action in another sector, what is it you suggest be done to persuade the Japanese in this case to change their course of conduct?

Mr. LIDOW. I think more than just saying—I don't disagree with the concept of reciprocity, I think it has to be used judiciously, since it is a form of protection, and a form of affirmative action. We do need to see an increase in our penetration of the Japanese semiconductor high technology markets. In that sense that is reciprocity. We want to see an increase in market share. We want to see our market share more closely resemble what we feel it is.

The things that we are concerned about is that we feel that our market share in Europe, for example, is rather great, and if reciprocity were invoked as a countermeasure to what we did in Japan, we would lose market share.

Also we are as an industry asking for the least amount of protection in our home markets. It would be in our customers' worst interests if a product that was competitive was not allowed to be imported. That is what we are trying to prevent. Maybe we are trying to prevent it with a lot of rhetoric, maybe what we need is some sort of official action of reciprocity to increase our market share.

But what we feel is that that is not a long-term solution to the problem and does not guarantee the long-term competitiveness of our industry.

Mr. FLORIO. I am working from the assumption that you argue that your industry is competitive and that absent the extraordinary efforts that you describe by the Government of Japan to be of assistance to at one point, its less than competitive industry, you would be in a position, with free market forces operating as they are supposed to, you would be in a position to have a larger share in Japan.

That is not the case, though. I think you make the point that as a result of governmental intervention that the less-than-competitive semiconductor industry in Japan has been increased to the point that it is now so competitive—not in the free market sense—but it is so competitive that it has been able to displace your industry not only in Japan but in the United States.

So I think that leaves us with the question of what it is we are supposed to do and whether there is a need for governmental involvement on our side of the trade balance question. If it is, what form does it take?

At least at the outset you said you didn't feel comfortable with the reciprocity concept, particularly if it was protectionist than some would see it, the question is what is it you see happening to change this balance other than governmental intervention? Do you see the private sector being able to take care of itself when it is competing against the Japanese industry plus the Japanese governmental activity?

Mr. LIDOW. Before we resort to protectionism we would like to see legislative approaches that don't necessarily restrict people coming into our country and competing, more in facilitating action if that competition is unfair. I think certain——

Mr. FLORIO. The competition in our country?

Mr. LIDOW. Right. As Mr. Wolff said, many times our legislative solutions are too slow in order to react to the fast pace of the high technology industry. You are three generations down the road and you are still trying to prove that the third generation back had been dumping or whatever.

Mr. FLORIO. I understand that and I agree with that. But I thought you said earlier on was that the key factor of the protected environment in Japan to develop the industry is the way that they are free from any effective competition that would keep everyone honest in terms of marketplace forces. I don't know how that problem is going to be addressed by import protection devices, 301, 201, whatever, and I am to a loss as to see how you are going to address what you have described as the key factor which is the ability of Japan to protect and to have this incubation period free from the rigors of the marketplace forces, and I don't know how that will happen without some governmental intervention on our side.

Mr. WOLFF. I think you are right. There has to be. This morning for the first time, at the Department of Commerce the Deputy Assistant Secretary of, Clyde Prestowitz and Jim Murphy from U.S. Trade Representative are sitting down with their counterparts of the Japanese Government, and Japanese producers and representatives of the American Semiconductor Industry are sitting down to discuss the problems of government targeting.

Our proposals are as follows: We want to participate in the Japanese market to a much increased degree, not years from now, not slowly, but now within the next few months. We want to be able to invest in Japan which has been a very slow process in the past. Now, the Japanese are making available Japanese Development Bank loans to American companies, in other words allowing us to produce in Japan and to participate in the joint R&D projects.

Targeting doesn't work if you have a lot of foreign participation in your marketplace. It needs protectionism. If we can dilute that protectionism then we undermine the foreign targeting practice.

Mr. FLORIO. I understand what you want and what the discussions are, but from the Japanese standpoint why? Why should they, particularly if we give away the club, which sounds warlike, but the leverage that comes from impacting their opportunities to penetrate our market in other areas where they clearly are more competitive. I don't know why they would voluntarily do those things?

Mr. WOLFF. Ultimately one has to resort to legal action if negotiations don't succeed. We said we would be willing to file a case and ask the Government to take Japan to the GATT both for its subsidies and its protection this summer if there isn't some help, some change in Japanese policies.

Mr. FLORIO. One of the things we are doing in our Service Reciprocity bill is to try to increase, provide jurisdiction on investments overseas. You have made reference on a couple occasions to the performance of the effort to invest in Japan and take advantage of

some of the programs they have there. Under the GATT as of now and even under 301 as I understand it, investment policies are not covered by some of those mechanisms that are currently in operation.

Many nations require there be overseas areas in investment policies and so one of the things we emphasize not only in the legislation we address today but in the Service Reciprocity bill is the need to define investment policies as services or define them somehow so they are covered by GATT or the existing mechanisms for filing complaints against overseas trading practices.

Mr. WOLFF. That will be essential. There are no rules to speak of governing either services or investment in a broad way internationally.

Mr. FLORIO. You are aware of the point I made before about the Defense Department. Do you have any thoughts on that initiative coming out of the Defense Department?

Mr. LIDOW. Whereas we welcome the interest of the Defense Department in such aspects of the fifth generation computer program which I believe is what you refer to, we feel that it would be in the industry's best interests to focus the effort by supporting the existing programs in that field like the MCC, which Mr. Wolff referred to earlier.

We are also somewhat concerned that the cloak of national security will be thrown over any developments in this area as it has at least in the very high speed integrated circuit program which is now going on.

Therefore, just in conclusion, we just think that the money would be better spent focused on existing programs designed to achieve the same things, and that we would also propose that it would be in the best interests of everyone if national security and secrecy were not invoked in any projects like this because the commercial implications are far greater, I think, than even the defense implications.

Mr. FLORIO. Of course the argument has been raised by some that we have been developing much of this technology and that in fact others are benefiting from it because there isn't sufficient security and that much of the technology programs have been benefiting others. Are there any improvements that would be required in terms of security on these types of technologies so as to inhibit some of our trading partners from developing those programs and initiatives that we have developed, and stopping them from taking advantage of some of the things we have developed in a costly way?

Mr. LIDOW. We think there are several steps that can be taken to prevent the flow of technology to, particularly to Eastern bloc countries. We are not that concerned about Eastern bloc trade. It doesn't mean much to us. What we are most concerned with is reducing our competitiveness by preventing West-West trade. I believe that the main issue is not the level of technology of the Eastern bloc countries, it is the relative level of technology between the East and the West. If our overall competitiveness or commercial edge is dampened in any way through restrictions in West-West trade, perhaps we will maintain a differential level of technology, but it will be smaller than if we are allowed to expand our technological capability as fast as we could in a free market.

Mr. FLORIO. Just to share with you, I mentioned before I went to the trade conference in Athens. One of the things I thought particularly interesting was the approach of the Prime Minister of Greece who was the host, host country, I don't think Greece acknowledged this point as being a world leader in high tech industries but they have the intention of moving in that area.

The Prime Minister suggested that one of the reasons for their interest was that they felt they had a particularly good relationship and one that could potentially improve beyond what it was with the Eastern bloc nations and therefore to the degree, particularly the Balkan areas, to the degree they could then develop and that meant protect their fledgling high tech industries from penetration by Western nations—talking about France as well as the United States and West Germany, of course—they would be able to develop that industry and then have in a sense a captive market in the Eastern bloc, particularly the Balkan nations, Hungary, Albania, et cetera.

That almost sounds like the same thing we are hearing now with respect to Japan. The intent is to keep out the more productive nations' industrial products in high technology so as to be able to build up and then to exist off the domestic market as well as in this instance a, what was perceived as a captive market, in that part of the world.

It just seemed to me that this trade conference which was discussing the opportunities for trade almost came down to everyone saying they wanted to maximize exports, minimize imports, and everyone saying that what they wanted to do was to stop competitive productive products from other nations from coming into their country because by virtue of being competitive and productive that would undermine the ability of those nations to develop their own less-than-productive competitive industries into productive competitive industries.

So that the Japanese model you describe in this particular area seems to almost be the goal of a whole lot of other nations and that their intent is to move in that direction which was relatively to my concerns as expressed to the representative of the Commerce Department, that the status quo doesn't take into account what it is that is the intention of most of the industrialized nations of the world and the less-than-industrialized nations who intend to be industrialized nations, that their goal for the future is to do the same thing that the Japanese have done, carrying out different areas of expertise, carrying out different areas of growth.

But if we accept the status quo or if we accept the fact that we are going to continue to do business as we have done in the past, we are going to be existing as an island in a world that is changing into a competitive arena in which everyone is going to be doing what you have described the Japanese as doing.

Is anything what I just said relevant to your own observations about what is happening in the world?

Mr. LIDOW. I would say very much so. The Japanese model is being adopted worldwide. It is a successful model so far. Unless in the 1980's or sooner than that we develop an effective counterstrategy to this the United States will be a character cast from which all the industrialized and soon-to-be-industrialized nations will feed.

Mr. FLORIO. You say "we", you are talking about we I assume as a nation inevitably requiring some governmental presence in that deliberative process of developing this strategy?

Mr. LIDOW. I think we have to compensate for the economic incentives across the oceans with extreme innovation on our part and the Government should help as much as possible in inspiring rather than thwarting innovation.

Or we will have to have some Government countermeasures, yes, to prevent targeting from coming into play as the innovation advantage diminishes, which is characteristic of even a high tech industry even after it has been around a few years.

Mr. WOLFF. We have enormous strengths and I don't think we should follow the Japanese model. I think we should build on our own strengths. One thing we can do, mentioned earlier, was allow joint R&D projects without threatening them with legal action if no harm is done. We also ought to be increasing the amount of electrical engineers and other kinds of scientists that we are graduating. And we can do that as a country.

We ought to work more on retraining of workers for the job opportunities being created now.

We ought to have manpower policies that bring workers from one area of the country or some industries into other industries. We don't even have a national jobs register to make information available to workers as to what kinds of opportunities are available generally in the economy.

There are a number of things that we can be doing and more targeted aid is important. Funding of individual projects where there appears to be a need. Ultimately you are quite right. The U.S. market is the world's largest market. It is an attractive market. If others are going to shut us out in a particular area in order to develop their own capability, then one has to create some uncertainties here as to continued access to this market.

Mr. FLORIO. Isn't the problem in some respects—when we talk about shutting others out of our market, inevitably one of the first responses, well, the consumers pay the price. We are sensitive to consumers' concerns, of course. Yet it appears that there doesn't seem to be that same consumer concern in other national markets.

I was in Japan not long ago and the price of some agricultural goods, and price of some food, it was rather high. It doesn't appear there is a consumer interest or consumer lobby or whatever you want to describe it as that puts appropriate or comparable pressure on the Government there to open the markets so that less expensive products, agricultural products to use an example, are able to be brought into that market so the consumers can benefit.

Is it the case that we just have an extraordinary sensitivity to consumers' concerns in this Nation that provides for the leverage to keep our markets open, notwithstanding the fact that it adversely impacts the businesses which are affected by imports?

Mr. WOLFF. I think there is an aspect of that, but also that we as a Nation strongly believe that the lesson of the 1930's is that openness of markets is absolutely essential to world prosperity. Therefore we maintain our own market open when others are tempted and sometimes succumb to those temptations to close down.

It doesn't mean that Europe is closed or Japan is entirely closed or the developing countries are, but there is an increasing tendency in the current recession to impose increasingly restrictive import regimes. We have to counter that.

Mr. FLORIO. Gentlemen, thank you very much.

Mr. WOLFF. Thank you very much.

Mr. FLORIO. We are pleased to have with us Mr. Lawrence Fox, vice president for international economic affairs of the National Association of Manufacturers.

We welcome you to the committee. We appreciate your patience through the course of the long but productive hearings, I think, this morning. Your statement will be made a part of the record in its entirety, you may proceed in summary fashion if you see fit.

STATEMENT OF LAWRENCE A. FOX, VICE PRESIDENT FOR INTERNATIONAL ECONOMIC AFFAIRS, NATIONAL ASSOCIATION OF MANUFACTURERS

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

I have in a sense enjoyed the hearings, not so much some of the somber conclusions that we must draw from them but I think the approach that you and your committee are taking at this time is particularly important, particularly your recognition of the interaction of trade policy and for an industrial policy and the requirement that the United States make some changes in order to adjust to the realities of the world marketplace under these conditions.

So I wish you well in these hearings and I hope you will continue them, particularly until the subject of industrial policy and trade policy is brought to a more satisfactory sense of understanding.

Mr. Chairman, NAM represents approximately 12,000 American manufacturing companies. That is about 80 percent of U.S. industrial output, and 85 percent approximately of our country's industrial employment.

Insofar as exports are concerned, our membership is even more significant in those numbers and I think our members represent a higher proportion of manufactured exports than even the figures I have just given.

In 1982 our manufactured exports were valued at $180 billion. This represents a decline of approximately 9.5 percent from our 1981 exports of manufactured goods. The explanation of this decline involves a number of factors, some of which we will be able to go into in a little greater detail but most importantly it is necessary to recognize the effect of the worldwide recession which has drastically reduced the purchasing power of many of our traditional and growing international customers and second, the high value of the U.S. dollar which in many cases has priced American goods out of export markets.

At NAM we are concerned by the effect of these and other developments on our balance of trade in manufactured goods.

In 1981 the United States enjoyed a $12 billion surplus in manufactured goods trade, but in 1982 suffered a $16 billion decline, in other words, that $12 billion surplus in manufactured goods in 1981 was succeeded in 1982 by a $4 billion figure in the red.

We cannot let these adverse developments obscure the fact that the value of trade to the United States is tremendous. As a percentage of our gross national product imports and exports were each at 4.3 percent in 1970, and currently are 8.3 percent on imports, and 6.8 percent on exports.

A good part of that differential is accounted for by the tremendous growth in imports of petroleum products.

It is precisely these trends which indicate a greater interaction of our economy and the world economy that require that we take into account the competitiveness of our industries, in world markets as well as in U.S. home markets.

Here there is considerable cause for alarm. In 1982 the trade deficit was a total of $42.7 billion. It was the worst in our history and it is entirely certain that at this point the trade deficit in 1983 will be worse.

NAM recently released a report, U.S. Trade: Record of the 1970's—Challenge of the 1980's; you have the report, Mr. Chairman, and copies are available for those who would like to take them.

In this report we analyze significant changes in the U.S. trade picture. I would like to share a few of the conclusions of this report with you and your committee, and I would request that the report be made a part of the record of the hearing.

The report makes very plain that the key to the growth in our exports since 1972 has been in manufactured exports. These have experienced a four-fold increase since 1972.

The purpose in this reference is not to denigrate the importance of agricultural exports; they are very important. But the big numbers are in manufactured goods.

Further, manufactured exports are critical to job creation. Between 1977 and 1980, 30 percent of the net increase in private sector employment was due to manufactured exports. Yet, in contrast to our chief economic competitors, Japan and Germany, we have not been able to maintain consistent net trade surpluses from trade in manufactured goods.

Our trade balance in manufactured goods has wandered in and out of surplus over the course of the past decade, while Germany's and Japan's have generated consistently higher net earnings.

In 1981, for example, Germany had a surplus of $61.7 billion in manufactured goods trade, five times the surplus of the United States that year, and Japan had an incredible $115.6 billion surplus.

I remind you that the corresponding figure for the United States was a surplus of $12 billion in 1981, and a deficit of $4 billion in 1982.

To conclude that this marked imbalance between the United States and Japan with respect to net earnings at almost the same level of exports is all right, because Japan needs to import raw materials, is in our view wrong. It is a concept put forward in this country to have this tremendous trade surplus in Japan because of the requirement to import raw materials. I think that is a view that is not entirely well-founded.

In 1981, the United States had a negative trade balance with Japan in manufactured goods of almost $30 billion.

In assessing how these trends can be reversed, the first point to be considered is that for the United States especially, the strength of the domestic economy itself is the primary determinant of international competitiveness. I have long argued that two-thirds of our trade problems relate to domestic issues; only one-third to trade policy directly. It is that one-third of the problem I will discuss today.

In a sense, we should be encouraged by the fact that much of our problem can be traced to the low priority given to exports, especially manufactured exports. One need look no further than pending legislation and administrative decisions in this area: Exchange rate policy, the Export Administration Act, the Foreign Corrupt Practices Act, DISC, Eximbank, and the *Houdaille* case. Each in its own way represents a failure to recognize our need to be competitive vis-a-vis foreign producers, whether that competition is for sales overseas or here at home. Similarly, each offers an opportunity for improvement of policies in our country.

Let me first refer to exchange rate policy. It has not been given sufficient weight in the hearing so far today and, in my opinion, it is the most important single factor that could be addressed by governmental policy at this time.

The serious misalinement in exchange rates which exists at this time is of growing significance, both with relation to Japan and with relation to other countries, particularly Germany.

The misalinement of the exchange rate with the yen, although it has varied, at present is about 20 or 25 percent. This gives Japanese goods a price advantage in our market in the 20–25-percent range; a corresponding price advantage in third-country markets where we must compete; and the same amount in Japan, raising the price of American goods sold to Japan.

When I assert that the yen-dollar rate is wrong, I refer primarily to the fact that though Japan has gained on the United States in recent years in virtually every measure of competitiveness, her currency has not strengthened. In fact, her currency has weakened.

The explanations relate primarily to factors other than trade. In many respects they relate to domestic monetary and economic policy and the high interest rates in the United States which have tended to strengthen the value of the dollar by bringing about very large and sustained inflows of capital into this country.

Under these circumstances, the dollar has risen and in fact the yen has fallen in great part due to the fact that interest rates in Japan are so low and Japanese money has come to this country, because of the differentials in the interest rates and other factors in relation to the tremendous flexibility and depth of our financial markets.

Perhaps another way to say it is, whereas the economic theory would relate exchange rates to changes in fundamental competitiveness as exemplified in trade flows, in recent years we see capital movements overwhelming the importance of trade flows and bringing about this very great strengthening of the dollar and the corresponding decline in American competitiveness of our manufactured goods in our own market and in third-country markets.

Mr. FLORIO. Doesn't that dictate some degree of intervention into what is traditionally regarded as things that automatically, by virtue of marketplace forces——

Mr. FOX. I smile at your reference to traditionally. Until August 15, 1971, there was a responsibility of governments to maintain a reasonable rate of exchange between their currencies and the dollar. The par value system under Bretton Woods did that.

Since 1973, we have had a floating exchange rate system, and it is only in that context that the observation of the traditional role of the market is appropriate to be referred to.

But, in fact, the old aphorism, "today's solution is tomorrow's problem," we have a situation now which is worse in terms of American trade competitiveness than that experienced under the par value system because the floating exchange rate system has floated, at least so far as the United States is concerned, in relation to its two most important industrial competitors, Japan and Germany. It has floated contrary to the change in the fundamentals.

I think the first requirement is a recognition of this on the part of our own Government, particularly the Treasury and the Council of Economic Advisers. Those two agencies say:

> Yes, it is true; there is a tremendous disadvantage on American companies arising from the very strong dollar and the weak yen and the mark. But that will all have to take its place in relation to the change in our interest rates and our interest rates can only change in relation to the closing of the size of our budget deficit. That is right in theory but wrong in practice.

I don't think we have the time to wait the 4 or 5 years or even longer, that the operation on the size of the Federal deficit would bring about that result.

I would conclude, therefore, that your observation about currency intervention is a correct observation. By the way, it is shared in a recent report by the U.S. Atlantic Council, which has recommended a target zone system involving the five major currencies that make up the SDR in the current IMF system: The dollar, the mark, the yen, the franc, and the British pound.

I personally favor such a system. I favor it with a reference point which could be adjustable with circumstances for the principal currencies, referring to the mark and the yen, to keep the matter manageable.

I think there is general agreement, and I think the Japanese agree also, that perhaps 200 to 1 would be an appropriate exchange rate for the yen, and perhaps 2 marks to $1 or 2.15 marks to $1 would be an appropriate exchange rate for the mark.

Mr. FLORIO. I think it is ironic, just to note that my recollection is that in the 1980 election, one of the major issues was, of course, the criticism that was raised with respect to the weakness of the dollar, and that at that point, the interest rates were at least as high as they are now.

The criticism was that that was resulting in outflow of capital. There almost seems to be no ability to correlate cause and effect.

When you are talking about higher interest rates than you have now, and the high interest rates now are thought to be the strength of the dollar which results in an inflow of capital from overseas sources, which causes economic problems in other nations,

there almost doesn't appear to be the ability to rely upon the traditional indicators to indicate which way exchange rates should go.

Mr. FOX. That is a good observation.

There are two things that influence that. One, its current account position, which is a broader statement of the trade position and takes into account investment and other earnings. And second, the interest rates.

What actually has happened is that the strength of the American economy was misperceived in 1978 and 1979, and in a relative sense, the dollar was weaker than it ought to be, and the mark and the yen subsequently adjusted to that weakness in the dollar.

As it was perceived, particularly following some events in the Middle East in the oil crisis, and our more successful efforts to control inflation here, the real strength of the American economy became more evident, and particularly the logic of putting savings here. Not only were the interest rates very attractive, but the safe haven effect began to take place.

If you were a country in the Middle East and had excess funds to invest in the range of $10, $15, $20 billion, there was really no place to put that money except in the United States. Even though those countries might put it in Switzerland or Frankfurt or London, it would end up in New York.

I think what your question implies is that a certain degree of management of the monetary system is right and the market isn't always right. In the instance that we are in now, it is obvious that the market is calling for a rate of exchange which may be correct in terms of the safe haven effect or current places to invest the money, but it is totally disastrous in its consequence to the American industrial base.

A very distinguished group of monetary economists known as "The Group of Thirty," in a report last spring referred to the consequences of a persistently overvalued currency. The statement was that a persistent overvaluation of a country's currency is a prescription for deindustrialization.

No country is cited. Some people might have thought they were talking about the United Kingdom. It seems to me that the reference could very well apply to the United States.

Might I just conclude on the target zone system. One establishes these so-called reference points. For illustration, I gave the dollar and the yen and the dollar and the mark, but you would have a 5 percentage point zone on either side of the reference point. And the countries would intervene in their own currency to maintain those rates.

It might be difficult, it might be easy to maintain those rates.

Mr. FLORIO. What is the form of that intervention?

Mr. FOX. Buying and selling foreign currencies.

When the dollar is getting outside that zone of relativity to the mark, and the yen is not in the zone, the Japanese would buy yen or the United States would buy yen. That would bring the yen up. Correspondingly, the same would be done with respect to the mark.

But the simple intervention alone is not likely to work in the face of the disparity in interest rates which now exists, even with the decline in interest rates in the United States of several points. We have a prime in this country of about 12 percent now and the

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corresponding figure in Japan is probably about 6.5 percent, maybe 7 percent.

There are differential primes in Japan, depending on how close your industry is viewed to being in the national interest.

I wanted to conclude on the exchange rate subject by saying that matter will be taken up again at the Williamsburg Summit—they will consider the efficacy of exchange rate intervention—but in my opinion, it is a unique responsibility of a government to maintain a proper exchange rate for its currency or to seek an international system that does that.

The U.S. Government appears to be unable and unwilling to recognize that problem, and defers to the market as being beyond contradiction. I think they are making a very serious error.

In view of your interest in the automobile subject, I might just say what the effect of this exchange rate misalinement is with respect to the price of Japanese cars. If you take an invoice price of the average Japanese smaller car at $5,000, a 25-percent differential is $1,250. If one adds the rebate of the Japanese commodity tax—similar to a value-added tax except the Japanese apply different rates on different products—for smaller cars it is 17 percent; so that is $850, a total of $2,100.

So, on a $5,000 car, those two differential factors account for 40 percent of the price.

If the United States had built into its system of taxation a commodity tax or value-added tax or some similar excise tax, that differential wouldn't be that great.

Let me state the importance of the tax more directly. What it means is that Japanese purchasers pay that tax when they buy a car but American purchasers do not. That is a benefit for American purchasers in a sense, but it represents a factor in world trade where internationally traded goods on the part of countries with that tax, a considerable portion of national taxation is not being borne by exports.

Virtually, the whole world is on a system involving either a commodity tax, a value-added tax, or a national excise tax.

So, the combination of the wrong exchange rate and the failure to tax exported goods on a comparable basis with other countries is of very considerable general importance, which should be evaluated in terms of our overall competitiveness.

Mr. Chairman, just to go on to the other subjects briefly, because I know you want to have time for questions, the areas where we could take action now in a more conventional sense are these.

Export Administration Act; we have needlessly hurt our exports of manufactured goods and agricultural products by creating a policy of unpredictability with respect to the application of export controls on exports to the Soviet Union and other countries. The actions with respect to the pipeline decisions particularly illustrate this and the response by other countries demonstrate the consequences to our trade.

We now have a situation in Great Britain where products cannot be assured of British export credit on exportation to the Soviet Union if they contain components from the United States.

Other countries have responded to our pipeline actions in similar ways. The net effect is to affect our export position on goods not

even intended for the Soviet Union but intended for those other markets of industrialized countries.

We have testified on this subject and have proposed that in effect, the export policy section of the Export Administration Act be removed; that if the President wishes to impose limitations on exports for foreign policy reasons, he use his authority under the International Emergency Economic Powers Act or seek congressional authorization.

DISC is another example. This is a modest American export incentive, not nearly as powerful as the value-added tax or commodity tax I referred to, and a small portion of what is referred to as the territorial system of taxation applicable in Europe.

By that, Europeans do not attempt to tax export earnings on exports, the portion of export profits earned abroad. They tax only the portion earned at home. The DISC is an effort to offset that.

I think it is very important that we maintain the DISC or an equivalent to it. As you know, it was found to be illegal under the GATT, and USTR, Commerce, and Treasury are attempting to devise adequate substitutes.

I say that should be done, but bear in mind the substitute is a very limited one relative to the nature of the differential tax treatment of exports and imports in foreign trade.

Mr. FLORIO. Why wouldn't the VAT be equally inappropriate under GATT, as DISC would be, if the concept is the same?

Mr. FOX. It is a matter of history. GATT was written by an American. Therefore, they were thinking of constraining malpractices in trade characteristic in our country.

The GATT specifically authorizes rebate of indirect taxes on exportation. What they had in mind was the American system of a 10-percent tax on handbags. We had at times taxes on other items, including tires and automobiles actually.

What has evolved throughout the world, except in this country, is a value-added tax or a national excise tax which goes across the whole economy and in many countries is the principal nonbusiness tax. It is a tax on consumption.

There is no, absolutely no question that the value-added tax is 100 percent legal under the GATT. The European answer always when this question is raised, "why don't you, the United States, have a value-added tax," the Europeans say, "you are free to do so. Why don't you?" So it is important.

That is an issue for the future. It is a major change in our tax policy, and it is obvious that the value-added tax has some disadvantages.

There is a regressive element to the tax, but I think the value-added tax, or some other type of consumption tax, is an indication of a direction for the United States to take.

The Export-Import Bank, as you pointed out in your questioning earlier, is not at the level of funding that it was at the end of the Carter administration. The administration, this administration, has proposed some increase in bank funding, which would be welcome but it is a two-step increase, with part of the direct lending funds of $2.5 billion to come in a second supplemental step. I think that is undesirable.

The Export-Import Bank will not be able to act freely to make loans if it has not obtained the funding. I would urge that the Export-Import authorization and appropriation be in the normal way, with the total amounts authorized and appropriated in connection with the current budget process.

Foreign Corrupt Practices Act; it is another example of unilateralism on the part of the United States to bring about a standard of conduct that we would regard as normal that others do not, with a penalty being placed on U.S. traders and exporters.

We would hope that the House of Representatives would take up the amendments to the Foreign Corrupt Practices Act. The Senate passed such amendments last year, which were an improvement, and is expected to do so again shortly this year.

Turning now to domestic content; we are convinced that domestic content legislation would not help but would further damage U.S. international competitiveness. Therefore, we oppose it.

This point was made quite forcefully in a resolution approved by NAM's International Trade Committee. A copy of that resolution is appended to my testimony, and I would hope you make it part of the record, Mr. Chairman.

The consequences of the domestic content legislation would force the United States to violate the international agreements we have undertaken in the GATT. It would encourage an inefficient use of resources in the United States in an uneconomic fashion. And finally, it would place at risk more jobs than it would be likely to save or to create.

We are concerned, of course, with the potential of foreign retaliation which, of course, is authorized under the GATT, in the instance of the placing of an import quota on goods contrary to the GATT, without going through the escape clause process.

We are even more concerned with the unravelling effect that the legislation would have on international trade practices, which though far from perfect now are more open than they would be in a system of covert retaliation and the further impetus that the domestic content legislation would give to regimes designed to protect home markets.

We think that the legislation, although we understand the intent and have considerable sympathy for the objective of saving American jobs, is mistaken, and that the consequences would not be favorable.

It is evident that other countries move with a higher degree of speed and lack of judicial process in formulating trade policy, and I think the consequences of legislation such as domestic content legislation would be some retaliation and some covert and some open retaliation by other countries, and some emulation, covert and open.

Finally, I would like to refer to the Houdaille petition, which is a response by the Houdaille Co., to subsidies in a Japanese cartel. Houdaille has requested that the investment tax credit be denied any U.S. firm that purchases equipment produced by the cartel, at least until such time as the practices are removed, and NAM has supported that petition, not that we are entirely satisfied that it answers all the questions to Japanese industrial targeting.

It happens to be a sufficiently well-documented case to have brought a degree of attention not evident in any other industrial policy action in our government. That matter is before the trade representative and the Interdepartmental Committee on Commerce and Trade.

I think the practices that are employed by Japan by way of subsidies protect the home market, the cartel practice in fostering the production of American-controlled machine tools are practices that could not be emulated by the United States, not only because of the role of U.S. antitrust laws, but because of other considerations in the nature of our open and more diverse market.

May I conclude with respect to reorganization of the executive branch?

We, of course, noted your bill, H.R. 2203, which we think is an important step in the right direction in terms of coming to grips with the analytical aspects of the interaction of industrial policy and trade policy.

We are not in a position to take a policy stance on that bill or some of the other bills with respect to government reorganization. That matter is now under consideration in NAM.

In the past, we have tended to favor a single department, a department which would encompass both the trade negotiations function, and the trade implementation function, including analysis and the granting of relief from import practices deemed to be unfair or otherwise relating to the domestic side of the import question, including the escape clause.

I still personally think there is some advantage to a single integrated department, and I note that your bill does not have the trade negotiations function in it, and I would think that is an important additional factor for you to consider.

Again, I would say this: There is more to the inability of our Government to focus properly on industrial policy, trade policy, than just the lack of organization in the executive branch.

The items that I have cited, the trade matters, and the legislation, are divided in responsibility among at least four committees of the House and a similar number in the Senate: Ways and Means; Banking; Commerce; Foreign Relations; and the Judiciary Committee with respect to antitrust. We have suffered uniquely from the inability of neither the executive branch, nor the Congress, to focus on the trade questions in their totality, and I just leave that issue for you as I conclude this testimony.

[Testimony resumes on p. 603.]

[Mr. Fox's prepared statement follows:]

STATEMENT OF

LAWRENCE A. FOX

ON

DOMESTIC CONTENT AND U.S. TRADE POLICY

BEFORE THE

SUBCOMMITTEE ON COMMERCE, TRANSPORTATION AND TOURISM

OF THE

HOUSE COMMITTEE ON ENERGY AND COMMERCE

APRIL 5, 1983

Mr. Chairman, members of the Subcommittee, I am Lawrence A. Fox, Vice President for International Economic Affairs of the National Association of Manufacturers. I am very pleased that this important committee decided to call hearings on international trade and honored to have been asked to testify. Virtually everything that affects commerce affects trade, and increasingly the impact of international trade works its way through the commercial life of every country. This is as true of the problems associated with trade as it is of the benefits that flow from it.

The 12,000 member companies of NAM account for approximately 80 percent of U.S. industrial output and 85 percent of our country's industrial employment. It is well known that a large share of U.S. exports are shipped by relatively few companies. Almost all of these are NAM members and so it is a fair guess that our members account for an even greater share of U.S.

manufactured exports than of production. In 1982 these exports were valued at $140 billion. I shall return later to the fact that this figure represents almost a 10 percent decline from our 1981 exports and to the fact that our trade balance in manufactures, which had been positive, suffered a $16 billion decline in 1982 and is now $4.3 billion in the red. Here at the outset, the point to be appreciated is that the value of trade to the United States is tremendous. The figures are familiar to many but bear repeating: One in six industrial jobs are supported by exports; one of every three acres under cultivation is for export, and 30 percent of American industry's profits are tied to international business. In short, trade is not something we have a choice about. To take only the most well known example, we have grown dependent upon the oil we import, and we must pay for it.

As percentages of GNP, imports and exports have each grown from 4.3 percent in 1970 to 8.3 percent and 6.8 percent respectively in 1982, and these trends will continue. It is precisely because they will that we need to be very concerned indeed about the competitiveness of our exports in world markets. Here there is some cause for alarm. The 1982 trade deficit, $42.7 billion, was the worst in our nation's history, and the 1983 deficit will almost certainly be worse. NAM's recently released report "U.S. Trade: Record of the 1970s-- Challenge of the 1980s" illustrates important characteristics of the American trade problem. I should like to share a few of its conclusions with you and to submit the full report as part of my statement.

The report makes very plain that the key to the growth we have had in our exports since 1972 is manufactured exports. These have experienced a fourfold increase since 1972. Even today, despite the growth in our agricultural exports in the past decade, manufactured exports account for more than four times the earnings of agricultural exports.

Further, manufactured exports are critical to job creation. Between 1977 and 1980, 30 percent of the net increase in private sector employment was due to manufactured exports. Yet, in contrast to our chief economic competitors, Japan and Germany, we have not been able to maintain consistent net surpluses from trade in manufactured goods. Our trade balance in manufactured goods has wandered in and out of surplus over the course of the past decade, while Germany's and Japan's have generated higher and higher net earnings. In 1981 for example, Germany had a surplus of $61.7 billion in manufactured goods trade, five times the surplus of the United States that year, and Japan had an incredible $115.6 surplus. To conclude that this marked imbalance between the United States and Japan with respect to net earnings from manufacturers at almost the same level of exports is all right, because Japan needs to import raw materials, is in our view, wrong. It ignores the fact that U.S. competitiveness measured in terms of both the world market and the U.S. market has declined in virtually every industrial sector.

These trends must be reversed; our well-being and our security depend upon it. In assessing how this is to be done, the first point to be considered is that for the United States, especially, the strength of the domestic economy itself is the primary determinant of international competitiveness. I have long argued and still believe that two-thirds of our trade problem relate to domestic issues, only one third to trade policy. Yet it is that one third that I would like to discuss today. In its simplest terms, the challenge before us is this: We must improve American competitiveness without jeopardizing the GATT trading system upon which both we and our trading partners depend. And indeed, this ought to be possible. In a sense, we should be encouraged by the fact that so much of our problem can be traced to the relatively low priority we have given to exports, especially manufactured exports. One need look no further than pending legislation and administrative decisions to appreciate this: exchange rate policy, the Export Administration Act, the Foreign Corrupt Practices Act, DISC, Eximbank, and the Houdaille case. Each in its own way represents a failure to recognize our need to be competitive vis-a-vis foreign producers, whether the competition is for sales overseas or here at home. Similarly, each offers an opportunity. Let me explain.

Exchange Rate Policy

Nothing has more severely undermined American competitiveness in recent years than the serious misalignment in exchange rates. Similarly, nothing would benefit U.S. trade more

than appropriate adjustments in the rates that link the dollar, the Japanese yen and the German mark. This is an unusually difficult area for two reasons. First, though the effect of the misalignment is easy enough to see--Japanese products have a 20 percent advantage against American products in every market in which they compete-- we do not have agreement on the nature of the problem, even within the U.S. Government. When I assert that the yen/dollar rate is wrong, I am referring primarily to the fact that, though Japan has gained on the United States in recent years in virtually every measure of competitiveness, her currency has not strengthened, as trade theory tells us it should, but weakened. Yet because there is a sense in which "the market" is determining the rate, there are those who would deny the problem.

Second, because exchange rates are influenced by the fiscal and monetary policies of each of the governments in the trading system, there is an inescapable link between the trade problems and the domestic policies of the governments concerned. These trade problems, uncorrected, threaten the trading system as a whole.

These difficulties themselves suggest it should be possible to obtain cooperation among the affected nations. It is this reasoning that has led us to urge that the United States work toward a new, target zone system of exchange rate management. We are not recommending a return to the Bretton Woods par value system but rather a modification of the current managed floating exchange rate system, one with a little more management. In this

context, we fully support the recent recommendation of the Atlantic Council of the United States to the effect that the Central Bank Governors of the five countries whose currencies are included in the SDR basket (United States, France, Germany, United Kingdom, and Japan), coordinate "intervention in exchange markets to support agreed exchange rate targets."

Export Administration Act

The Export Administration Act, which expires at the end of September, has on more than one occasion tempted the President to ignore the importance of exports in order to make a political statement. Perhaps the most important recent examples were the foreign policy controls on oil and gas equipment for the Soviet Union of December 29, 1981 and June 24, 1982. These controls were lifted on November 5 of last year. The damage they did to American industry was more enduring. This injury is impossible to measure. Yet we can say with confidence that it has been severe. Preliminary results of an informal NAM survey show that some $1.5 billion in export sales have been lost as a result of export controls in the last four years, and that estimate is based on results from only ten companies.

The fact that the now discontinued grain embargo cost American suppliers 45 percent of the Soviet market is well known. The parallel effect on U.S. manufactured exports is less obvious but no less crippling. Little that we make is truly unique.

All but a very few of the world's product markets are buyers' markets. And buyers are understandably reluctant to elect uncertain sources of supply or sources which insist on a series of non-commercial conditions not only before but long after the sale has occurred.

We had an illustration of this point a few weeks ago when the British Export Credits Guarantee Department announced it would no longer insure losses on sales to the Soviet Union arising from actions by the U.S. Government. It would be naive to assume that the effect of this decision will be limited only to U.S. exports to the U.K. of intermediate products destined for the U.S.S.R. Manufacturers abroad cannot be bothered with one set of suppliers for their Soviet and Eastern European business and another set for the rest of their trade. The significance of this point is underscored by the realization that, though exports have a growing importance in the United States, as I have discussed, they are even more important to the countries we sell to. In 1981, for example, U.S. exports represented about 18 percent of U.S. industrial production. In Germany and the U.K., they were 73 percent and in Canada almost 90 percent.

It is for these reasons that the National Association of Manufacturers has recommended that the foreign policy section of the Export Administration Act, Section 6, be, in essence, deleted when the Act is renewed. As we have explained in testimony before other committees of the House and Senate, this would not in any way tie the President's hands. He has ample power to deal

with emergencies under the International Emergency Economic Powers Act. Further, he is always free to ask Congress for specific authority to deal with any foreign policy matter. It is our conviction that the Constitutional delegation to Congress for the regulation of commerce and international trade was designed to ensure that governnment does not interfere with this vital element of our national life, at least not without the kind of consideration that only Congress can give. We believe the deletion, with some exceptions, of the foreign policy controls in the Export Administration Act would reaffirm this Constitutional intent and perhaps more importantly assure the business community that government recognizes the value of exports. It is our hope that this, the oldest committee of Congress, will share this view.

Domestic International Sales Corporation (DISC)

I shall not trouble you with the full ironic story of the DISC. Many members of the Subcommittee are well acquainted with it. Suffice it to say that in 1971 Congress enacted into law a separate mechanism for calculating and paying taxes on certain export profits. This provided a lower effective rate of taxation on export earnings than on domestic ones. The essential purpose of the legislation was to put American exporters on a more nearly equal footing with their foreign competitors, most of whom operate from tax systems more conducive to exporting than our own. The value added tax, which can be and is remitted on

exports, gives the goods of the exporting country a significant advantage in export markets. In effect, it represents the decision by the taxing country that it would rather have foreigners buy its goods than pay its taxes. The United States, on the other hand, has no means of relieving its exports of the U.S. taxes associated with them. Similarly, since we operate a global rather than a territorial tax system, it is difficult for our companies to reap the same advantages from offshore selling subsidiaries as their competitors do.

We have now reached a stage where, because the DISC has become a cause celebre--whether or not justifiably so--we are obliged to change it. For the past several months the Administration and the business community have been working on a replacement provision for DISC. In principle the Administration is, in our view, moving in the right direction. Yet there is a danger that in drafting the final version of their bill, the Administration will put undue emphasis on negative criteria. This is because they are concerned primarily with two objectives: ensuring that the DISC-replacement costs Treasury no more in forgone taxes than DISC itself and, second, ensuring that the replacement is acceptable to GATT. Obviously, however, the most important test, the one we hope Congress will insist upon, in any DISC substitute, is that it preserve, to the maximum extent possible, the export incentive value of the current DISC.

Export-Import Bank

We have been concerned for several years by the failure of successive Administrations to appreciate the importance of export finance to America's overall export effort. The fact that, in the period from 1978 through 1980 30 to 40 percent of the total exports of Japan, France and the United Kingdom were assisted by official export credit while only about 5-1/2 percent of U.S. exports were so assisted is not so much a tribute to the private capital markets of the United States as it is an indictment of U.S. trade policy, which to a significant extent, failed to see the importance of such financing to the health of the U.S. economy. We are hopeful that this situation will improve, that the Administration will make good on the President's promise of March 4. We believe he was talking to all American exporters when he said then: "Our Administration will give you the tools you need, because we know you can get the job done." We believe, however, that rather than fund the Eximbank in installments, as is proposed in the 1984 budget, all of the money should be authorized and appropriated in the normal way. This would not only ensure that Exim actually gets the promised sums, it would give confidence to both U.S. business and foreign rivals that Exim is prepared to offer competitive financing. It is also our view that the language of the Eximbank charter should be changed to make clear that the purpose of the bank is to ensure that, at least in so far as export financing is concerned, American exports are competitive.

Foreign Corrupt Practices Act.

It should be clear by now that in its present form this law hurts American exporters. Many in the House and Senate have been working hard for over two years to amend existing law in a manner that will improve competitiveness without sacrificing principle. This effort may fail, however, because the legislation does not enjoy a sufficiently high priority or rather because exports do not.

Domestic Content.

I have discussed the previous issues before dealing with Mr. Ottinger's bill, H.R. 1234, because I wanted to establish that there is a great deal that can and should be done to make America more competitive. NAM is convinced, however, that domestic content legislation would not help but would rather further damage U.S. international competitiveness. Therefore, we oppose it. This point was made quite forcefully in a resolution approved by the NAM International Trade Policy Committee last July, a copy of which is included as part of my testimony. Essentially our Trade Committee rejected domestic content last year because it would force the United States to violate the General Agreement on Tariffs and Trade; would encourage an inefficient allocation of resources; and would put at risk more jobs than it is likely to create. The Committee further objected to the legislation on the grounds that the industry had not fully exhausted administrative remedies open to it.

Certainly the Congress has not exhausted solutions to the crisis in the automobile industry that are in keeping with the international obligations of the United States

Briefly, it is our understanding that H.R. 1234 would require companies selling automobiles in the United States to ensure a certain percentage of U.S. parts and labor, depending, in part, upon the number of vehicles sold each year. After 1986 this percentage, which applies only to companies selling over 100,000 vehicles per year, would be roughly equal to the total number of vehicles sold divided by 10,000. Thus a manufacturer selling 500,000 units in the United States in 1986 would have to meet a 50% local content test. These provisions would be enforced by means of quotas on the noncomplying importers of automotive parts. H.R. 1234, which is broadly similar to H.R. 5133 as approved by the Energy and Commerce Committee in the 97th Congress, would therefore represent a violation of GATT Article III, which guarantees national or equal treatment for imported products once they have cleared the customs hurdle, and Article XI, which basically outlaws import quotas.

Because this legislation would affect Japan more than any other country, there has been a good deal of speculation on the question, Would Japan retaliate? It may be, as some have suggested, that she would not, that the American market is too valuable to Japan for her to risk an escalation of trade friction by retaliation. On the other hand that reasoning can be turned around. Japan might feel retaliation was necessary to forestall

any further efforts to limit Japanese exports to the U.S. Surely, it is naive to think that if the automobile industry were to win protection it had not sought that Congress could easily turn away more forthright pleas from other industries.

On this point, our Ambassador in Japan is perhaps our best guide. Writing to Chairman Gibbons of the Trade Subcommittee last September Ambassador Mansfield said, "Since content legislation is clearly GATT-illegal, Japan would be entitled to retaliate, and I think we have to expect it would do so." In making the calulation, it is worth remembering that Japan, the most profoundly affected country, would not be the only interested party. The European Community regularly exports automotive parts to the United States, and by the logic of H.R. 1234 these parts would be discriminated against in favor of U.S. parts and in violation of GATT. They have not been shy about pressing their rights in the GATT any more than the United States has. Today they have a case against the United States for nullification and impairment of concessions won in the MTNs, that is an Article XXIII case, on the grounds that the 1982 extension of the manufacturing clause, which denies copyright protection to certain works not printed in the United States, essentially nullified the promise of the 1976 Copyright Law Revision Act, that this clause would lapse in 1982. They could be expected to react similarly to domestic content.

Our concern is not simply with the potential for retaliation, however. It is rather with the potential unravelling of the open trading system that domestic content threatens. The United States is the world's largest exporter. We earned $212 billion from exports in 1982. It is a mistake to think that countries open their markets to our goods because we are the sole source for such goods. They do so because they want access to the U.S. market, which is the largest component of the world market.

We must accept that if we encourage begger-thy-neighbor policies, we shall be imitated in that even more faithfully than we have been in encouraging open markets. I expect it is because the House itself fully appreciated this truism that it passed last year's domestic content bill, H.R. 5133, only after first adopting an amendment, the so-called Fenwick amendment, providing that "nothing in this Act shall be deemed to supersede the terms or conditions of any treaty, international convention, or agreement on tariffs and trade which is in existence on the date of enactment of this Act and to which the United States is a party." The Fenwick amendment effectively nullified the essential provisions of the domestic content bill. We were, therefore, not surprised to see that no such language was incorporated in H.R. 1234, the current domestic content bill, when it was introduced on February 2. I am not recommending another Fenwick amendment. I am suggesting that it serves as a useful reminder of what is wrong with this bill.

As to adminstrative remedies, it has now been three years since the Ford Motor Company and the United Auto Workers petitioned the International Trade Commission for relief under Section 201 of the Trade Act of 1974. The fact that they were turned down is not in itself reason to presume the outcome of a new petition. If, for example, the full U.S. automobile industry were to join the case, or at least more than one company, that would be a material change which, doubtless, the Commission would take into account. Other factors that offer hope of a different outcome include the new investment the industry has made, the history and uncertainty of the restraint policies of Japan, and the obvious determination of the Commission to demonstrate that a recession need not necessarily be a bar to import relief under Section 201. This determination has been demonstrated twice recently, once in the Harley-Davidson motorcycle case and again in the specialty steel case.

These considerations aside, it would be more than understandable if the automobile industry were to conclude, in the light of experience and the expense, that it did not wish to file. Under the law, however, the President, the USTR, the Senate Finance Committee and the House Committee on Ways and Means all have the power to request an ITC investigation to determine whether automobiles are "being imported into the United States in such increased quantities as to be a substantial cause of serious injury or threat thereof, to the domestic industry..." In short, Congress, which can pass H.R. 1234, can also open a new ITC investigation.

Further, if Congress were to conclude, on the basis of the Ford and UAW experience of 1980 that the law provided little opportunity for relief, it could amend Section 201, in a manner fully in keeping with the GATT, to deal with the problem cited in the 1980 case. In fact, NAM is in the process of considering whether to ask for the "substantial cause" test, which requires that imports be as or more important than any other cause of injury, to be deleted from the Section 201. The argument for doing so is that this language is not required by GATT Article XIX, the international counterpart of Section 201. Surely, it would be unfortunate if the United States were to enact legislation that violates the basic international trade agreement out of frustration with a U.S. law that goes beyond that agreement.

Houdaille Petition

Before addressing the issue of domestic content, I referred to a series of steps that might be taken to improve our international competitiveness. By and large those measures dealt with improving our own export performance, rather than countering the policies of others. Yet, as the proliferating articles on foreign industrial policies make clear, it may occasionally be necessary to take just such action.

In an article which he submitted to the Trade Subcommittee, Noble Laureate Paul Samuelson makes the observation that "The deductive syllogism that free trade maximizes each market participant's welfare is logically false." Japan's industrial

targeting offers an example of how one country has interpreted and acted upon that insight. In Japanese terms, Samuelson's observation means that a nation cannot rely on market forces alone to ensure that it, among the world's nations, will end up producing the higher value products and so enjoy relatively advantageous terms of trade. For Japan, it was a short jump from that understanding to a highly successful industrial policy that did not rely entirely upon market mechanisms but rather upon cartels and subsidies. The problems posed for the United States by these policies were brought into sharp focus last May when Houdaille Industries, a machine tool company in Fort Lauderdale, Florida, filed a petition under Section 103 of the Revenue Act of 1971 requesting denial of the investment tax credit for two Japanese machine tools, numerically controlled punching machines and numerically controlled machining centers, which benefit from an "international cartel". NAM supports this petition because it involves Japanese policies which, if left unchallenged, will in the long run have serious, adverse consequences for U.S. industry. A copy of our submission to USTR is attached. We should be grateful to have it made a part of the record.

Competitiveness in International Trade Act, H.R. 2203

Mr. Chairman, I am not in a position to comment definitively on either of the bills referred to in your letter to me of March 31, 1983. I would, if I might, offer a few impressionistic comments with respect to two of these bills.

As for the International Competitiveness Bill, H.R. 2203, there is much to be praised. In the past NAM, has favored investing all responsibility for negotiating trade agreements and implementing U.S. trade laws in a single department. We have felt that such a department should also have the capability of analyzing changes in U.S. competitiveness. If we were to support a reorganization of the Government's trade functions, we would, I expect, urge the creation of a new department along these lines.

Reciprocal Trade and Investment Act, H.R. 1571

Finally, I would note that NAM supported this legislation when it was introduced last year by Congressman Frenzel. It is our understanding that H.R. 1571 is broadly similar to, indeed comes out of the drafting work on, H.R. 6773 of the 97th Congress. This in turn closely parallels Senator Danforth's bill of the same title, S. 144. We would very much like to see legislation of this type enacted. Our reasons are set out in my letter to Senator Danforth of February 1 and the NAM testiomony before the Trade Subcommittee of the House Ways and Means Committee on July 26, 1982, both of which are attached.

Thank you again Mr. Chairman for the opportunity to testify this morning.

COMMENTS OF

THE NATIONAL ASSOCIATION OF MANUFACTURERS

ON

THE PETITION OF MAY 3, 1982, BY HOUDAILLE INDUSTRIES

FOR THE EXERCISE OF PRESIDENTIAL DISCRETION

AS AUTHORIZED BY SECTION 103 OF THE REVENUE ACT OF 1971

JULY 30, 1982

The petition for withdrawal of investment tax credits under Section 103 of the Revenue Act of 1971, which was filed by Houdaille Industries, Inc. on May 3 is formally very narrowly focused. It requests denial of this credit for two products only: numerically controlled (NC) machining centers and numerically controlled punching machines from Japan.

In general, it is not the policy of the National Association of Manufacturers to comment on individual import cases. The Houdaille petition, however, is in our view a landmark case with broad implications for U.S.-Japan commercial relations, for U.S. trade policy, and for U.S. industry. If the case as set forth by the petitioner is substantially correct, and we have no reason to doubt that it is, then in our view it is essential that the President provide adequate relief. Not to do so could jeopardize the industrial revitalization that is the bedrock of America's future.

The Comptroller General's 1979 report, United States - Japan Trade: Issues and Problems, notes important similarities between the machine tool industries in the two countries. They are relatively small in each country and highly fragmented. In 1975, for example, there were only ten U.S. machine tool firms with more than 1,000 employees but over one thousand plants with forty-nine employees or less. Comparable figures for Japan show 35 plants with 300 employees or more and 1,480 plants with 49 or less.

Two other similarities should also be noted. First, machine tools have an economic importance beyond their dollar value as they are critical to a variety of industries from aircraft to farm machinery. Second, the industries are strong ones in both countries. In 1981, the United States was the world's largest producer with sales of $5.15 billion and Japan the second largest with sales of $4.86 billion. Though the U.S. has had a negative balance of trade in machine tools since 1978, it is still an important exporter, and in 1981 sold more than $1 billion in machine tools abroad. Thus, in comparing the two industries, one is comparing strengths of the two economies, not a strength of one and a weakness of the other.

The starting point for the petitioner is the phenomenal and for it painful increase in Japan's share of the U.S. market for the products at issue. It notes that in 1976 Japan enjoyed 3.7% of the U.S. market for (NC) machining centers. By 1981 Japan had 50.1% of the machining center market. The increase in Japan's share of the U.S. market for NC punching machines was only slightly less dramatic, going from 4.7% in 1976 to 37.6% in 1981.

The allegation is that this was achieved by means of a government sponsored cartel. The petitioner might as well have said it was achieved as a result of Japanese industrial policy. Presumably it did not because a foreign industrial policy per se provides no explicit basis for a petition under U.S. law, but one that involves "tolerance of international cartels" does. It is, however, precisely because the petitioner has demonstrated the breadth and power of Japanese industrial policy that his case commands the attention of anyone concerned about preserving and strengthening the U.S. industrial base. Japan is, of course, not unique in having an industrial policy/or policies. Certainly, though, those policies are uniquely successful, with consequences of some importance for U.S. industry in American, Japanese, and third country markets. Their rationale was well explained in 1970 by a minister for Japan's Ministry of International Trade and Industry speaking before the OECD Industry Committee:

> "After the war...Japan's first exports consisted of such things as toys and other miscellaneous merchandise and low-quality textile products. Should Japan have entrusted its future in the theory of comparative advantages in these industries characterized by intensive use of labor?
>
> ... If the Japanese economy had adopted the simple doctrine of free trade and had chosen to specialize in this kind of industry, it would have almost permanently been unable to break away from the Asian pattern of stagnation and poverty...
>
> "The Ministry of International Trade and Industry decided to establish in Japar industries which require intensive employment of capital and technology, industries that in

consideration of comparative costs of production should not be the most inappropriate for Japan, industries such as steel, oil refining, petrochemicals, automobiles, aircraft, and electronics, including electronic computers. From a shortrun viewpoint, encouragement of such industries would seem to conflict with economic rationalism. But from a long-range viewpoint these are precisely the industries of which income elasticity of demand is high, technological progress rapid, and labor productivity rises fast."

Cartels provide a means by which the Japanese Government can identify and work with an industry. They are at the heart of Japanese industrial policy. It is our understanding that Japan has informed the OECD that it formally recognizes 469 cartels. Admittedly, many of these are small concerns with little impact on international trade. The figure does not include a number of cartels of major Japanese industries, like the machine tool industry, that do have such an impact. Clearly collections of firms subject not only to regulation but to direction from central authority, whether it be the Government of Japan through its administrative advice procedure or their trade associations, are in essence cartels. The petitioner identifies the cartel of interest to him as one made up of the largely overlapping memberships of the Japan Machinery Exporters Association and the Japan Machine Tool Builders Association. He traces the Japanese government's involvement with this cartel from the First Extraordinary Measures Laws of 1956 through the successors of that legislation, namely the Extraordinary Measures Law for Promotion of Specific

Electronic Industries and Specific Machinery Industries Law No. 17 of 1971 and the Extraordinary Measures Law for Promotion of Specific Machinery and Information Industries, Law No. 84, of 1978. These laws, he notes, made possible domestic anticompetitive relationships within the industry and the skewing of orders to selected firms in the name of rationalization. According to the petition, "there appears to be no risk (to the cartel) of prosecution (under Japan's antitrust laws) as long as (it) complies with MITI guidance, regardless of how anticompetitive that guidance may be."

Further, the report is replete with examples of other, more direct forms of government involvement and assistance, including the following:

1) Import protection. The petition alleges that for a considerable period Japan did not permit the importation of machine tools for which there were Japanese equivalents. This protection served to ensure high domestic demand and thus lower unit costs. Further, the "monopoly profits" that flowed to Japanese producers as a result of these restrictions strengthened their ability to price exports more competitively than would otherwise have been the case.

2) Subsidization. The petition refers, inter alia, to the fact that in the '50s, favored industries, including the machine tool industry, were licensed to import sugar, the value of the license being assured by the government's quota on sugar imports. Additionally, the attorney for the petitioner has informed us that between 1954

and 1981 the machine tool industry received approximately $1.46 billion in the form of receipts from national bicycle races, these funds to be used for industry rationalization, export promotion and research development.

3) Taxation. Several provisions of Japanese tax law explicitly favor the machine tool industry.

4) Finance. Japanese banks have provided significant loans to the industry to enable it to sell on deferred payment terms to the domestic Japanese market, an option not open to American and other foreign competitors in Japan.

These are, of course, only elements of the Japanese industrial policy with respect to machine tools, not an exhaustive description. It might appear that some of these practices could provide a basis for action against Japanese machine tool imports other than that taken and requested by the petitioner. In our view, the petitioner has done a service to American industry by focusing on the relationship of these practices to a cartel. Such a focus permits one to consider the problem not in terms of one or another practice which may or may not be a specific offense under U.S. or international law but in terms of the unique challenge to American industry of Japanese industrial policy. United States law may not be fully adequate to deal with foreign industrial policies that hurt U.S. companies and U.S. industry; it is not, however, bereft of remedies.

Because of the Houdaille petition, it is no longer possible to argue that advanced and healthy U.S. industries are immune from the injurious effects of foreign industrial policies. It is, therefore, important to demonstrate that where the danger of such policies is perceived, it will be addressed. Accordingly, the National Association of Manufacturers urges the Administration to take effective action with respect to NC machining centers and NC punching machines from Japan if it concludes that the allegations of the Houdaille petition are substantially correct.

Lawrence A. Fox
Vice President for
International Economic Affairs
National Association of Manufacturers
Washington, D.C.

National Association
of Manufacturers

LAWRENCE A. FOX
Vice President and Manager
International Economic Affairs Department

February 1, 1983

The Honorable John C. Danforth
Chairman, Subcommittee on International Trade
Senate Committee on Finance
Room 460 RSOB
United States Senate
Washington, D.C. 20510

Dear Senator Danforth:

The National Association of Manufacturers strongly supports the Reciprocal Trade and Investment Act, S. 144. By itself, of course, S. 144 cannot solve our country's trade problems. Much of what needs to be done is outside the scope of this kind of legislation. We need, for example, to find some way of ensuring that monetary developments unrelated to merchandise trade do not harm American manufacturers as current exchange rate misalignments do. And we need to take those measures domestically which will make the U.S. economy stronger, more vibrant and hence more competitive.

Even if it does not do everything, however, S. 144 does accomplish three important objectives. First it promises to improve U.S. trade policy by ensuring a greater correlation between U.S. interests and actions. If the Administration is required to identify annually the most serious barriers to U.S. trade, their actions are more likely to be calculated to remove or overcome those barriers. This should be true of all Administration trade initiatives, whether GATT actions, bilateral negotiations, or unilateral action under Section 301 of 1974 Trade Act.

Second, S.144 highlights U.S. determination to strengthen the rules of the international trading system and so increases the likelihood that negotiations to that end will be successful. Existing GATT rules are not adequate to deal with serious problems involving trade in services and investment. As for trade in high technology products, the special treatment accorded the manufacturers of certain of these products in several GATT countries and the reluctance of these countries to eliminate trade barriers for high-tech products is testimony to the importance governments attach to high technology. While the definition of high technology leaves much to be desired, it is clear that the term is meant to apply to industries that are likely to dominate the future economies of the developed countries. It would appear, then, that the ability to reach an understanding on trade in high technology products may in large measure equate with an ability to preserve the open trading system.

1776 F Street, N.W.
Washington, D.C. 20006

Third and finally, S.144 gives U.S. producers a credible promise that their legitimate complaints with respect to "unjustifiable", "unreasonable", and "discriminatory" practices by others will be forcefully pursued. While we regard it as essential that the Administration retain considerable discretion in pursuing cases under Section 301 et seq of the 1974 Trade Act, we think the amendments proposed for these sections in S.144 are helpful. In this regard, we were especially pleased to see that both "unjustifiable" and "unreasonable" have been defined so as to include within the scope of both terms failure to provide adequate protection of intellectual property rights.

More generally, we are pleased that services and certain foreign direct investments by U.S. persons are brought within the scope of the word "commerce" as this is used in the suggested amendment to Section 301 of the Trade Act. The fact that this Act provides a legal basis for unilateral action against "unreasonable" foreign trade practices should reassure U.S. industry that the Administration has adequate statutory authority with which to defend U.S. interests. It should also provide whatever incentive may be lacking for other countries to work for international agreements in the difficult areas referred to in the legislation.

We have never had a more serious trade deficit than the $43 billion deficit of 1982. And next year's is likely to be much worse. These unhappy facts both reflect and compound the current recession and unacceptably high unemployment. Pressure for protectionist responses to our problems is an inevitable political consequence of the current economic dilemma. It is critical that those in the Administration, in Congress, and in the business community respond to this challenge by strengthening the international trading system rather than abandoning it. We believe S.144 does this and urge its passage.

Sincerely,

Lawrence A. Fox

Lawrence A. Fox

P.S. I should be grateful if this letter could be made part of the record of the hearings on S.144 scheduled for February 4, 1983.

STATEMENT OF

ROBERT McLELLAN
VICE PRESIDENT, FMC CORPORATION

ON BEHALF OF

THE NATIONAL ASSOCIATION OF MANUFACTURERS

BEFORE THE

SUBCOMMITTEE ON TRADE OF THE

HOUSE COMMITTEE ON WAYS AND MEANS

JULY 26, 1982

Mr. Chairman, members of the Committee, I am Robert McLellan, Vice President of FMC Corporation, a multinational, diversified producer of machinery and chemicals with 1981 sales of $3.5 billion in the United States and 150 other countries. I am also a former Assistant Secretary of Commerce for Domestic and International Business, having served in that post from 1969 to 1971. I am here today as Chairman of the International Trade Policy Committee of the National Association of Manufacturers.

The legislation you are considering has the potential to affect significantly my company, the broad spectrum of firms represented by NAM, and the economic well-being of the United States. I am, therefore, pleased and honored by the opportunity to present to you today our views on this legislation.

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The roughly 12,000 members of the National Association of Manufacturers account for approximately 80% of U.S. industrial output and 85% of U.S. industrial employment. Because the lion's share of U.S. exports are shipped by the larger American companies, almost all of whom are NAM members, it is a fair guess that our members account for an even greater portion of U.S. exports than of U.S. industrial production. In practical terms, this means that our concern for an open international trading system is second only to our concern for the strength of the U.S. industrial base. In fact, the two cannot be separated. At present both are in some danger.

The current worldwide recession has caused belt-tightening and soaring unemployment in the United States and in Europe but not of course in Japan, which even in the unhappy year of 1981 managed an astounding $115.6 billion surplus in trade in manufactured goods. The continued contributions of economically pressed countries to the continued success of Japan have motivated many to look at that country's export-led growth in a new light. This inclination is reinforced by Japan's ability to hold on to or increase her share of shrinking markets such as the U.S. automobile market, and it is further exacerbated by the legitimate questions that have been raised about some of the offensive policies behind Japan's international commercial triumphs.

Strategy for Japan

In our view, the failure to deal successfully with the challenge of Japan is not so much a weakness in the law as it is our apparent inability to fashion and implement an effective strategy. I have

brought with me an NAM Board Resolution on U.S.-Japan Commercial Relations. This sets out, in broad outline form, what we believe the objectives of that strategy should be. I also have a letter that NAM's President, Alexander Trowbridge, has sent to Secretary Regan regarding the damage being done to U.S. industry by the dramatic undervaluation of the yen. I would be grateful if both of these could be considered part of my testimony.

Domestic Content

Whatever the prudent limits of legislation, it is only natural that Congress should react to the trade problems we confront with legislative proposals. Among these there are two -- I am referring to approaches rather than bill numbers -- that have become the subject of serious debate and which must be considered candidates for the statute books. One of these, the domestic content legislation, would, in NAM's view, be very bad law. It shows little promise of increasing employment or of reviving the American automobile industry.

This would be a blatant violation of our commitments under the General Agreement on Tariffs and Trade and would probably create more problems than it would solve.

I hope that this Subcommittee will thoroughly review any domestic content bill that is likely to be considered by the full House. In the meantime, I would be grateful if the NAM Trade Committee's resolution on this legislation could be included in the record as part of my testimony.

Recipricity

My main purpose in raising the subject of domestic content here is to contrast it with the other prominent proposal for new trade law, namely the reciprocity bills, such as Congressman Frenzel's bill, H.R. 6773.

This is a good bill. By requiring the Administration to identify annually the most serious barriers to U.S. trade and to attempt to quantify them, this legislation could have a significant, beneficial impact on the development of American trade strategy. At present there seems to be little correlation between the U.S. actions in the GATT, for example, and our national concerns about trade. We are pursuing half a dozen GATT cases against the European Community and not one against Japan. It is not necessary to question the merits of any of the cases we have taken to the GATT (wheat flour, sugar, pasta, etc.) to appreciate the irony of that. Traditionally, we have had a large trade surplus with Europe. It was down in 1981 to $10.7 billion from 1980's strong $17.6 billion, but it is still impressive and important. In contrast, the series of alarming deficits with Japan threatens to continue and grow worse. Because of this lack of symmetry between action and interests, NAM has suggested that the Administration review its trade relationship with Japan as the Europeans have, in the context of GATT Article XXIII. Larry Fox, NAM's Vice President for International Economic Affairs, noted in testimony in May before the Joint Economic Committee that, "A society like Japan with a trade surplus in manufactured goods of $93.7 billion (1980) and an exports-to-imports ratio in manufactured products of 4 to 1 must be doing something right. It must also be doing something fundamentally wrong."

We shall not succeed in demonstrating that what is wrong for Japan's trade partners is wrong for Japan unless we systematically identify and quantify the barriers and trade practices at issue.

I have discussed the identification and quantification of trade barriers, because these requirements and the consultation with Congress on trade policy priorities are, in my view, the most significant features of this legislation. Nevertheless, we are in full agreement with the first of the stated purposes of the bill: "To foster economic growth ... through the achievement of commercial opportunities in foreign markets substantially equivalent to those accorded by the United States." There is, however, a paradox in that objective that is worth pointing out.

In intent, I take the language as reflecting the traditional American concern with equality of opportunity. Looked at from another point of view, it would be impossible for any nation to provide "commercial opportunities substantially equivalent to those accorded by the United States". No market in the world is as rich as the U.S. market. And in most product areas no market of the world has been as open to imports. The question then is whether the United States will continue to be able to share this most precious resource with the world or whether like the Japanese we will husband portions of it for our "infant industries," that is, the industries of the future.

There is a sense in which this legislation, H.R. 6773, rests on three principal points:

- It provides a systematic method for improving and developing U.S. trade policy.
- It strengthens the Administration's ability to deal with "unreasonable", "unjustifiable", and "discriminatory" practices that affect U.S. trade and investment; and

- It provides specific negotiating authority with respect to both services and investment and in the Senate version with respect to certain high technology items as well.

Having dealt with the first of these, I should like to devote the balance of my testimony to the other two.

In general, we find Mr. Frenzel's recommendations for strengthening the 301 process extremely helpful. Three of these changes would in my view justify the legislation on their own. I refer to:

- the explicit inclusion of failure to adequately protect industrial property rights within the meaning of the word "unreasonable" and the word "unjustifiable" as these words are used in Section 301;
- the explicit inclusion of investment within the meaning of the word "commerce" as it is used in Section 301; and
- the amendments to Section 302 of the Trade Act of 1974 authorizing the U.S. Trade Representative to pursue 301 cases on his own initiative.

As you know Section 301 serves a dual purpose. On the one hand, it provides U.S. citizens a mechanism for demanding compliance by foreign traders with international agreements. On the other hand, the statute makes it clear that the President's ability to act against unfair foreign trade practices is not limited to those already

subject to international agreement. None of the three profound changes relate to current GATT rights. Understandably, the Administration may be reluctant to act, even with this new authority, without first trying where appropriate to achieve an international agreement. This is especially true with respect to investment, and the legislation explicitly provides negotiating authority in these areas. The hope must be that the existence of these provisions, with their implicit threat of unilateral action by the United States, will encourage our trading partners to negotiate on investment and trade in services. It should be obvious, however, that even the incentive value of these provisions will be lost if the Administration does not make it clear to other countries that where unilateral action is called for it shall be taken.

Foreign Direct Investment

The dilemma of international investment in the 1980s is perhaps the best illustration of the necessary relationship between the proposed expansion of 301 and the "reciprocity" bills' negotiating mandate. H.R. 6773 and S. 2094 would both amend the Trade Act of 1974 to include explicitly under the definition of commerce, "foreign direct investment by United States persons with implications for trade in goods and services." This revision reflects and addresses the inconsistency between the proper exploitation by many countries of a more liberalized world trading system and increasing tendency of some governments to control foreign investments in ways that are violative of the principles of free trade. Countries that expect to benefit from access to

the U.S. markets should not be surprised when we become concerned about their discriminatory investment policies. NAM supports both the broadening of the definition of "commerce" to include direct investment and the adding of investment to the list of congressionally mandated negotiating objectives. These changes give force to our concern. Further they reflect NAM's long standing support for the free international movement of capital, allowing, of course, for restrictions necessary for safeguarding national security and related purposes.

Many countries have tailored their investment policies to optimize their international export positions. This is objectionable, and it is unfortunate that the U.S. government has failed to use the legal powers available to it under existing law to respond.

For example, thirty years ago the Government of Japan signed a treaty of Friendship, Commerce and Navigation with the United States. The promise of that treaty was that American firms investing in Japan would receive treatment equal to that accorded to Japanese companies, at least in so far as the application of Japanese investment law was concerned.

Since then, Japan has carefully restricted, controlled or simply prohibited U.S. direct investment in Japan. A few companies received special consideration because their technology was critical to the development of Japan's own technological capabilities. But most U.S. firms have been frustrated by an approval procedure that makes foreign investment in Japan very difficult.

We believe that bringing investment practices within the scope of the term "United States commerce" as used in Section 301 of the

Trade Act will bring about a more effective U.S. Government posture to the problems that U.S. firms encounter in international investment. This is urgently needed as a growing number of countries are applying de jure and de facto controls over foreign direct investment within their territories. Among the industrialized countries, Canada and France are particularly notable for enforcing such requirements. U.S. firms also face difficulties in some of the more advanced developing countries, some of which have had restrictive policies on foreign investment for some time.

NAM, therefore, welcomes the idea that bilateral and multilateral investment agreements be a congressionally mandated negotiating objective.

OECD Declaration

There has been growing international recognition that discriminatory treatment of foreign direct investment has a distorting impact on world trade flows and there have been some attempts to address this problem in international negotiations. In 1976 the Organization for Economic Cooperation and Development (OECD) adopted a declaration of principle that members would treat established foreign-controlled firms within their borders on the same basis as domestically-owned companies (the so-called "national treatment" principle). But the OECD National Treatment Declaration, with a companion declaration on incentives and disincentives, is severely limited in its effect on national policies.

These commitments are non-binding statements of intention. For example, Canada agreed to the 1976 declaration. Though Canada has been criticized strongly by a number of countries in the OECD's

investment committee because of its increasing violation of national treatment and its frank discrimination against foreign-controlled companies in the energy sector, it has not revised its policies. Refusal to incorporate national treatment principles into policy remains all too common in other member countries as well. In a statement on national treatment, presented last month to the OECD investment committee, the officially recognized private sector Business-Industry Advisory Committee concluded that, "While the principle of National Treatment is generally upheld in OECD member states, significant departures from this principle remain and these are in fact on the rise in certain countries."

Furthermore, the OECD national treatment principle applies only to existing investment, not to rules governing new investments. Further, most countries of the world do not belong to the OECD. There are only twenty-four members, most of them industrialized countries. The entire set of 1976 OECD principles, in fact, were established partly as a guide for the U.N. Code of Conduct on Transnational Corporations but in this long-running negotiation there has, to date, been very little sign that the less developed countries will accept the principle of equitable and non-discriminatory treatment of foreign investment.

NAM, therefore, continues to support and encourage the efforts of the present Administration to seek bilateral agreements with specific countries, which would provide for non-discriminatory treatment of U.S. direct investment abroad, as well as explore a broadening of GATT rules to incorporate an explicit reference to

the treatment of foreign direct investment. Both of these actions, we believe, are consonant with the intent and purpose of this legislation.

Hi-Tech Tariffs

Finally, Mr. Chairman, I should like to comment briefly on the only significant difference between H.R. 6773 and S. 2094, which was approved by the Senate Finance Committee last month. The Senate bill gives the President tariff cutting authority with respect to certain hi-tech items; the Frenzel bill does not.

As a broadly based, horizontal trade association, NAM has little interest in promoting a sectoral approach to trade. Indeed, we would have preferred to have dealt with this problem by extending and perhaps expanding the President's tariff cutting authority under Section 124 of the Trade Act of 1974.

We doubt, however, that that extension of Presidential authority will be approved this year. It is being held up, of course, not by people who want their protective tariffs slashed but by those who do not. However, if the companies affected by the Senate bill want the President to have tariff cutting authority with respect to the items listed in the bill -- and I believe they do -- it would in our view be foolish to withhold such authority for the sake of theoretical concerns about a sectoral approach to trade. Therefore, Mr. Chairman, we support the hi-tech provisions of S. 2094.

Again, Mr. Chairman, I should like to thank you for the opportunity to testify. Larry Fox and I would be happy to respond to questions.

RESOLUTION
ON
DOMESTIC CONTENT LEGISLATION

Whereas the domestic content legislation now pending before the House and Senate (H.R. 5133 and S. 2300 respectively) has implications for all manufacturing sectors and for the conduct of U.S. economic policy both domestically and internationally;

Whereas the National Association of Manufacturers believes the interests of the United States can best be served by strengthening competitive market forces and furthering the rule of law in international trade;

Whereas these bills, by establishing quantitative regulation for the purpose of affording protection to U.S. automotive production, would involve the United States in a serious violation of its obligations under the General Agreement on Tariffs and Trade and would cripple U.S. Government efforts to remove foreign trade barriers, including domestic content requirements, that undermine the international trading system;

Whereas the proposed legislation may prove self-defeating by encouraging an inefficient allocation of resources and retarding the U.S. automobile industry's adjustment to international competition;

Whereas this legislation is ill-conceived in that it would put at risk more jobs than it could reasonably be expected to create;

Whereas the legislation is ill-timed in that there are still administrative remedies open to the automobile industry, e.g., further action under Section 201 of the Trade Act of 1974;

Whereas Congress has yet to consider amendments to Section 201 that would increase the likelihood of relief being granted under Section 201 without violation of the international obligations of the United States;

Whereas the domestic content legislation is inappropriate in that it does not address the underlying causes of the trade friction in the U.S.-Japan commercial relationship, including an undervalued yen, protected markets, barriers to investment, and Japanese commercial policies that adversely affect U.S. industry; and

Whereas the legislation ignores options open to the United States under international trade law:

The National Association of Manufacturers opposes the aforementioned domestic content legislation. We urge the Congress and the Administration to reject it as inappropriate to the problems of U.S. industry, including the automobile industry, and injurious to the pursuit of international economic policies better calculated to preserve and strengthen the U.S. industrial base;

Further, recognizing that domestic content legislation has been inspired in large measure by Japanese policies that have unjustifiably burdened U.S. commerce, the National Association of Manufacturers urges the Congress and Administration to take appropriate action with respect to these policies at the earliest possible moment.

Adopted by the
NAM International Trade Policy Committee
July 15, 1982

RESOLUTION
ON
U.S.-JAPAN COMMERCIAL RELATIONS

Whereas Japan's industrial, trade, investment, and financial policies have led to gross imbalances in Japan's trade with the United States and other industrialized countries;

Whereas certain of these policies, as manifested in unduly large global and bilateral manufactured goods trade surpluses, pose a threat to the world trading system and to the industrial base of the United States;

Whereas the National Association of Manufacturers, the principal representative of American industry, regards the health of the U.S. industrial base as fundamental to U.S. well-being and security; and

Whereas the NAM supports a market-oriented, open international trade and investment system;

Resolved that the National Association of Manufacturers should work toward the following goals:

- greater internationalization of the yen and a more appropriate yen-dollar exchange rate;
- reduced barriers to foreign investment in Japan;
- openness of Japanese markets for goods, services and capital equivalent to that of the United States and commensurate with Japan's standing as the second largest economy of the Free World and currently the most dynamic; and
- commitment on the part of the Japanese government and Japanese business to shoulder the full measure of responsibility for the world trading system that Japan's economic strength and stake in the world trade confer upon her.

NAM, working with the American government, will take appropriate steps to inform Japanese government and business leaders of our views and thereby help to bring about constructive solutions to our mutual problems.

Adopted by the
NAM Task Force on U.S.-Japan Commercial Relations
March 9, 1982

Adopted by the
NAM Board of Directors
March 17, 1982

National Association
of Manufacturers

ALEXANDER B. TROWBRIDGE
President

July 14, 1982

The Honorable Donald T. Regan
Secretary of the Treasury
U.S. Department of the Treasury
Washington, D.C. 20220

Dear Mr. Secretary:

In January 1982, the National Association of Manufacturers established a Task Force on U.S.-Japan Commercial Relations. The Task Force membership is broadly representative of U.S. industry, as well as major banks and export-related service industries. This Task Force is now in the process of working on a number of trade, financial and investment issues. The broad outlines of the Task Force's work are set out in a resolution passed by NAM's Board of Directors on March 17, 1982 (copy enclosed). NAM's objectives relate to the resolution of immediate as well as longer range problems of a systemic nature in our commercial relations with Japan.

One of the most critical concerns of the Task Force is the exchange rate between the U.S. dollar and the Japanese yen. We are, of course, aware of the Administration's general concern about the consequences for U.S. industry of the undervalued yen, but regret that no practical steps have been taken or proposed to deal with the problem. The manufacturing community is intensely concerned about the undervalued yen in both the immediate and longer term.

In the short term, U.S. industry is losing market shares at home and abroad. The yen has depreciated since 1980 by approximately 25% — from about 200 to the dollar to the 250 level at present. The meaning of this depreciation in competitive terms is dramatic: While Detroit has been seeking to close a $1500 gap between U.S. and Japanese built cars the depreciating yen has in fact given Japan an additional $1200 to $1500 advantage during this time.

In the long term, new investment by American industry is not taking place because in many instances this investment would be uneconomic in light of the inordinately competitive price of Japanese goods resulting from an undervalued yen. To the extent that the Japanese challenge represents the free play of economic forces, it can be viewed as a natural development and should not be interfered with. We have become increasingly concerned, however, that the American response to the Japanese challenge is being distorted and undermined by a gross misalignment between the U.S. dollar and the Japanese yen.

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Washington, D.C. 20006

Our concern is not unique. The European Community in its formal case against Japan under Article XXXIII of the General Agreement on Tariffs and Trade (GATT) referred to the yen as "a sui generis currency", which was "in certain respects tightly controlled and which has been insulated from the outside world". The Community noted that "the yen does not play a role internationally commensurate with the strength of the Japanese economy". Reference is made to the European view, not so much to buttress our arguments, but to indicate the necessity for international cooperative action in dealing with an international trade and financial problem which cannot be left only to Japanese authorities to deal with and which under present circumstances defies a straight-forward market solution.

Today the yen stands at more than 250 to the dollar — a rate not much higher than in March 1973, when generalized currency floating was established. Indeed, if we utilize the well-known Morgan Guaranty real effective exchange rate index, we find that the dollar is now 16% higher in value than in 1973, while the yen is about 15% lower, as measured on a multilateral, trade-weighted basis. During this interval the volume of Japanese exports has grown over twice as fast annually as U.S. exports (8% to 4%). At the same time, the annual price increase for Japanese manufactured exports, in national currency terms, has been five points per year lower than the equivalent U.S. figure (7% to 12%). These and other fundamental underlying economic conditions — such as current account balances, official reserves, trade balances, productivity growth, and wholesale price increases — indicate that the nominal value of the yen should have risen much more substantially over this time period against the dollar; instead we have seen a fairly steady drop in the yen since its peak of 180 in 1978.

The interest rate differential between the U.S. and Japanese domestic credit markets is undoubtedly an important reason for the misalignment of the dollar and yen during the last few years. As you know, NAM fully supports the Administration's concern regarding high U.S. rates. However, we feel that reduction in our interest rates will help relieve only part of the exchange rate problem between the dollar and the yen. We are inclined to believe that a good part of the problem will persist despite interest rate changes because the Japanese have to an important degree cut their domestic credit markets off from the influences of the international financial markets.

Japan's low domestic interest rates, which are less than half American and European rates, obviously reflect the interplay of a number of factors, including a superior performance in maintaining a low level of inflation since the 1973-74 oil crisis. It is also important, however, to realize that Japan's domestic credit system relies in many respects as much on quantitative restrictions and official guidance as it does on price in allocating credit to priority sectors of the economy. Consequently, interest rates can remain relatively low and provide a reliable and cheap source of domestic as well as export credit to major Japanese exporters of manufactured goods.

It is not hard to appreciate the current desire of the Japanese government to maintain low interest rates in light of relatively poor domestic economic performance and the need to hold down the cost of financing their large budget deficits. Yet, to what extent are these low rates also enabling Japan to "solve" its domestic economic problems by exporting them through an undervalued currency? Estimates have been made that two-thirds of Japan's almost 3% real GNP growth for the fiscal year ending in March 1982 came from exports. It is hardly unreasonable to ask how much longer countries with no real growth and with unemployment reaching toward double digit figures can tolerate this situation, especially in light of a 2% unemployment rate in Japan. Does it make much difference if a country pursues a "beggar-thy-neighbor" policy by means of trade protection or domestic monetary and credit policies?

You will appreciate that I am not suggesting that Japan is now actively intervening in foreign exchange markets to bring about a low price for the yen, although Japan has done this in the past. Quite the opposite is the case — since the misalignment at this point is so notorious, causing Japanese officials to be quite defensive respecting the undue trade advantages conferred on Japanese goods in export markets as well as in the Japanese home market. The most "successful" Japanese exchange market intervention was in the mid 1970's, when massive intervention halted the appreciation of the yen. Japanese intervention in January 1981 appears to have halted yen appreciation at that time and perhaps help to set the stage for the current weak yen. Lisle Widman, former Deputy Assistant Secretary of the Treasury for International Monetary Affairs, observes:

> Bank of Japan officials acknowledge that in January 1981 they did intervene to stop the appreciation of the yen when it moved back above 200. Whether they did so because they had concluded that they should protect their trade position by avoiding further appreciation or simply because the rapidity with which the rate was moving created a "disorderly" market we will never know. Japan had been running a deficit in its current account balance in 1980 and the country was still very concerned about its ability to finance oil imports. I suspect the gut judgement of Japanese officialdom is that a 200 to 220 rate would be best for Japan. Nevertheless, Japanese officials maintain that the intervention was not intended to alter the long-term trend.

Our view is that a good deal of the undervaluation of the yen basically results not from direct exchange rate intervention but from Japanese policies in respect to their domestic credit markets. To the extent that these policies maintain the trade advantages of an undervalued currency, they are a fair target for attention in the International Monetary Fund under Article IV of the IMF Articles of Agreement.

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This prohibits signatories from manipulating their currencies or taking other action to "gain an unfair competitive advantage" in trade. Additionally Article IV calls for IMF surveillance over exchange rate policies for a number of reasons, including, "...behavior of the exchange rate that appears to be unrelated to underlying economic and financial conditions including factors affecting competitiveness and long term capital movements."

We were pleased to see that agreement was reached at the recent Versailles Summit on an improved consultation process involving the IMF and the major industrial countries, as well as the initiation of an IMF study of the efficacy of foreign exchange intervention. We would certainly support Administration efforts to use this consultation process to the fullest in examining the interaction between the Japanese domestic credit markets and the continued undervaluation of the yen. We would also suggest a careful examination of Japanese currency intervention in the 1970's which may have laid the groundwork for the present undervaluation of the yen.

I would conclude by expressing the opinion that the persistence of a seriously undervalued yen for the next several years obviously presents serious obstacles to the modernization of the American industrial base and to the general American economy. The Administration's successful efforts to resist protectionism in this country and abroad has the full support of the National Association of Manufacturers. Perhaps no greater step to assure the continuation of open markets in the U.S. and around the world could be taken than to help bring about promptly a major appreciation of the yen. It is likely that high U.S. interest rates may persist for some time and lower rates, once achieved, may be only of limited value in the context of the yen-dollar exchange rate. We therefore, urge consideration of policies that work toward the improvement of the operation of the international monetary system, including the requirement that major trading countries maintain a reasonable foreign exchange value for their national currencies reflecting underlying economic forces.

To date the Treasury has given no indication publicly that the yen-dollar exchange rate is of concern to the U.S. government. To relate how significant this issue is to the revitalization of American industry, I would be pleased to call on you with members of NAM's Board of Directors to elaborate business views on the importance of this critical issue in industry's investment decisions to become more competitive in U.S. and foreign markets. We hope your schedule will permit such a meeting in the near future.

Sincerely,

Sandy Trowbridge

Attachment

U.S. Trade: Record of the 1970s – Challenge of the 1980s

NAM January 1983
International Economic Affairs Department

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(Classification by "End-Use" Categories)

Introduction

Achievement of long-term goals of healthy economic growth and full employment cannot be accomplished without improved U.S. international competitiveness. International competitiveness in this context means the ability of our producers to compete in both domestic and world markets. A restoration of U.S. competitiveness in manufactured goods means more jobs in an economy that may be plagued with low growth throughout the 1980s. Finally, U.S. political and economic leadership of free world nations will be decidedly enhanced by demonstrable improvement in U.S. economic performance.

The U.S. Has Lost Its Competitive Edge

By the 1970s, the United States had lost the economic edge which it had held over the rest of the world since 1945. The "catching up" of our foreign competitors forced the end of the Bretton Woods par value system and caused the devaluation of the dollar in 1971. But the new floating exchange-rate system did not restore American trade competitiveness in the 1970s. Other industrial countries, notably Japan, have continued to improve their trade competitiveness relative to the United States. The high price of imported energy in the 1970s placed a new premium on making manufactured exports even more competitive. Japan, certain developing countries, and to some extent Germany met this challenge, but the United States did not.

In 1979 and 1980, the United States enjoyed a boom in manufactured exports. Exports increased at a rate of 23 percent per year, and in 1980 the U.S. manufactured goods surplus hit a near record of $19 billion. Some thought that the U.S. had turned the corner on trade competitiveness. But the surplus of 1980 did not signal a return to competitiveness. Rather, it was only the traditional short-term result of the depreciation of the dollar in 1977-78, bolstered by relatively strong demand in some foreign markets. Since 1980, our manufactured exports have tended to fall or grow very slowly, while imports have grown at a faster pace—and in 1982 we had a trade deficit in manufactured goods.

Now we face the difficult task of achieving the goal of regaining trade competitiveness which we failed to attain in the 1970s. This is doubly difficult for a number of reasons:

- Demand in foreign markets is low and world-wide recession presents dubious prospects for improvement in the short or medium term. World trade, which has grown steadily since World War II and provided demand for American exports in both developed and developing countries, has, according to GATT statistics, stopped growing. This has affected even Japan's export growth rate and may bring about changes in Japanese economic policy that are difficult to foresee.
- American producers selling in both domestic and overseas markets are penalized by the high value of the dollar and the undervaluation of other currencies, especially the yen, which does not reflect relative costs of production. The yen is selling at nearly the same rate as in 1973, even though productivity in Japan has increased four times as fast as in the United States, while Japanese inflation as expressed in export prices has been only 40 percent of the U.S. rate. A recent report by the New York Federal Reserve Bank estimates that by the end of 1983 the overvaluation of the dollar may reduce our annual gross national product growth by 1 to 1.5 percent.

The Task for the 1980s

We have learned that it is difficult enough to deal with the consequences of economic interdependence in good times. We have yet to learn how to work together to overcome the intensified strains placed on the world trading system and the international monetary system in the midst of bad times,

when the world scene is characterized by economic recession or very slow growth. We seem to be particularly hard pressed to contain the ever more pronounced manifestations of economic nationalism that characterize the policies of important countries.

We are, therefore, keenly aware of the importance of maintaining an open, market-oriented international trading system, one that establishes agreed-upon norms for commercial conduct among nations and mechanisms for enforcing them. The system, of course, should be fair and not unduly influence the distribution of trade benefits among the participants. Further, the international monetary system must be made to function more effectively in expressing through exchange rate relationships the real changes in competitiveness among countries, if the GATT system is to survive and prosper.

Growth + Exports = Jobs

Asserting that improved competitiveness means more jobs is not a purely hypothetical proposition. The Census Bureau has recently reported that in 1977-80, nearly 30 percent of the net increase in private sector employment was due to manufactured exports. On the other hand, thousands of American jobs in individual industries have been lost due to increased import penetration and the loss of world market shares by U.S. exports, as is shown in Part III of this booklet. Nor have such losses affected only older industries facing inevitable adjustment and re-structuring. This report shows that many high technology industries, especially in the electronics industry product groups, are meeting tough competition at home and abroad.

The answer to this problem is not protectionism as embodied in recent "domestic content" proposals placed before Congress. Protectionist policies endanger our place in the world export markets, delay necessary adjustment in our industrial economy and ultimately are self-defeating in encouraging wrong market responses to rapidly changing conditions of international competition. The answer lies in political recognition of the basic need of our economy to become and remain internationally competitive—and consequently to formulate and carry out an integrated policy to achieve this high-priority national objective. Resumption of non-inflationary growth in the U.S. economy is, of course, essential to improved U.S. trade performance, as well as economic well-being in more general terms. But policies designed to achieve resumption of non-inflationary growth in the United States cannot be framed in a purely national context. Certainly the U.S. cannot sustain such growth if the rest of the world remains in an economic slump. Coordinated national and international policy actions are clearly required on issues such as exchange rates, the debt problems of developing world, and the GATT system of open world trade.

The long-term economic future for this country is bright, if we can find appropriate solutions for the problems that we face in the 1980s. The United States must, of course, make more certain that we have the educated workforce, the technological knowledge and the infrastructure required to compete in the international economic environment of the 1990s. It is therefore all the more important to learn why we find ourselves in our current unsatisfactory international economic position so that we have a sound basis for making the critical decisions of the 1980s.

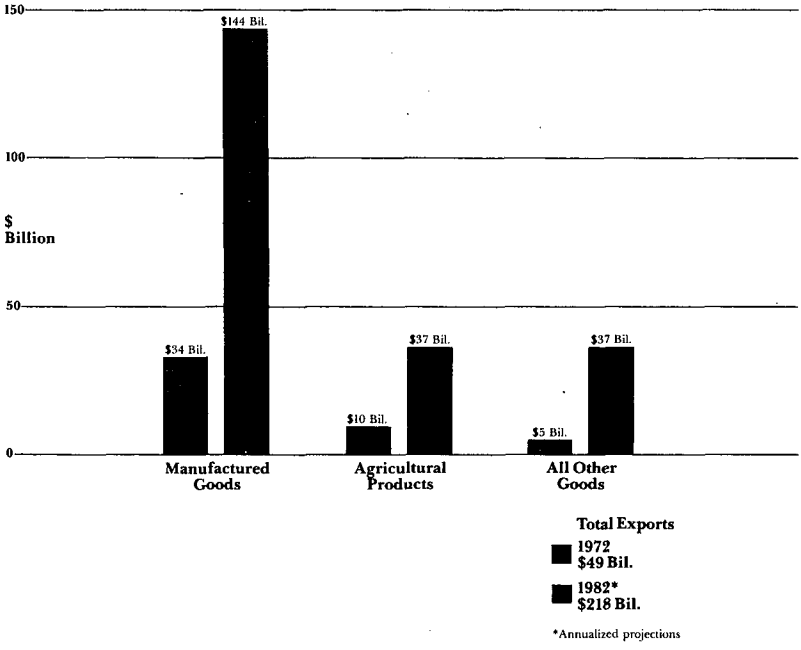
Lawrence A. Fox

Lawrence A. Fox
Vice President
International Economic Affairs

I.
Manufactured Exports Are Critical to a Successful U.S. Economy

Manufactured exports are the key element in overall export growth.

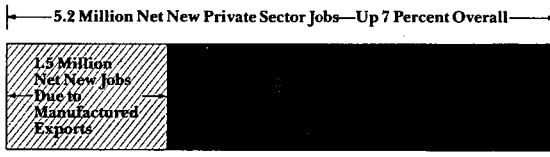
Figure 1. Growth of U.S. Exports by Sector



Source: U.S. Department of Commerce, *Highlights of U.S. Export and Import Trade*

Manufactured exports create jobs—30 percent of the net private sector job increase from 1977 to 1980 resulted from U.S. manufactured exports.

Figure 2: New Jobs Created by Manufactured Exports



New Jobs Related to Manufactured Exports Increased by 47 Percent—Much Higher Than Overall Rate of Job Growth.

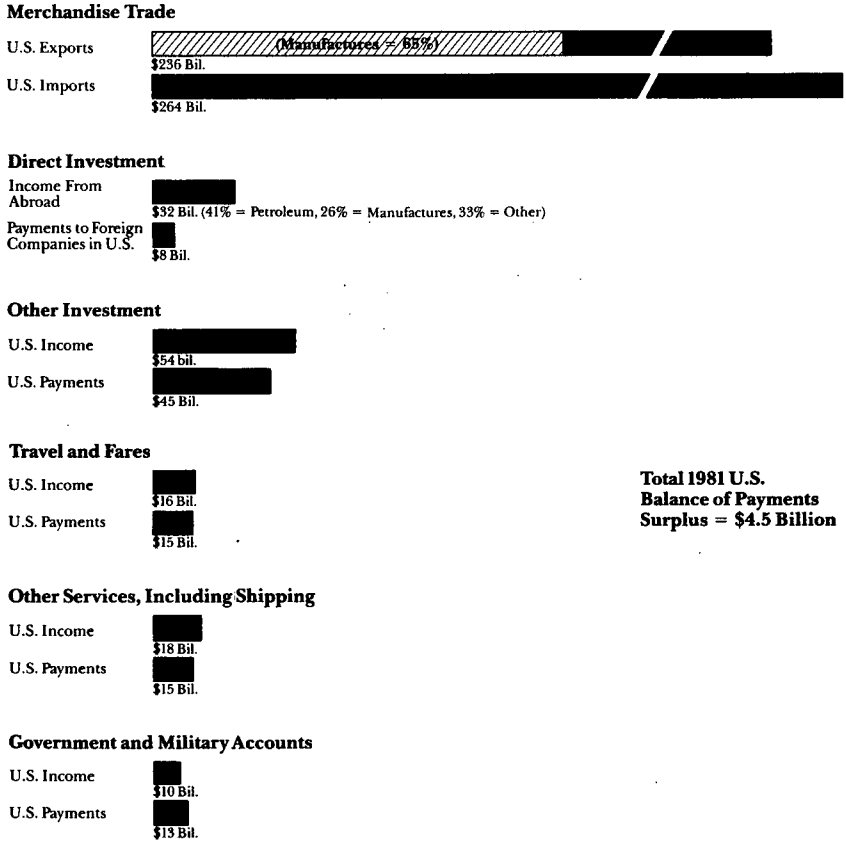
Where the Export Jobs Are—How Many Jobs Are Tied to Exports of Manufactures

Industry	% Jobs	Change from 1977
Chemicals and Plastics	19	+5
Machinery	22	+4
Electronics	18	+4
Transportation Equipment	18	+4

Source: U.S. Department of Commerce, *1980 Annual Survey of Manufactures: Origin of Exports of Manufactured Products*

Manufactured exports are by far the largest income earner for the U.S. balance of payments. Manufacturing and petroleum firms also contribute most of the direct investment surplus.

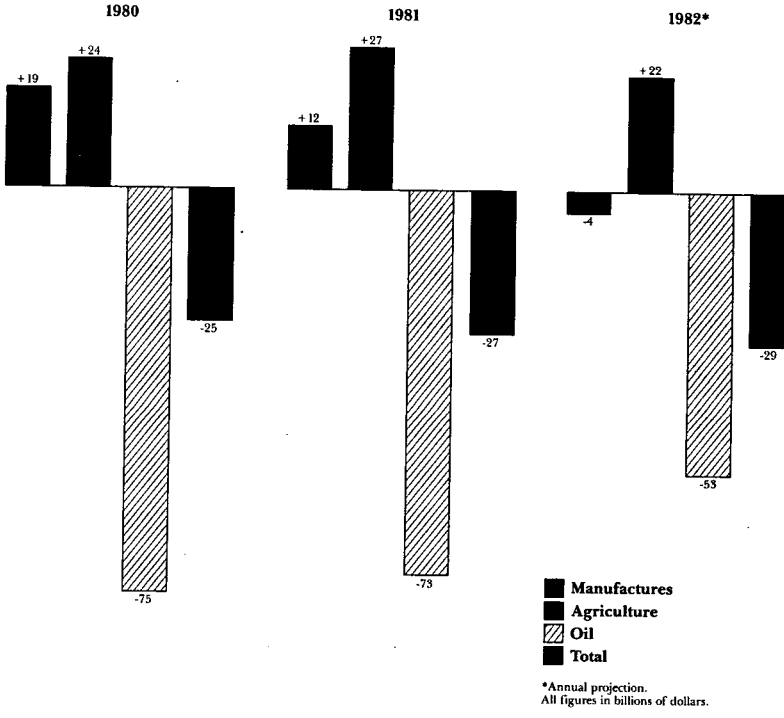
Figure 3: Major Items in 1981 U.S. Balance of Payments



Source: U.S. Department of Commerce, *Survey of Current Business*

Manufactures trade determines direction of total U.S. trade account. Since 1980, poorer performance in manufactures has wiped out savings on imported oil of over $20 billion.

Figure 4: Principal Components of U.S. Trade Balance

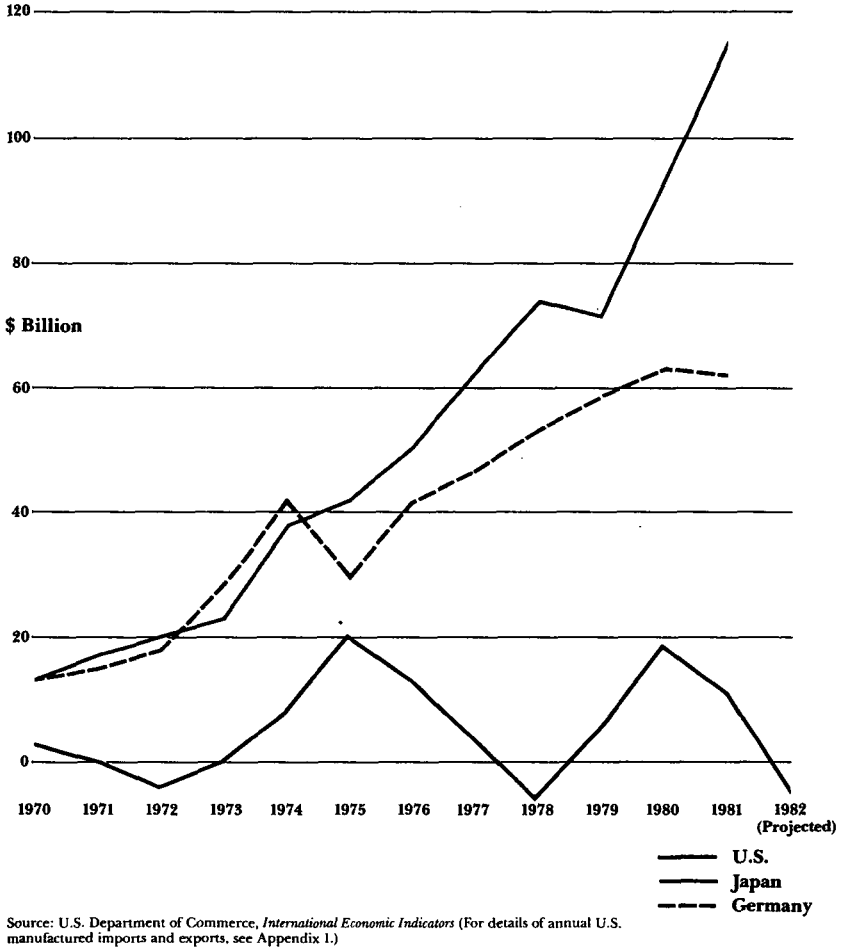


Source: U.S. Department of Commerce, *Highlights of U.S. Export and Import Trade*
(For details of annual U.S. trade balances, see Appendix I.)

II.
U.S. Industry Is Losing Its International Competitiveness

U.S. manufactures trade balance since 1970 has fluctuated between surplus and deficit. Japan and Germany have built growing surpluses to support their economies.

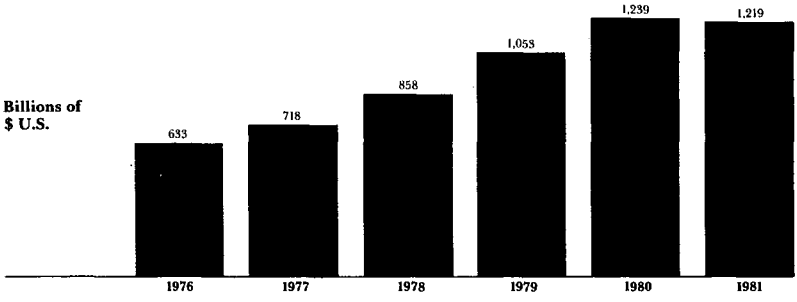
Figure 5: U.S., Japanese and German Manufactured Goods Trade Balances



Source: U.S. Department of Commerce, *International Economic Indicators* (For details of annual U.S. manufactured imports and exports, see Appendix 1.)

World trade has stopped growing in the 1980s, making it even more difficult for U.S. exports to regain lost market shares.

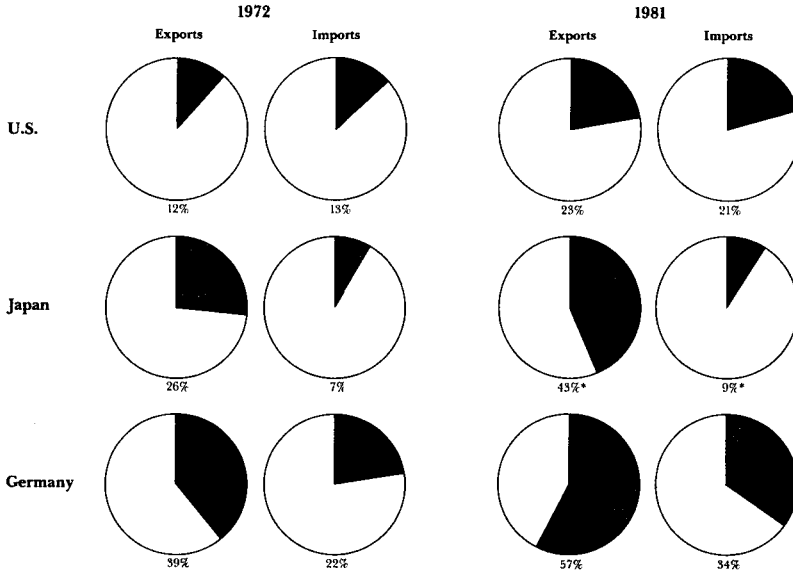
Figure 6: Total World Exports, 1976-81



Source: International Monetary Fund, *Direction of Trade Statistics*

U.S. exports as a share of industrial production have nearly doubled in 10 years to over 20 percent. But, unlike the situation in Japan and Germany, import levels are nearly as high as exports.

Figure 7: Manufactured Exports and Imports as Shares of Total Manufacturing Production

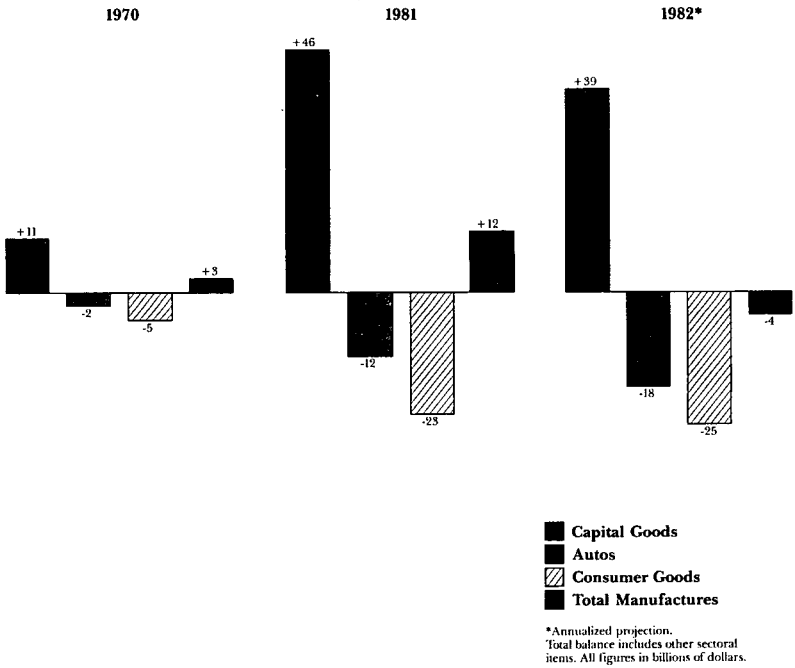


*Based on estimates of manufacturing output (see Technical Notes)

Sources: Organization for Economic Cooperation and Development (OECD), *National Accounts*
U.S. Department of Commerce, *International Economic Indicators*.

U.S. trade surplus in capital goods has covered deficit in automotive and consumer goods. But growth of capital goods imports and decline in exports eliminated 1982 manufactures surplus.

Figure 8: Major Sectoral Balances in Manufactures Trade



Source: U.S. Department of Commerce, *Highlights of U.S. Export and Import Trade* (For details of imports and exports by sector, see Appendix 2.)

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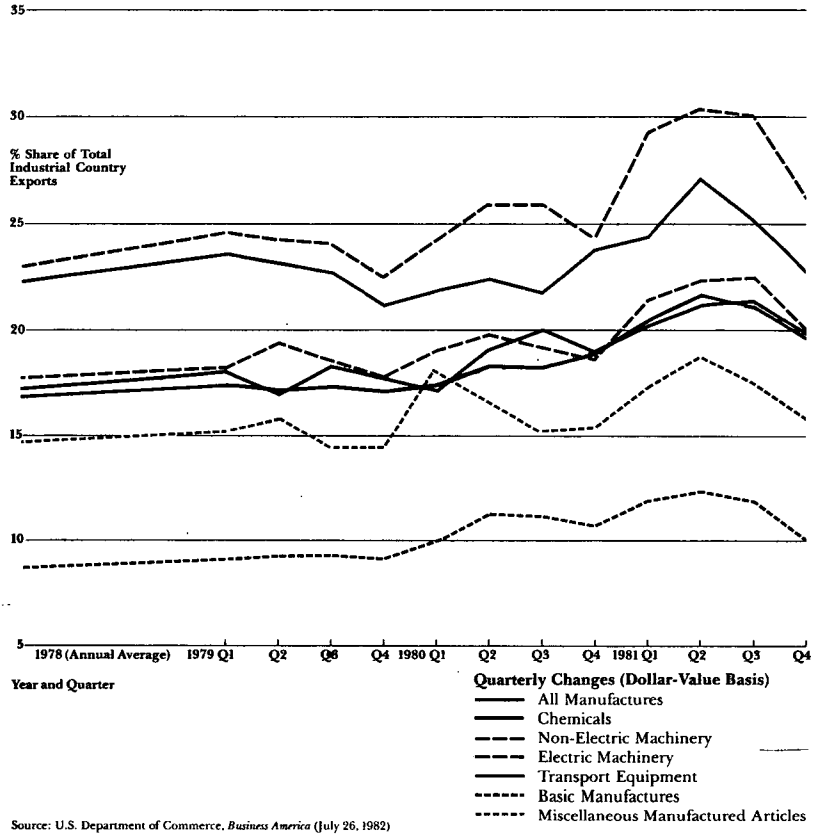
Both volume and value of exports have steadily declined since mid-1981, leading to loss of market shares by U.S. producers.

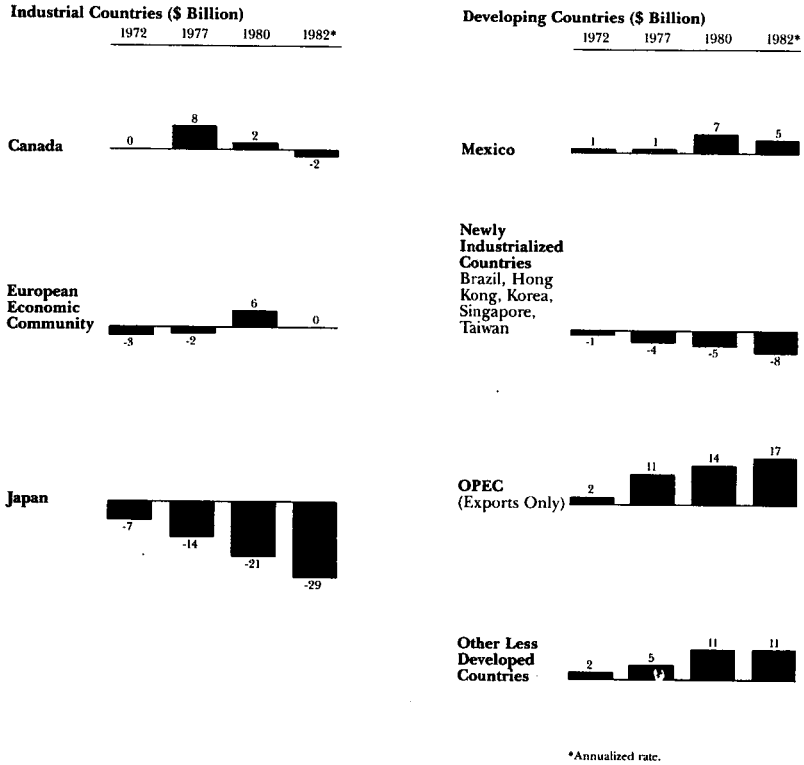
Figure 9: U.S. Share of Industrial Country Manufactured Exports, 1978-81



Source: U.S. Department of Commerce, *Business America* (July 26, 1982)

U.S. manufactures trade balance has worsened with virtually all major partners since 1980.

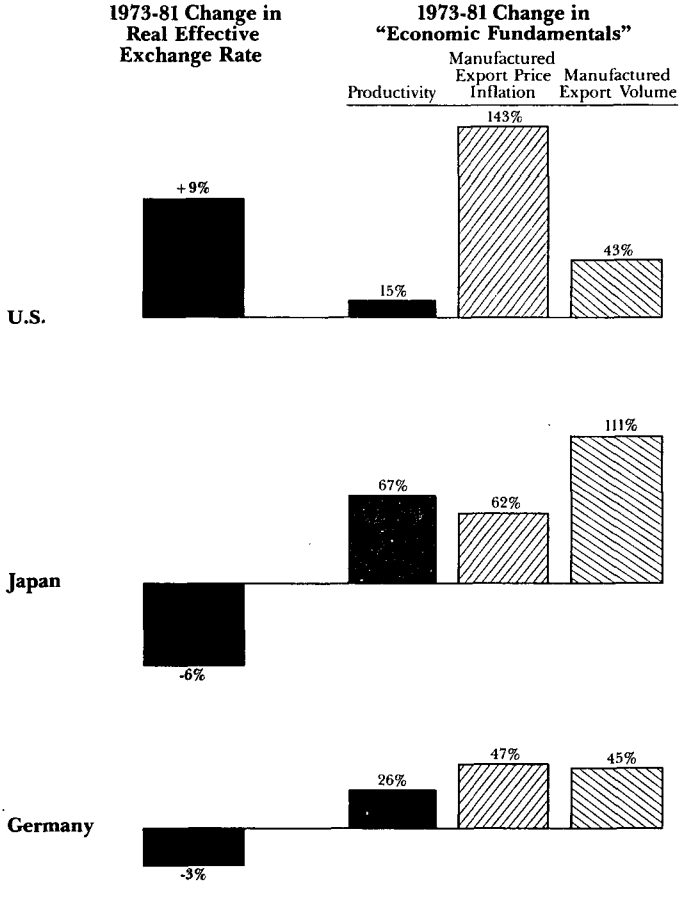
Figure 10: U.S. Manufactures Trade Balances With Major Trading Partners



Source: U.S. Department of Commerce, *Highlights of U.S. Export and Import Trade*, and annual reports, *U.S. Exports* and *U.S. Imports*

World exchange rates have moved opposite to direction indicated by changes in economic fundamentals, penalizing U.S. manufacturers in both domestic and world markets.

Figure 11: Comparison of Morgan Guaranty Real Effective Exchange Rate Index With International Competitiveness Indicators, 1973-1981

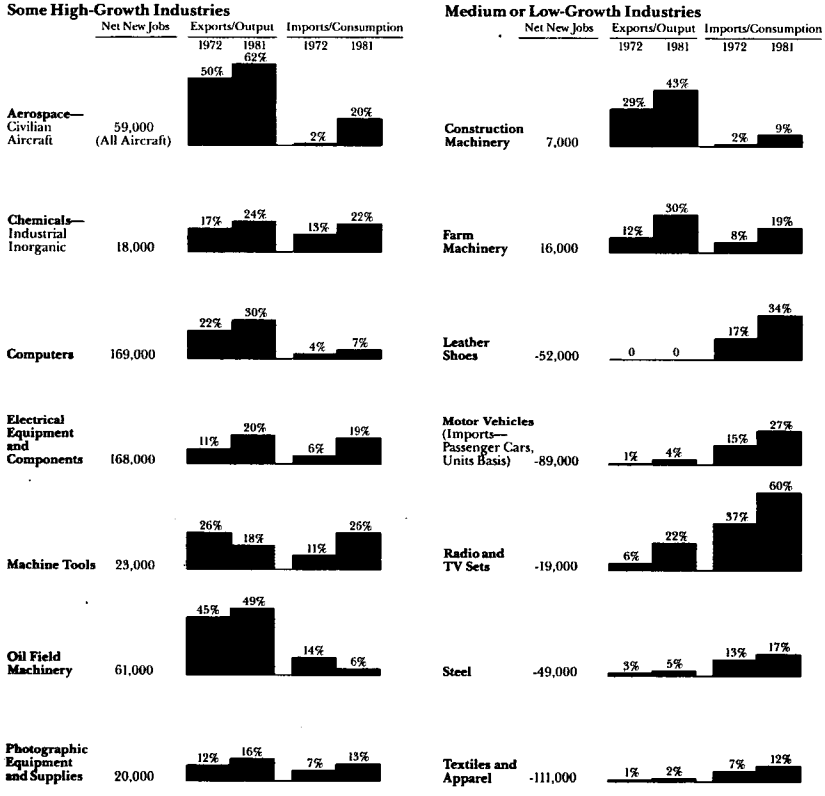


Sources: Morgan Guaranty, *World Financial Markets* (October 1982)
United Nations, *Monthly Bulletin of Statistics*
U.S. Department of Commerce, *International Economic Indicators*

III.
Even the Most Competitive Industries Face Tough Competition in the 1980s

More exports have helped some industries create new jobs—but even most successful exporters have faced tougher competition at home from imports.

Figure 12: Exports, Imports and Growth by Industrial Product Groups



Source: U.S. Department of Commerce, *1982 U.S. Industrial Outlook*

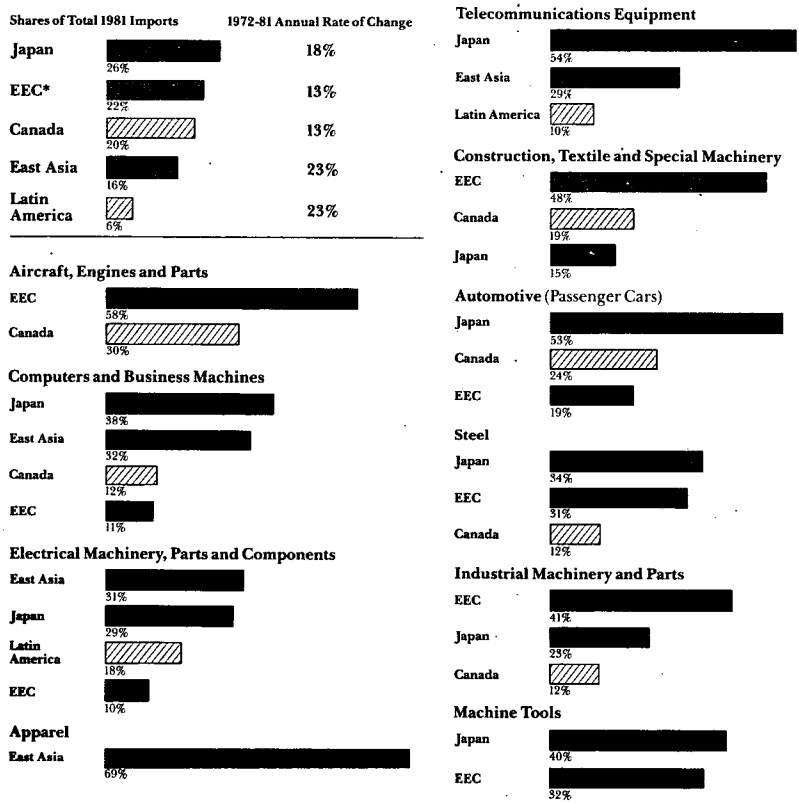
Many important U.S. capital goods industries have lost shares of the world export market—none has made major gains in the last decade.

Figure 13: U.S. Shares of Industrial Country Exports to World Market, 1970-80

Source: OECD, *Foreign Trade*, Series C

Japan has the largest share of the U.S. import market, and a higher growth rate of import penetration than other industrial countries. East Asian countries are also becoming important sources of U.S. manufactured exports.

Figure 14: Sources of U.S. Manufactured Imports

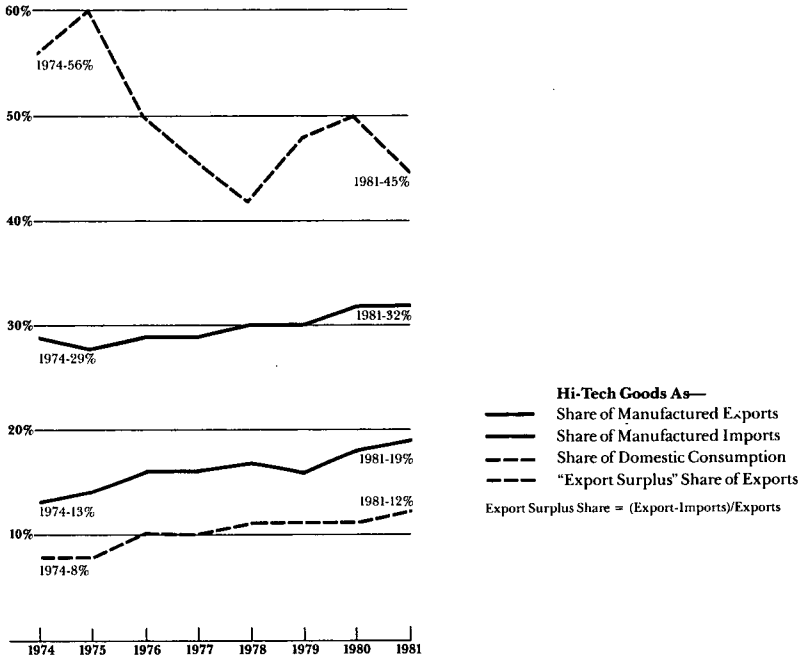


Source: U.S. Department of Commerce, *Highlights of U.S. Export and Import Trade*

*European Economic Community

Will high-technology industries help us through the 1980s and point us in the right direction for the 1990s? High-tech exports have grown rapidly, but so have imports—and in many cases U.S. producers have lost shares of the world market.

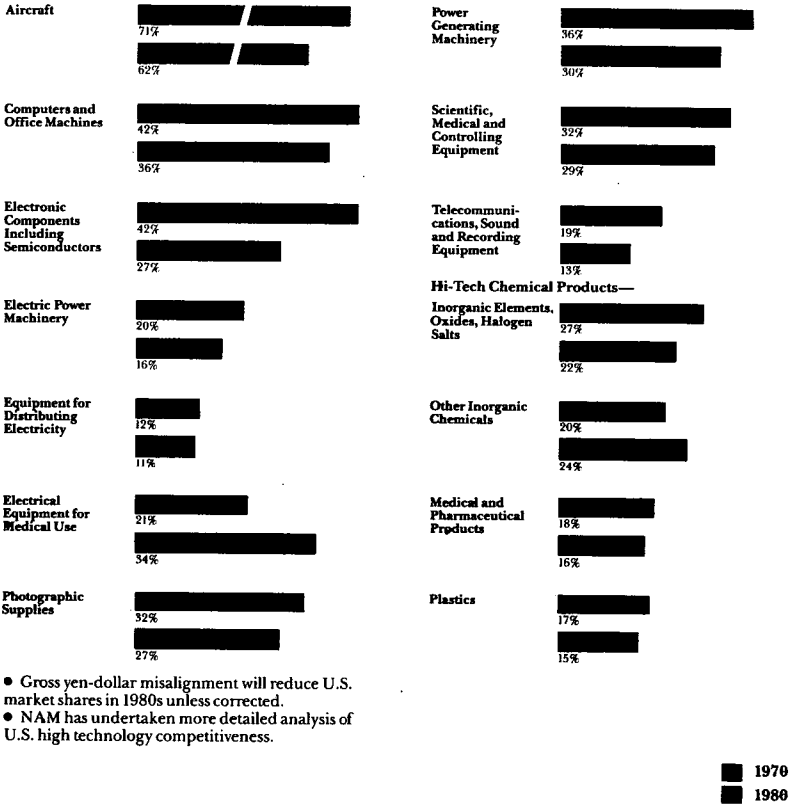
Figure 15: U.S. Commerce Department Reports Overall Loss of Competitiveness in Key Hi-Tech Fields, 1974-81



Source: U.S. Department of Commerce, *Business America* (October 18, 1982)

Virtually all U.S. high-tech exports lost market shares in the 1970s.

Figure 16: Market Shares of U.S. High Technology Exports, 1970-80



- Gross yen-dollar misalignment will reduce U.S. market shares in 1980s unless corrected.
- NAM has undertaken more detailed analysis of U.S. high technology competitiveness.

Sources: U.S. Department of Labor, *Trends in Technology-Intensive Trade* (1980)
OECD, *Foreign Trade*, Series C.

General Note: In all tables, U.S. imports are counted on a "free alongside ship" or customs value basis.

Technical Notes

Figure 1. 1982 projection based on nine months' data. Manufactured goods and agricultural products as defined by U.S. Department of Commerce.

Figure 2. "Export-related" jobs are as defined by Census Bureau in the *Annual Survey of Manufacturers.* This definition includes both the direct production of manufactured exports, and jobs in related supplier industries and services.

Figure 3. Balance of payments defined as U.S. balance of payments on current account. Manufactures share of exports is approximate, since the figure for manufactured exports is counted somewhat differently from the overall balance of payments merchandise export figure. "Direct investment income" includes earnings reinvested abroad.

Figure 5. 1982 projections on same basis as Figure 1.

Figure 6. Nominal current-dollar value of world exports, as reported each month by the International Monetary Fund.

Figure 7. Manufacturing production is defined as manufacturing sector of gross domestic product. Japanese figures for 1981 are based on national industrial production and price indices, as reported by OECD.

Figure 8. 1982 projection on same basis as Figure 1. Sectoral totals are based on Commerce Department trade statistics "end use" definition. The sectoral figures do not include certain basic manufactured goods (chemicals, steel, textiles) which are categorized with raw materials (such as oil) as "industrial supplies and materials," but these basic manufactures are included in the total manufactures trade balances in Figure 8. Excluding petroleum, the projected 1982 U.S. trade surplus in industrial supplies and materials is about $4.2 billion, down by over $2 billion dollars from 1981.

Figure 9. According to Commerce Department source given in Figure 9, the rise in U.S. share in earlier part of 1981 is due chiefly to short-term statistical effect of rapid dollar appreciation.

Figure 10. 1982 projections based on eight months' data.

Figure 11. Morgan Guaranty "real effective exchange rate" index is trade-weighted and adjusted according to domestic wholesale price inflation. (For full explanation, see *World Financial Markets*, May 1978.) Export price inflation is defined in terms of national currency value. Productivity is defined as manufacturing output per hour worked.

Figure 12. Output is defined as value of product shipments. Consumption is based on *Industrial Outlook* definition of "apparent domestic consumption": product shipments minus exports, plus imports. 1981 data taken from *Industrial Outlook* annual estimates.

Figure 13. 1980 is latest year for which complete OECD data is available. Total world exports do not include exports to the U.S., for purposes of this table. Product groups are defined to allow for the 1978 revision in the Standard International Trade Classification (SITC).

Figure 14. Latin America is defined as Commerce Department regional category "20 Latin American republics." East Asia is defined as Commerce Department residual Asian category, i.e., excluding Japan, South Asia and Communist countries. Nearly all manufactured imports from this residual group originate in four major newly industrializing countries: Korea, Taiwan, Hong Kong, Singapore.

Figure 15. High technology goods defined as 10 product categories listed in *Business America* article. These 10 product groups "account for over 51 percent of total R & D embodied in U.S. manufactures, as well as nearly 60 percent of the direct R & D expenditures." Import penetration defined as in Figure 12: imports as percentage of apparent domestic consumption. "Export surplus" shows strength of exports *net of imports*. Figure 15 indicates that while "hi tech" exports are growing as a share of total exports, hi tech imports into the U.S. are increasing relative to U.S. hi tech exports.

Figure 16. See note for Figure 13 regarding OECD data. High technology categories (based on SITC trade classification) are taken from a 1980 Labor Department study given in source note. Road motor vehicles and domestic electrical appliances, which are not generally considered high technology products, are dropped from the Labor Department list, and electronic components have been added. Also excluded are two other categories (explosives and watches) in which U.S. exports are low in value.

Appendix 1
U.S. Trade Balances—Manufactures and Total Trade, 1970-82

Year	Manufactures Trade			Total Trade		
	Exports	Imports (f.a.s.)	Balance	Exports	Imports (f.a.s.)	Balance
1970	$ 29.3 bil.	$ 25.9 bil.	$ 3.4 bil.	$ 42.7 bil.	$ 40.4 bil.	$ 2.3 bil.
1971	30.4	30.4	0.0	43.6	45.8	-2.2
1972	33.8	37.8	-4.0	49.2	55.9	-6.7
1973	44.7	45.0	-0.3	70.9	69.8	1.1
1974	63.5	55.2	8.3	98.0	100.6	-2.6
1975	71.0	51.1	19.9	107.6	96.6	11.0
1976	77.2	64.8	12.4	115.2	123.5	-8.3
1977	80.2	76.6	3.6	121.2	150.4	-29.2
1978	94.5	100.3	-5.8	143.7	174.8	-31.1
1979	116.7	112.2	4.5	181.9	209.5	-27.6
1980	144.0	125.1	18.9	220.6	245.3	-24.7
1981	154.3	142.5	11.8	233.7	261.0	-27.3
1982 (annual rate)	143.7	147.3	-3.6	218.4	246.9	-28.5

Sources: U.S. Department of Commerce, *International Economic Indicators* and *Highlights of U.S. Export and Import Trade*

Appendix 2
U.S. Trade by Manufactured Goods Sectors, 1970-82 (Classification by "End-Use" Categories)

	Capital Goods			Automotive Products			Consumer Goods (Except Foods and Autos)			Industrial Supplies and Materials (Except Petroleum)		
	Exports	Imports	Bal.	Exports	Imports	Bal.	Exports	Imports	Bal.	Exports	Imports	Bal.
1970	14.4	3.8	10.6	3.7	6.0	-2.3	2.7	7.6	-4.9	13.3	12.3	1.0
1977	39.0	13.4	25.6	12.1	18.7	-6.6	8.8	22.4	-13.6	32.2	34.2	-2.0
1980	72.6	29.6	43.0	15.9	27.1	-11.2	16.2	34.4	-18.2	67.7	52.2	15.5
1981	80.2	34.5	45.7	18.0	29.7	-11.7	15.8	38.7	-22.9	64.0	57.5	6.5
1982 (annual rate)	74.6	35.9	38.7	17.4	35.0	-17.6	14.5	39.8	-25.3	56.8	52.6	4.2

All figures in billions of dollars. Imports f.a.s. or customs value (1982).

Source: U.S. Department of Commerce, *Highlights of U.S. Export and Import Trade*

Mr. FLORIO. I identify with your frustration, and a number of committees have the same frustration.

I wonder frequently if it is not a facet of our pluralistic society that we are faced with some ~~of those~~ problems, and that while we lament our lack of centralized authority, whether it be in the Congress or the executive branch, or through our economy, as a whole, particularly when we are faced with more monolithic actions by some of our trading partners. You heard just today's discussions. The feelings of some that moving toward a more coordinated, coherent, centralized, if you will, approach runs counter to the feelings and the concerns of a good portion of the country, or at least some of the leaders in the country.

I am particularly appreciative of your testimony because, as spokesman for a very important business association, to have you state some of the things that you did, I think it is very important to have on the record, because it does, from a business organization standpoint, state that there is a need to change, and that the traditional approach of implying that the business community is in some way automatically opposed to the public sector in the marketplace under certain circumstances is not exactly the case.

I appreciate that.

Mr. FOX. You can be sure, Mr. Chairman, that the National Association of Manufacturers would not favor a system with the Government picking winners and losers, but we do recognize the important points of industrial policy that were cited this morning; that there is an inordinate advantage given to the Japanese under the present system; that the Japanese action with respect to the ability to develop industries and exploit our market is not fully made available to American firms reciprocated in the Japanese market, and it is no longer possible to have a strong economy in this country, in the industrial sector, that is entirely supported by our large domestic market.

New investment in these higher technologies, as well as in some of the more traditional areas of automobiles and steel, require a world market approach.

With interest rates at the level that we have them, obviously new investment has to be thought through very carefully by companies, even those most dedicated to competing in this market and foreign markets, but in addition to the high cost of money, 5 percentage points higher than Japan, the problem of the unequal competition arising from the exchange rate issue must be borne in mind.

The two issues taken together definitely account for a very large aspect of the relatively slow increase in domestic investment. It has been a negative in the past 2 years.

Mr. FLORIO. I am very impressed with your discussion on the exchange rate policy and would like to follow up on it, if you don't mind, asking the staff to coordinate with your office.

It is clear that the Members of the Congress don't have a full appreciation of what they regard as a very esoteric subject, and there is a need for more of a national sense of awareness of this facet of our economic problem, and I would like to take advantage of your obvious expertise to educate ourselves so we can perhaps do something about educating everyone else.

Mr. FOX. Thank you, Mr. Chairman, on that. You will recall the recent revaluation of the French franc in that whole lost weekend where the French argued with the Germans, and the net result was a compromise; the franc was devalued by 2 percent, and the mark revolved upward by 5 percent.

The importance of the exchange rate is fully understood by our competitors. That result is not a bad one from our standpoint.

Mr. FLORIO. May I ask your thoughts on the recent Harley-Davidson 201——

Mr. FOX. My point is that our officials in Government have too short a time horizon on the exchange rate. Basically, Japan has had an undervalued currency substantially since 1960. There were a few years in the seventies when the rates floated correctly, but part of Japan's industrial strategy is to compete with an undervalued currency.

If you are putting all that money in the fifth generation computer or microprocessors, or into the semiconductors, it is really wonderful to start selling those products abroad, even after you have done this great job of building it up in a domestic market that is substantially protected, be able to sell them at a 25-percent discount.

Mr. FLORIO. Why aren't they subject to the same pressures that we have, in the area of outflow, our overpriced market? One would think that there would be internal pressure as a result of capital outflow from there, and obviously there isn't?

Mr. FOX. No; there is that pressure, and that accounts in part for the weaker yen.

There has been a substantial outflow of dollars from Japan to the United States perhaps $18–$20 billion in the last 2 years, and that brings about a weakening of the yen.

Mr. FLORIO. Isn't there the argument—I mean, on balance, doesn't the weaker yen work in the interest of the Japanese economy?

Mr. FOX. A weaker yen gives them this extremely competitive pricing of exports and competitiveness with imports.

Mr. FLORIO. How do they provide the generous capital assistance?

Mr. FOX. Because their savings rate is so high and they keep that money to themselves. If the rates of interest in Japan are only 6 percent, 6½ percent, why doesn't G.M. go there and borrow $500,000 for their modernization? Why should it go to Chase-Manhattan and borrow it at 12 or 14 percent?

The answer to that: lots of luck. Japan has a system that the foreign borrowers give notice to the Minister of Finance, and that the borrowing be approved, and 1½ borrowing per quarter is approved.

Japan is husbanding its own savings, which is, of course, the highest savings rate in the world, for its own development.

On the export side of its foreign currency, it really misjudged the situation with respect to the outflow, and the weakening of the yen was not, in my opinion, brought about by deliberate Japanese policy in 1981 and 1982.

Mr. FLORIO. How does this savings take place in the Japanese economy, in the face of the incentives to export capital?

Mr. FOX. Because it is not a completely international financial market. Most pension funds invest in Japan. The national govern-

ment savings system, which is a source of a lot of this low-interest rate lending, just invests in Japan; so you have sort of a regime with respect to savings and investment which, by our standards, is not completely rational. A lot of it stays in Japan except this very low return on capital, and the Japanese Government has encouraged that.

Mr. FLORIO. One last question, Mr. Fox.

Mr. FOX. You asked about the bicycle, motorcycle case.

We have a situation now with respect to the escape clause, section 201, which is an unintended consequence of the change in the trade laws in 1974.

The term that is used in the statute is that imports be a substantial cause of injury, and that has been stated in the statute to be the most important single cause. Accordingly, it has not been possible to grant relief in some instances where other causes were deemed to be more important, and in the case of the motorcycle decision, a determination was made that the imports were more important than other causes, including the current recession.

Mr. FLORIO. Do you agree with that?

I don't purport to be a motorcycle expert. Harley-Davidson makes large motorcycles that don't appear to be in demand, and the imports are smaller, fuel-efficient motorcycles, and, therefore, they are not in direct competition.

What has happened is the imports are addressing the concerns of the marketplace in terms of motorcycle riders, and that the less-than-efficient larger motorcycles made by Harley-Davidson, are, therefore, being priced out of the market not by overseas competition for their design models, but because they are making motorcycles that are not relevant to the marketplace.

Mr. FOX. I think they have done a remarkable job of readjusting its product mix. In addition to making larger motorcycles, it makes medium-sized motorcycles, and it has greatly improved its efficiency.

The escape clause was always intended to deal with an industry like that.

In my opinion, imports are the substantial cause of injury, even in the case of a relatively weak domestic market. Their difficulties are occasioned by imports, and I find that a correct decision.

Mr. FLORIO. If the automobile brought a similar complaint?

Mr. FOX. The automobile industry never got together. Actually, Ford Motor Co. and the United Auto Workers brought a petition under 201, but the other members of the industry did not join that petition, and the International Trade Commission found that causes other than imports were more important.

In other words, imports, although important, were not as important as the demand for fuel-efficient cars, which were not produced in this country in adequate numbers, or the recession, itself. That is an anomaly, actually, that an industry that should be so greatly adversely affected by a decline in the economy be held to the standard that the imports be more important than any other factor such as the recession.

By the way, Mr. Chairman, the GATT does not require that. Article XIX of the GATT simply requires that imports be the cause of serious injury or threat thereof.

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It does not impose this additional requirement. That is a condition imposed by the Congress presumably in an effort to limit excessive use of the escape clause mechanism, and it reflects the conditions of the early 1970's. It does not take into account the type of deep recession that now would appear to make in most instances the recession a greater cause than imports in most instances.

Mr. FLORIO. If an automobile complaint was filed, 201 now, and the same interpretation that was given to the Harley-Davidson case, as was given to the automobile industry, is it your thought that the automobile industry would be able to prevail?

Mr. FOX. We refer to that in our statement. Our advice to the Congress might be before you act on domestic content with all of its consequences that are obviously adverse, and perhaps even beyond what can be analyzed, that the industry and labor be asked to file, or that the suggestion be made that the law be followed, it would not bring about a different result.

Mr. FLORIO. You said that would be in accordance with GATT?

Mr. FOX. In accordance with domestic law and in accordance with GATT, and my suggestion is that a different result might be brought about.

Mr. Brock testified this morning that in the future, for at least 1 year, all of the increased production of cars in the United States, as our economy picks up, substantially all will go to domestic producers because of the Japanese voluntary export restraint.

Well, that is provided the Japanese choose to continue that voluntary export restraint, whereas if an escape clause petition were filed and approved, that would not be a matter of discretion on the part of the Japanese.

That could be something that could be set in place, the typical escape clause relief could be, say, for 5 years, and perhaps there could be a degressivity in the import relief, but then it would justify major new investments upon the part of companies, and it conceivably would justify the introduction of new and more efficient work practices on the part of the work force, not to say the possibility of holding wages or reduction in future increases, but it places it in a different context of American automobile companies gearing up for the competition, where it is left up to the Japanese.

You could almost argue that the extension into the third year of the voluntary export restraints on automobiles was brought about by the Japanese concern for the domestic content legislation.

Mr. FLORIO. Let me ask one last question of you in your capacity.

Many of us are concerned that we hear that the recovery is at hand, and yet, at the same time, we foresee that there will be rather substantial unemployment carried on through 1984, and the tax laws have been modified to such extent that this recovery will not generate the revenues for the Treasury that had been traditionally associated with revenues, and we will not be able to deal with the deficit.

If revenues had come in in the way they had in the past, as a spokesman for a business association, are you concerned that the recovery—we have had testimony here this morning; we have wrung the economy out substantially, and some say, well, now, we are ready to go off in a new direction, higher degree of productivity because of the wringing-out process, and yet if we talk about sub-

stantial deficits, and there is not going to be the ability to correct those deficits in incoming revenues, are we going to have the outflow of dollars as a result of carrying massive numbers of people unemployed because they are not productive or generating taxes, and, of course, there are programs that are designed to provide for their relief.

Are we really talking about a recovery that is going to be acceptable to the business community if the recovery occurs in the way that I have just described it?

Mr. FOX. I think your concerns are well justified.

The NAM has an official forecast which is for a relatively modest recovery, a weak recovery. We are not prepared to say how long it will last, and we definitely find that the recovery will not be strong enough in and of itself to reduce the size of the budget deficits in the outyears.

The conclusion one draws from that is that unemployment will remain high this year, next year, probably the year after that, and interest rates will remain relatively high, also, thus discouraging investment.

Our conclusion is that there is a tremendous difference between a recession bottoming out and the return to an acceptable level of economic growth, and we have not seen that acceptable level of economic growth.

The administration has just revised its forecast and sees a more rapid rate of growth this year than forecast in the budget. I, myself, cannot participate in that numbers game.

I am not qualified to judge where the Council of Economic Advisers' guess about the growth rate is likely to be correct or not, but, over all, the NAM finds the recovery just beginning, and, therefore, subject to the circumstances of a recovery that never gets full-blown, is aborted in the process, or is just not a very peppy recovery at all primarily because of the high interest rates associated with the very large Government budget deficit.

Mr. FLORIO. Well, the deficit, of course, is a factor, like a lot of things, but I am wondering, if we find higher rates of recovery being talked about by the administration, unacceptable, if they still contemplate higher unemployment rates, and no reduction in the deficit, it then is incumbent upon the Congress to try to deal with diminishing or reducing the deficit, and, obviously, the administration's approach is to talk about further reductions in domestic spending.

The feeling among many is that that is not feasible. You really then are talking about some way to generate revenues, and I am just wondering if your association has suggestions, and I realize that is not the subject that we are supposed to be talking about today.

Mr. FOX. Budget deficit, cutting expenditures, and that includes defense expenditures, and sizable cuts in the defense side of the budget, as well as in other elements of the budget.

Mr. FLORIO. We are talking about over $200 billion in deficit, and I don't know anyone that is talking about bridging that gap just by expenditure reductions.

Mr. FOX. That is correct, so then the question is how much by other means, and we have not at this time recommended any tax

increases. I think our position is that all the expenditures in the Federal budget have to be looked at, that so far the address to the defense budget has been insufficient.

Mr. FLORIO. The tax cut has been proposed as the generator of $70 billion for 2-year deferral.

Mr. FOX. The whole tax subject is subject to review. NAM has not favored deferral of any of the tax cuts due in July.

Mr. FLORIO. You have been very generous with your time, and I appreciate your participation today.

The committee stands adjourned.

[Whereupon, at 1:15 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

[The following letter was received for the record:]

STEPTOE & JOHNSON,
Washington, D.C., May 10, 1983.

Hon. JAMES J. FLORIO,
Chairman, Subcommittee on Commerce, Transportation and Tourism, Washington, D.C.

DEAR MR. CHAIRMAN: It has come to our attention that, during the course of hearings before the Subcommittee on Commerce, Transportation and Tourism on April 5, there was a brief discussion of the heavyweight motorcycle import relief petition under the "escape clause". As counsel for Harley-Davidson in that proceeding, we would like to clarify the issue raised concerning with the imports subject to relief.

It appears from the record that there was some confusion about whether the imports subject to the relief were smaller motorcycles that did not compete with Harley-Davidson heavyweight motorcycles. It was suggested that the true source of the problem for Harley-Davison was that heavyweight motorcycles were not in demand, whereas the smaller imported motorcycles were in great demand.

In fact, the "escape clause" petition and the import relief are limited to heavyweight motorcycles (with engine displacements greater than 700 cc) were fully competitive with Harley-Davidson heavyweight motorcycles. Further, over the last five years, sales of Japanese-brand heavyweight motorcycles have declined precipitously. Finally, the greatest increase in Janapese-brand heavyweight motorcycle sales over the last few years has been of models that emulate the traditional Harley-Davidson styling and engine configuration.

We hope that these comments may be of assistance and respectfully request that they be incorporated in the record.

Very truly yours,

SUSAN G. ESSERMAN.

GENERAL TRADE POLICY

Trade Problems and Currency Imbalances

WEDNESDAY, MAY 25, 1983

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE,
TRANSPORTATION, AND TOURISM,
Washington, D.C.

The subcommittee met, pursuant to call, at 9:30 a.m., in room 2218, Rayburn House Office Building, Hon. James J. Florio (chairman) presiding.

Mr. FLORIO. The subcommittee will come to order.

Mr. Lent is on his way and he has requested we commence the hearing and other members will be joining us in the immediate future. I wanted to welcome you all to our hearing this morning, a continuation of the hearings that the subcommittee has been having on a regular basis dealing with problems involving international trade.

We have recently heard testimony from representatives of the automobile industry, the U.S. trade representative, and representatives of labor and trade associations in connection with domestic content and other trade legislation before the subcommittee. They all stated unequivocally that one of the biggest problems facing U.S. trade today is the imbalance in the value of the dollar against all other currencies, particularly the Japanese yen.

For example, we have been told that the cost to produce an automobile is clearly greater in the United States than in Japan. In 1981 the production cost differential was $1,500, and it has continued to increase to $2,000 today. This difference in cost is due more to differences in currency values than to any other factor, including labor costs, productivity, and tax inequities, and so on.

The automobiles themselves are competitive, because domestic manufacturers over the last few years invested billions of dollars to improve their products. General Motors alone has put $23 billion into capital and plant expenditures over the last 3 years. Ford invested $3 billion this year to introduce six new automobiles and two new trucks. And, Chrysler is investing $6.6 billion in new products over the next 3 years.

Quality and fuel efficiency have also improved in the domestic automobile industry. Most importantly, productivity increased 13 percent since 1980 compared with 2 percent for manufacturing as a whole. Yet the U.S. trade deficit continues to increase.

The answer in part seems to be that the strength of the dollar makes our products too expensive for other nations to buy. At the end of 1978, 172 yen were worth $1. Today it takes 234 yen to have the same purchasing power as $1. The exchange rate for the yen has been as high as 260 yen to the dollar.

The primary purpose of our hearing today is to learn more about the currency imbalance and the impact it has on U.S. exports. We are here to learn what can be done to correct the imbalances, and what the United States should do at next week's Williamsburg economic summit to begin addressing these problems on an international level.

We look forward to hearing from each of our witnesses on these important questions.

I am going to call all four of our witnesses as a panel so that we can get the benefit of their thoughts in a cooperative way so that at the appropriate time they may feel free to comment on the thoughts of each other. I think that would be a useful exercise for the panelists to become involved with.

We are pleased to have with us Donald Fites, vice-president of Caterpillar Tractor Co.; Frank Southard, representing the Atlantic Council; Mr. George Liney of Ingersoll-Rand; and Professor Samuel Katz of Georgetown University.

As with all of our witnesses, your testimony will be put into the record in its entirety. We may proceed as you see fit. We will hear from all the witnesses, and at the conclusion of their testimony feel free to proceed with questions.

Mr. Fites, welcome to the committee. You may proceed.

STATEMENTS OF DONALD V. FITES, VICE PRESIDENT, CATERPILLAR TRACTOR CO.; FRANK SOUTHARD, DIRECTOR, ATLANTIC COUNCIL; GEORGE LINEY, INGERSOLL-RAND CO.; AND SAMUEL I. KATZ, GEORGETOWN UNIVERSITY

Mr. FITES. Thank you, Mr. Chairman. We appreciate this opportunity to testify on a matter that we feel is of top priority for our company and for many others. I am of course talking about the imbalance in the dollar exchange rate you referred to. I think your review is particularly timely. As you mentioned, later this week President Reagan will join the heads of state of six other nations in an economic summit at Williamsburg, Va. Many weighty concerns should be on their agenda. But, in my view, none is more important than the need to address the continued exchange rate imbalance which has caused tensions among allies, and which threatens to undermine the U.S. economic recovery.

We have been pleased to support congressional initiatives by Representatives Traxler and Hillis and by Senator Percy to highlight the importance of this matter to President Reagan, as he prepares to leave for Williamsburg.

The ongoing work of this subcommittee should make the yen/dollar issue one of highest importance to you as well. You have, for example, been reviewing the merits of local-content legislation. Caterpillar is firmly on record in opposition to such legislation. We believe it represents a form of protectionism that potentially could undermine the world trading system.

I believe domestic-content legislation addresses the symptoms, but not the causes, of the U.S. auto sector's problems. And one of those causes, which I know auto company representatives have discussed before this subcommittee, is the sustained undervaluation of the Japanese yen relative to the dollar.

The problem of the misalinement of the yen and the dollar is one which affects nearly every segment of U.S. industry—autos, steel, machine tool builders, computers, banks, service companies—all these and many more have vigorously expressed their concern. For example, Rimmer de Vries, a senior vice-president of Morgan Guaranty Trust Co., recently wrote in a Business Week article that the strong dollar is hindering the United States and world recovery and sizable yen undervaluation has led to more protectionist pressures against Japan.

In statements by Caterpillar spokesmen and other American businessmen, we have called for a commitment from U.S. policymakers to actively pursue remedies to the imbalance in the yen/dollar relationship, so that American companies can compete fairly against their Japanese counterparts in world markets. Similarly, European businessmen have highlighted the yen problem. For example, in a complaint filed 1 year ago under GATT article XXIII, the EC identified the undervalued yen as an important component of Japan's unfair trade advantage.

This morning I would like to renew that call for action by the United States and Japanese Governments, and offer what we believe to be some constructive suggestions on how to proceed.

In asking for action, I would note that the Japanese are expressing nearly as much concern about this problem as we are.

Their business leaders have spoken frankly about the need for the yen to strengthen, and for our two Governments to work together toward that end.

And I can report to you that just within the past few days, we have had reinforced the understanding that Prime Minister Nakasone is prepared to review the issue at Williamsburg. We hope our statement will take the lead in stimulating a dialog on the topic.

I will refrain from inundating you with all our analysis of what is causing the yen/dollar misalinement. But let me summarize, repeating a sentence from a speech given by Caterpillar's chairman, Lee Morgan, last week.

Lee said:

> When the dollar is and the yen is not an international currency * * * when Japanese interest rates are held, by specific government actions, well below the world level * * * and when capital flows to and from Japan are greatly imbalanced in the out direction, then a free market for yen does not exist.
>
> And realism dictates that some offsetting actions be taken to balance the serious disadvantage faced by American exporters who are competing—not very well, I would say—against a significantly undervalued yen.

Consider, for example, an average American economy.

In 1978, the yen was properly valued at about 200 to the dollar, and both the American company and its Japanese competitor could be profitable.

Since then, and particularly in the last year, the typical American company has cut costs to cope with the recession and to stay competitive with its Japanese competition. It lowered its break-

even point by closing inefficient plants, by investing in more productive equipment, by trimming its work force, and maybe even by cutting salaries. As an entrepreneur, you feel pretty good about yourself.

But when you look at external factors, over which you have no control, the euphoria fades. That is because you will find that your costs have increased about 35 percent relative to your Japanese counterpart since 1978. You lost competitiveness because of a weakening yen.

Your Japanese competitor's exports grew 5.5 percent per year compared with 2.5 percent for you and your European counterparts. His competitiveness improved while yours, as well as those of your counterparts in other industrial countries, deteriorated.

The undervalued yen has been the major cause of this shift in competitiveness.

I should acknowledge that from its absolute weakest point last November of 278 to the dollar, the yen has strengthened to its present value of about 235 to the dollar. However, after adjusting for differences in inflation, the yen is still 35 percent weaker than it was in 1978.

These facts argue rather conclusively, in my opinion, that the problem cannot continue to be brushed aside as the strength of the U.S. dollar; rather, the facts point to the weakness of the Japanese yen. Japanese export performance continues to be relatively strong at the expense of other industrial nations. It has been estimated that the $75–$100 billion U.S. trade deficit projected for 1983 translates into 2 to 3 million lost job opportunities; or, said another way, potentially adds 2 to 3 percent to the U.S. unemployment rate.

Caterpillar, in concert with others in the business community, has made a detailed review of what actions could be taken to help correct the yen/dollar imbalance. To say there is consensus in the business community on every detail of the proposed program would be an exaggeration. But some general themes and specific recommendations have clearly emerged in the debate, and I would like to summarize them for you.

Most analysts agree that the appropriate yen/dollar exchange rate should today be no weaker than 200 yen to the dollar. This figure represents a basic structural equilibrium rate around which short-term cyclical variations could occur. Variations have occurred in the yen/dollar rate in the past year, but they have been around a significantly higher base than 200 to 1.

The interest rate spread between the United States and Japan is a major factor affecting the relative valuation of the currencies. There is general agreement that while Japanese savings propensities are an important contributor to this differential, conscious insulation of the yen from worldwide interest rate trends exaggerates the spread.

Thus, we recommend policies in both countries to reduce that interest rate differential.

In the United States, lower interest rates must continue to receive high-priority attention. This will require firm control over the U.S. budget.

To complement our domestic efforts, the United States should insist that Japan allow its interest rates to be set by market forces.

An induced, short-term raising of Japanese interest rates is not sufficient; the basic factors that underlie the interest rate distortion need to be addressed.

Highest priority should be given to liberalization of Japanese financial and capital markets and especially the encouragement of capital inflows. The much-touted reduction of Japanese capital flow barriers has been one-sided. Capital now flows out of Japan much more freely than it did in the past. But there has been no commensurate increase in capital inflows. This one-sided adjustment in capital flows is a major contributor to the yen/dollar exchange rate imbalance.

Restraints on the flow of yen need to be removed. Ultimately, there should be complete internationalization of yen financial markets.

Japan needs to further liberalize foreign direct investment. The Government's screening and approval process remains a major obstacle to foreign direct investment. Last year, only 17 foreign companies decided to build plants in Japan. Preliminary data indicate foreign companies built 535 plants in the United States in 1981—quite a difference.

Restrictions on stock purchases make it very difficult for a foreign entity to acquire a Japanese company. Liberalization of investment policy would accomplish one of the major obligations Japan has to its world trading partners; that is, to operate in an open, free, and fair trade and investment environment.

Most of the actions I have discussed are aimed at achieving an appropriate long-term equilibrium in the yen/dollar relationship. But there needs to be short-term action as well, because in the view of many of us, the problem is critical to our short-term economic vitality. Thus, we propose the following:

One. Declare it a problem. The imbalance in the yen/dollar relationship is, in the view of Japanese and American businessmen, and apparently in the view of the Japanese Government, causing economic and political problems for both sides. A simple joint declaration, by the United States and Japan, that the Governments intend to undertake a joint program to bring the exchange rate to an appropriate level will help strengthen the yen relative to the dollar.

Two. Undertake joint intervention in support of the yen. The United States could convert more reserves into yen; Japan could reduce permanently its large dollar reserves. The working group on exchange market intervention, formed at the Versailles Summit, felt intervention was effective in influencing short-term exchange rate behavior—the kind of action we propose. One of their studies suggested intervention to affect yen/dollar rates could have appreciable effects.

Three. If the Japanese are not willing to cooperate, it may be necessary to impose a surcharge on Japanese goods. We believe this could be accomplished consistent with both countries' obligations under the GATT.

Four. We believe the United States should immediately request the IMF to look at Japanese exchange rate relationships. The IMF articles of agreement call for a review of a country's policies which affect exchange rates where the exchange rates allow an unfair

competitive advantage over other members. We believe the present situation demands such a review.

Let me assure the subcommittee that we view these proposals very seriously. Import surcharges and currency intervention are not actions I like to recommend. Philosophically, I prefer the non-intervention approach, and it is my hope that implementation of the longer range measures discussed earlier will obviate the need for long-term intervention and surcharge programs.

Finally, I would like to address for a moment the question of whether the present international system that determines exchange rates works properly. Many people believe it does not; that is, there is broad concern that capital movements are overwhelming the traditional role of trade flows in determining exchange rates.

Technically, the present system should dictate exchange rates which reflect the trade competitiveness of the trading partners. But that technical purity is destroyed by the kinds of trade and capital flow barriers the Japanese maintain. So it seems appropriate that the United States seek to determine what kinds of modest or major adjustments need to be undertaken, to assure that the exchange rate system works equitably.

Mr. Chairman, in summary, let me repeat three general themes which run throughout this presentation:

One. The present system of exchange rates is not properly accounting for trade competitiveness. Its failures are influencing the protectionist sentiments that are growing in the world. This may require some strengthening of our international institutions—such as the GATT and IMF—to deal with exchange rates more effectively. But unless all nations play the trade and investment game fairly and equitably, there is no exchange rate system which will provide satisfactory results. It is well to remember that the fixed exchange rate system collapsed in the early 1970's because then, as now, exchange rates did not reflect trade competitiveness.

Two. The United States has a part to play in resolving this problem. U.S. domestic policy decisions must take greater cognizance of the implications for our position in the international marketplace.

Three. A heavy burden lies on the Japanese' shoulders. They must, either by their own initiative or by force of outside pressure, take major steps to open their capital markets and internationalize their financial system. The U.S. business community is fully prepared to undertake initiatives as needed to assert such pressure.

It is our very strong hope that President Reagan, Prime Minister Nakasone, and the rest of the world's leaders will initiate this discussion later this week in Williamsburg. Not doing so would indicate failure or unwillingness to recognize a vital part of what is needed to keep the United States and the rest of the world on the road to economic recovery.

We believe the United States and Japanese Governments should be able to build on the framework we have set out here. We urge them to do so.

Mr. FLORIO. Thank you.

Let me ask a question at this point. The strength of the yen has resulted, as you have indicated, and others have, in the net outflow of capital out of Japan into the American market, benefiting of

course the export capability of the Japanese. The strength of the dollar has resulted in the inflow of capital, but diminishing our ability to compete in terms of exports. Might it be that this just reflects the governmental priorities that certainly this administration from the beginning, the essence of supply-side economics is the desire to enhance capital development so as to retool the economy and the rest of the parts of the theory, and that the administration therefore is following a policy which is theoretically encouraging the development and the inflow of capital, the theory being that that capital will be used to reproduce a more productive economy. Might that just be the major policy tradeoff that this administration versus the Japanese approach, that there is more emphasis placed upon the national good that will flow from export potential on the side of the Japanese and on the side of the U.S. economy, more emphasis placed upon the need to induce capital even at the expense of diminishing induced capital inflow and development, even at the expense of the capability of exporting products.

Mr. FITES. Mr. Chairman, that may be the policy. If it is it has been well hidden, because I have not really heard a policy articulated by the current administration on this particular issue. If it is the policy, I would say that it is shortsighted, because I think much of that money that I referred to, the direct investment flooding into the United States is not to put permanent assets in place, but it is safe-haven money, and it is flowing here because of the jitters that one finds in the international financial community, and it is flowing here because this is really the only safe haven. Japan would be an ideal place for some of this safe-haven money to flow if one looked at the basic strength of their economy and one looked at the fact that the yen is undervalued so you have a chance for appreciation, but the financial instruments do not exist in Japan to make people feel comfortable about putting their safe-haven money into Japan. If that is the administration's policy, they have not articulated it.

Mr. FLORIO. Mr. Southard.

STATEMENT OF FRANK SOUTHARD

Mr. SOUTHARD. Thank you, Mr. Chairman.

I was formerly the U.S. Executive Director and later the Deputy Managing Director of the International Monetary Fund from 1949 to 1974. I am currently a director of the Atlantic Council, where I share with Mr. William McChesney Martin the chairmanship of the Working Group on International Monetary Affairs. That group has issued four reports, beginning in 1977, on the international monetary system. The latest, issued in February of this year, bears directly on the subject of this hearing. It is entitled "The International Monetary System: Exchange Rates and International Indebtedness." I have brought several copies as of possible interest to the committee. They are in the committee's folders. The summary and recommendations are brief and could be suitable for inclusion in the record of this session. I should say, Mr. Chairman, that I see I am listed as representing the Atlantic Council. The council does not undertake to approve all the reports. The reports are always

the responsibility of the working parties. Certainly what I will say here would be consistent with the published report.

I have been asked to speak briefly on the foreign exchange aspects of foreign trade, with special reference to competition in exporting and importing.

To begin with, I wish to emphasize three points. First, all foreign trade and trade-related transactions involve exchange rates. Much U.S. exporting and importing is invoiced in dollars. But this means only that the foreign seller or buyer carries out the foreign-exchange transaction and bears the exchange risk. Second, the exchange rates for a currency should over a reasonable time be adjusted to reflect basic cost—or, in older terminology, purchasing-power-parity factors. Third, as a corollary of point 2, persistent overvaluation and undervaluation of a currency distorts trade, either imposing a cost or conferring a subsidy. I will give two examples. If an American producer of computers is able to quote a price at port of exit of $5,000, but the current exchange rate overvalues the dollar by 20 percent, the foreign power would have to pay 20 percent more for the dollars. Conversely, a Japanese exporter of the same item would have an advantage, because if he offered his item at $5,000, he would receive 20 percent more undervalued yen. If competition required him to do so, he could cut his price by 20 percent, and end up as well off as the American exporter. If you transpose that latter case to a quotation of prices of Japanese automobiles in the U.S. market, you can see what an advantage is conferred by an overvalued dollar and an undervalued yen.

Now I wish as briefly as possible to sketch historical and current foreign exchange-rate developments.

From 1945 to 1971 countries operated under the Bretton Woods par-value system set forth in the Articles of Agreement of the International Monetary Fund. Each country established a par value—expressed in gold and U.S. dollars—for its currency and maintained exchange rates within 2 percent either side of the par value. If economic and financial developments in a country caused its par value to be out of line, that is, to be overvalued or undervalued, the par value could be—and it often was—changed with IMF approval. This system worked well. But as years passed, the dollar became progressively overvalued and the U.S. balance of payments moved increasingly into deficit. In retrospect, the par value of the dollar should have been changed. But with the dollar as the keystone of the international monetary system, this was difficult. I lived through that long period of soul-searching on that matter.

Finally, responding to heavy pressure on the dollar, large gold losses, and very large support intervention by other leading countries, the United States in August 1971 closed the gold window and let the dollar float. By December 1971 an agreement was reached at the Smithsonian Conference among the 10 leading countries to realine their currencies. But the realinement did not hold and in February 1973 there was a final breakdown in the par-value structure.

Thereafter 3 years were spent in a major effort to reform the system around the formula of "stable but adjustable" exchange rates. But in the event the revised Article IV of the IMF Agreement allows countries to have whatever foreign exchange regime

they wish, subject only to a general obligation to promote stability and avoid manipulating exchange rates to gain an unfair competitive advantage which also was mentioned by the previous speaker.

From 1973 until today the currencies of leading countries have floated. There is a grouping of six currencies—led by the deutsche mark—in the European Monetary System which maintains fixed rates with adjustments as needed—for example, the recent adjustment centering on the DM and the French franc—with the six floating against the dollar as do the pound sterling, the yen, and the Swiss franc, of course others as well that are relative minor currencies. The resulting fluctuations have frequently been wide. For example, the dollar, 1978 to end 1982 moved from 93 to 120 on a 1975 base of 100, the yen moved from 190 to 260 per dollar, and the DM from 1.75 to 2.40; and recently the pound sterling dropped to a level of around $1.55, which of course is exceedingly low for the pound sterling.

At times—for example, 1976-78—the dollar has declined and been undervalued; but in the past few years it has been overvalued, probably 20 to 25 percent. Official market intervention has been erratic, and for the past 2 years U.S. officials have been opposed to it.

The consequences of overvaluation have been severe. A recent study indicates that there could be a deterioration by end-1983 in our merchandise trade balance of more than $45 billion. In fact, the United States is currently running a very large trade deficit of $50 billion. I take that out of the Rimmer de Vries thing. The previous speaker has mentioned that it may be considerably higher. I think we will not know until the year is over, but in any case we can agree that it is going to be large. At the same time we are losing in third markets and the losses that we are making in third markets are going to be very, very difficult ever to regain.

It may well be asked why, under those circumstances, the dollar has not depreciated so as to eliminate the costly overvaluation—in fact, this is what the theory of floating rates presupposes. But the difficulty is that interest rate differentials plus the attraction of the U.S. economy for investment and as a safe haven have induced a persistent inflow of funds. That has overridden the basic or cost-related factors which, as I said at the beginning of my statement, should—in a well-structured foreign-exchange system—be the primary determinants of exchange rates.

In my opinion, we must either find a way to deal with persistent overvaluation or undervaluation of exchange rates, or the pressures for the imposition of tariffs or import restrictions and some form of export encouragement will become irresistible.

What, then, can be done. The growing dissatisfaction with the floating-rate system—as evidenced by a stream of articles, by complaints from industrialists and labor leaders at the level of the White House, and by a conference in Washington last week—has produced several prescriptions. All of them are premised on the objective of a more stable foreign-exchange system. Even the most ardent defenders of the existing system accept that objective. I went to the conference a week ago yesterday and an old friend of mine, Professor Hobbler, who is an uncompromising defender of the floating rate system, started out by saying of course the best system is a system of fixed rates.

The existing system—if, indeed, it deserves to be called a system, which I really doubt—is serving the world very badly. But two of the remedies which are currently being offered are, in my view, impracticable—at least for some time to come. The first is a return to a full gold standard, involving a gold parity for the dollar and official selling and buying of gold to support the parity. I consider that the erratic and wide swings on the price of gold preclude its use as an international monetary standard. Moreover, I am sure that it would be impossible to negotiate a gold-based system among the leading countries. The second is a return to the pre-1971 par-value system, with the maintenance of exchange rates within narrow margins. There is nothing wrong with this proposal—it worked before and it may someday work again. I always was and am still in favor of it. But, considering the current differentials in rates of inflation and rates of interest, the major uncertainties provoking capital movements, and the near-crisis situation involved in international indebtedness, I do not believe it would be at all prudent to attempt to leap in one huge jump, from a very unstable system to a firm and formal par value system with narrow margins.

But I feel very strongly that there must be a start on the road to more stable exchange rates. Such a start could be made if the five leading countries (United States, United Kingdom, France, Japan, and Germany), under the leadership and technical advice of the IMF, would agree on a continuing surveillance of exchange rates, which incidentally is required by the articles of agreement, so as to arrive at a basis for coordinated official intervention to push rates within stated margins. Uncoordinated agreements would not be effective.

Mr. FLORIO. We have a vote.

The committee will stand in recess for approximately 10 minutes, and we will resume when we come back.

[Brief recess.]

Mr. FLORIO. The committee will reconvene.

Mr. Southard, perhaps you could go forward to the conclusion of your testimony. I understand that Mr. Fites is required to leave at approximately 10:30. Perhaps we could conclude with your testimony and have questions of Mr. Fites.

Mr. SOUTHARD. With your permission, I will go back to the beginning of the paragraph.

But I feel very strongly that there must be a start on the road to more stable exchange rates. Such a a start could be made if the five leading countries (United States, United Kingdom, France, Japan, and Germany), under the leadership and technical advice of the IMF, would agree on a continuing surveillance of exchange rates so as to arrive at a basis for coordinated official intervention to push rates within stated margins. The margins initially could be wide—5 or even 10 percent either side of the agreed central rates. As the system took hold, the margins could be narrowed. Moreover, as the respected London Financial Times suggested on May 12, the special drawing right, administered by the IMF, could be used as the standard. The SDR is based on a basket composed, in weighted amounts, of the currencies of the five countries I have just mentioned.

I do not argue that this beginning would be easy, and I am fully aware that as recently as May 17, 1983, Secretaries Shultz and Regan have rejected any effort to agree on a moving band or any other step involving concerted intervention. But we have a choice. Either we can make a beginning at a move to more stable and better alined exchange rates which will serve world trade without distortions in competitive positions, or we and the other leading countries will go down the road of protectionism and trade subsidies.

I conclude by quoting from an article by a British business economist, Roger Bootle, presented in the Banker of May 1983:

> * * * The recent experience of France provides demonstration that intervention does not enable the authorities persistently to fly in the face of economic fundamentals. But a decade of floating rates has taught us to beware of other dangers—of markets carrying rates beyond levels appropriate to economic fundamentals causing unnecessary volatility, uncertainty, and economic disruption. The world will have to feel its way to a compromise.

Thank you, Mr. Chairman.

Mr. FLORIO. Mr. Fites, let me ask you a few questions before you are required to leave, relating to some of the points made by Mr. Southard. He warned us, as all have warned us, about going down the road to protectionism. You suggested that a short-term approach might be import surcharges on the currency differential on the value of imports. Is that not a remedy to deal with this problem that some would describe as protectionism?

Mr. FITES. I do not believe so, Mr. Chairman. I think that the articles under GATT and IMF Mr. Southard has referred to, and the obligation that the IMF has to monitor currencies and exchange rates, that does allow for the imposition of surcharges under article XII, is consistent with the position that we have outlined here in regard to a surcharge. And on the other hand, I think it is a much more practical step because if we take, for example, the national-content law, once enacted, the national-content law would put assets in place, it would fix permanently a situation that would be very difficult to—for one to extract itself from. So you are making a permanent step that will in all likelihood, there will be pressure to expand that step. Now, a surcharge can be put on on a very temporary basis, as President Nixon did in 1971, I believe, and can be withdrawn and in effect you have done the same thing, but without disrupting people's lives, without disrupting large investments that do not come so easily. So I think there is a vast difference between the legality and also the practicality of it.

Mr. FLORIO. Is not a key point the difference between disrupting on a permanent structured basis as opposed to disruption that flows from more modest temporary adjustments? It seems you are saying that by definition if it does not violate GATT, even though it may achieve the same intent as a violation of GATT, it is no longer accepted as protectionism. I refer to, we have had as you know automobile legislation we have talked about and there are proposals, one of which I have introduced myself, to provide for modifications in the 201 application standard that will in some people's opinion make sure that if a petition, an unfair-trade-impact petition was filed under the safety valve or the safety clause of GATT, that the result would be almost a need in the automobile

field to find that there has been inappropriate impact from imports, and then one of the options might be domestic content as a remedy. That does not seem to offend individuals as much as the domestic-content legislation, precisely for the point you have made. It is a more modest, flexible application of domestic content than a statutory scheme that would be somewhat inflexible. So it is not so much protectionism versus nonprotectionism as modest, flexible protectionism for the short haul as opposed to something that would put us on a road from which we cannot easily retreat. Is that an analysis—

Mr. FITES. I think it is an excellent analysis. I am sure that you and I would prefer not to have any intervention of any type, but you and I have to deal with the real world, and the real world has a set of rules out there and we try to comply with them. There are GATT rules or IMF rules, and I think it best that we try to comply with them, and I think this is a situation, a solution of how we could comply with them. But I do not deny your analysis and its basic impact. The specter though of something like the national-content legislation starting a permanent trend toward protectionism in the end is going to be detrimental to all consumers. So I guess this is where we have our concern about the national-content legislation as originally proposed.

Mr. FLORIO. You said in your comments parenthetically almost making reference to the yen/dollar valuation, that 180 to 1 would be properly valued. Is the art of valuation sufficiently objective that one can describe what is the proper valuation with some degree of consensus that could be achieved in the international community?

Mr. FITES. I think Mr. Southard made an interesting point on that and was even pithy prior to testifying. Perhaps one cannot exactly describe what is the correct value between the yen and dollar, but one certainly can know when there is a significant imbalance, and everyone agrees today there is a significant imbalance. So there is something wrong.

Mr. FLORIO. That sounds like the definition of the Supreme Court on obscenity. We cannot tell you what it is, but we know what it is when we see it.

Mr. FITES. 180 to 200, one can argue that you could have a 5-percent range, a 7-percent range, we cannot be rigid in that. But everyone can be rigid in recognizing that a 35-percent or a 30-percent difference today, whether you are talking about 180 or 200, is recognizable as being completely out of balance. I did not want to dodge your question.

Mr. FLORIO. Thank you. I appreciate your participation.

I acknowledge the presence of the gentleman from Pennsylvania, Mr. Ritter, and we will ask Mr. Liney to go forward with his testimony, and then we will deal with Mr. Katz, and then we will have an opportunity for exchange. We appreciate your presence and participation.

STATEMENT OF GEORGE LINEY

Mr. LINEY. We applaud your initiative in holding these hearings, and appreciate the opportunity to express our view on this very se-

rious issue, namely, the overvalued U.S. dollar and its adverse impact on U.S. exports and imports.

My employer, Ingersoll-Rand Co., is a manufacturer of heavy equipment, and has been engaged in exports since before World War I. Between World War II and 1980 our exports grew steadily in real terms, that is, after adjusting for the effect of inflation. In current dollars our 1980 exports from the United States exceeded $700 million.

Ingersoll-Rand has always welcomed and accepted as inevitable that we have to compete freely in terms of technological capability, quality, customer service, and finally price. Over the years we have succeeded because the competition was fair; we were not subjected to forces or circumstances totally beyond our control which literally destroyed our ability to compete in a free market environment.

Notwithstanding all the Government rhetoric that we as a nation believe in, practice, and promote free trade in a financial environment free from governmental interference, the present value of the dollar simply does not reflect the underlying structural equilibrium vis-a-vis the key currencies of the world. In other words, there is an imbalance or a misalinement between the value of the dollar and the value of other major currencies.

Much has been said about the imbalance between the dollar and the Japanese yen, and we agree that the yen is undervalued. We also support efforts to reach an agreement with the Japanese Government to redress the situation, that is, to realine the rate of exchange between the yen and the dollar. However, I will demonstrate to this committee that the currency imbalance is worldwide, and that if something is not done to correct the situation, it will have dire consequences for not only U.S. industry, but for the country as a whole.

I have with me a graph which portrays the movement of the Belgian franc, Swedish krona, Italian lira, and the British pound since 1980, after adjusting for the inflation in each country. We selected 1980 as a base period to demonstrate the incredible magnitude of the currency wings during such a short period of time, and it also coincided with the development of our loss of competitiveness. The graph shows that their currencies are between 22 percent and 37 percent lower than the U.S. dollar since 1980, and that is after adjusting for the respective rates of inflation; I repeat, after adjusting for the rate of inflation. What that means is that all other things being equal, to a customer in let us say Australia, the cost in Australian dollars is 58 percent more from the United States than it is from Belgium, compared to 1980. No, I did not make a mistake, I said and meant 58 percent more. We cannot stand that disadvantage in Australia, and the same holds true for a customer located in just about every other country in the world.

My employer, Ingersoll-Rand, has manufacturing plants in Italy and in the United Kingdom, and we are competing against a company which manufactures primarily in Sweden and Belgium.

In many cases we make products in our Italian and United Kingdom plants which are identical to units made here in the United States. Because of the increasing lack of competitiveness of the U.S.-made units we undertook earlier this year, and just completed a few weeks ago, a major detailed study of the cost of identical ma-

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chines produced here in the United States and in our Italian and United Kingdom plants. To get complete impartiality and objectivity we engaged the services of a highly respected consulting firm known for its expertise in manufacturing to assist us.

We then compared, by major component, the cost of our machines against our competitor's costs in Belgium.

The conclusions confirmed almost exactly what the graph shows. I want to emphasize that Belgium, United Kingdom, Italy, and Sweden are not any more efficient than we are. In fact, because our manufacturing plants in Italy and the United Kingdom do not have the volume which we have here in the United States, they do not have the benefits from automation which we have here in the United States. But, notwithstanding their manufacturing disadvantage in terms of lower volume and less automation, their manufacturing costs in total are so much lower than the costs in the United States that we cannot compete against our own factories abroad and against our competitor's products made in Belgium and Sweden.

I also want to mention that every day we are purchasing more and more parts and components from abroad. If I read the list of countries from which we now source parts and components, it would read like the list of member countries of the United Nations. A few years ago practically every part was made in the United States.

Ingersoll-Rand has traditionally supplied Latin America and Asia-Pacific with U.S.-made units. Unless the dollar weakens substantially and quickly, we cannot continue to do so because the machines we compete against are made in Belgium and Sweden. We are making plans to change the sourcing out of the United States, and that means loss of jobs at home.

What will the long-term effect be if the dollar's value stays where it is? We will have to give serious consideration to transfer overseas models which we now make in the United States, and eventually we may have to supply units for the U.S. market from abroad. I respectfully suggest that if that happens, it will amount to a tragedy for the United States, and furthermore, if Ingersoll-Rand has to do it, it is obvious that the other U.S. manufacturers of all kinds of equipment will have to do the same thing.

Here are some specific examples during the last few months:

One. At a recent public bid for a large number of compactors in Indonesia, the following prices per unit were bid:

(a) Italian made—$24,473; Japanese made—$26,154; made in Malaysia or Indonesia—$26,330; Swedish made—$28,601; made in the United States by Ingersoll-Rand—$35,298.

Needless to say, with our price 44 percent over the lowest bid, we did not have a chance. I might add that we only make compactors in the United States and were therefore not able to offer Ingersoll-Rand machines made abroad.

(b) The same project also called for a large number of portable compressors, and here is how that bidding per unit went: made in Belgium—$5,507; made in Japan—$6,098; made in the United States by one of our competitors—$7,290.

Ingersoll-Rand's bid was not in contention, and it is interesting to note that the generally competitive U.S.-made unit made by another company was 32-percent higher than the Belgian machine.

Two. A similar public bid took place in Korea, also for a large number of portable compressors, and here is the lineup per unit: made in Belgium—$7,569; made in Japan—$9,159; Ingersoll-Rand made in the U.S.—$10,269.

Our price was 36-percent higher than the Belgian machine.

Three. The following example was a public bid in the Philippines for 70 large compactors. The quote was in Philippine pesos: made in Germany—pesos 15,673,140; made in Sweden—pesos 15,892,450; made in Japan—pesos 16,838,500; made in the United Kingdom—pesos 18,281,620; made in the United States—pesos 19,448,725; made in the United States—pesos 24,727,180; made in the United States—pesos 30,531,967.

The lowest-priced U.S.-made machine, which happens to be ours, was 24-percent higher than the German units, and the highest-priced U.S. machine was 94-percent higher than the German bid. I might add that our unit, although it was the lowest of the U.S.-made machines, was practically quoted at our cost.

Why is this happening? I cannot answer that, but I know that the theory that floating exchange rates will reflect the underlying relative competitiveness is not materializing. Economists who think they know, claim that it is because of the enormous flow of capital between countries, which of course has nothing to do with underlying trade. Other economists blame the difference in interest rates between the United States and other countries. While interest rates and capital flows obviously impact on the rate of exchange, it is hard to accept that they alone have caused the present havoc. Last week the short-term prime rate equivalent was 6 percent in Japan, 15½ percent in Belgium, 6 percent in the Netherlands, 12½ to 14½ percent in Sweden, 6 percent in Switzerland, and 11 percent in the United Kingdom. The U.S. prime rate was right in the middle at 10½ percent. How that can be with every currency of the countries mentioned undervalued, is certainly beyond my comprehension, and the comprehension of most reasonable men.

Whether the economists are right or not is, in our opinion, irrelevant. The fact is that benign neglect on the part of the U.S. Government has gotten us to where we are, irrespective of the causes. What we cannot understand is how the administration can believe that the problem will be corrected by continued laissez-faire or benign neglect, because it is that policy which has produced the situation in which the country finds itself.

The negotiations with Japan to correct the dollar/yen imbalance have gone on for a long time, and Japan is only one country, not the whole world. Furthermore, prominent Japanese businessmen have admitted publicly that the dollar/yen imbalance is one of the most serious problems in Japan which also contribute to the resentment against Japan. If it has taken years of negotiation with Japan, without any results, how can anyone possibly be naive enough to believe that negotiations with every industrialized country, and many developing countries, could possibly lead to a solution of an American problem, and that is what it is, an American problem. Of course, the dollar is the world's most important cur-

rency, but if we do not realize that the dollar is this country's currency first, and the world's second, we are going to do serious and irreparable damage to our economy.

If the dollar stays where it is now relative to other currencies, the potential losses in terms of jobs will probably be staggering, the adverse impact on the economic recovery inestimable, and, we believe, cause virtual destruction of the core of our industry.

We have followed and supported the efforts in both the House and the Senate during the last few years to extend the life of the Eximbank, to broaden its powers, and to increase its resources. We believe the latest bills in the Congress should be passed quickly, but I want to point out a very significant difference between the financing disadvantage we exporters have and the potential consequences to U.S. industry of a dollar which continues to be overvalued.

If we cannot meet foreign financing on a job, we lose that order, but if we cannot compete because of a basic cost disadvantage due to an overvalued dollar, and therefore transfer manufacturing abroad, we lose whole factories and the jobs that go with them. And, decisions to transfer production overseas are only reversible over a long period of time.

We are also encouraged by your own bill, H.R. 2203, Mr. Chairman, to improve the competitiveness of U.S. industry, and the resolution bills in the Senate and House by Senator Percy and Representative Traxler, respectively, to put the rate-of-exchange problem at the top of the agenda at the upcoming Williamsburg meeting. We are pleased that you, Mr. Chairman, are a cosponsor of Representative Traxler's bill. We also strongly support the efforts to extend the DISC benefits.

However, the negotiations with Japan, and all the bills in Congress to which I have referred above, are efforts which deal with the long-term competitiveness of U.S. industry.

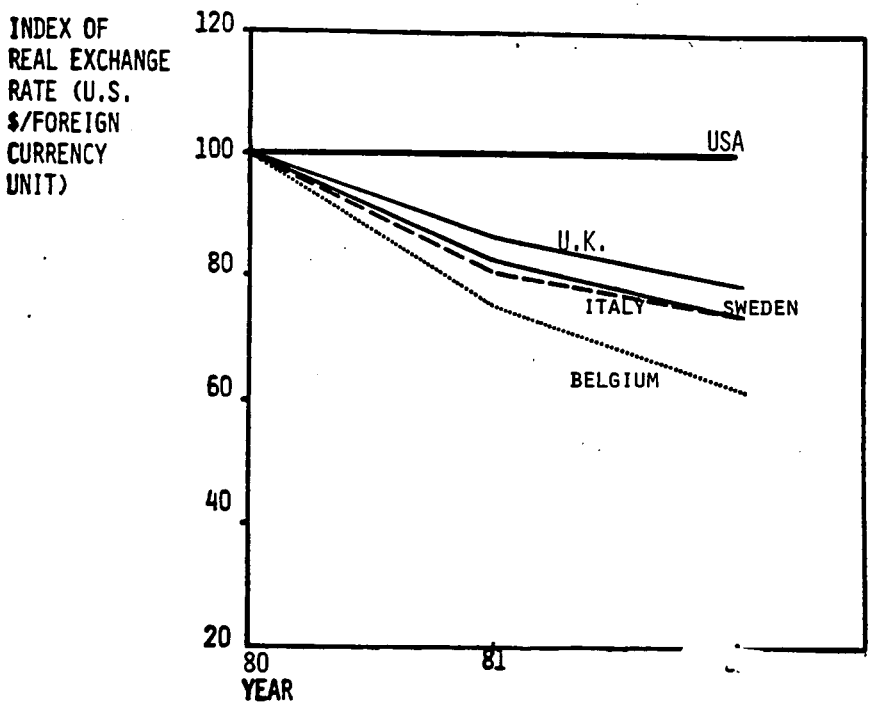
The matter of the overvalued dollar is something that has to be dealt with now. In our opinion there is not time for another Bretton Woods or Smithsonian agreement. I am almost tempted to say that there is not time for a Williamsburg agreement. The U.S. Government must intervene now in the foreign exchange market to restore structural equilibrium; that is, to reduce the value of the dollar until it reflects the underlying economic purchasing power of the United States versus the purchasing power in the major industrialized countries. While the administration professes to be against intervention in the foreign exchange market on the grounds that government intervention in international trade is wrong, it saw fit to impose a 40-percent import duty on Japanese motorcycles to help Harley-Davidson. We do not know if that was right or not, but we find the willingness to engage in perhaps the most objectionable form of protectionism, namely exorbitant import duty, totally ideologically incompatible with the Government's unwillingness to intervene in the foreign exchange market to correct an obvious wrong which not only threatens a company, but a whole industry and probably the entire economic foundation of the country.

Intervention in the foreign exchange markets to restore equilibrium is not protectionism, and we do not think it will be perceived as

such by anyone. In fact, to our knowledge there is no provision in any international agreement of any kind which prohibits or even discourages a country from intervening to correct its misalined currency. The Government has the tools to restore sanity in the foreign exchange markets, but if the administration is unwilling to act, I hope the Congress will force the administration's hand, and I appeal to this committee to take the lead.

[The graph referred to follows:]

REAL EXCHANGE RATES, 1980 - 1982



Mr. FLORIO. I just cannot resist the question as to the exact form, when you mention the Government has the tools, are you specifically making reference to Government purchase of foreign currencies as the form of unilateral intervention that you are advocating?

Mr. LINEY. It seems to me that the U.S. Government has the resources to be a seller of dollars if it wishes. It is interesting to note that previous attempts by governments to intervene in a market have failed, but they were on the other side of the equation. They were trying to improve their currency, and they were financially weak countries. We are trying to be sellers. It seems to me that

there are no fundamental obstacles or resource problems that would prevent the U.S. Government from doing so, because effectively they will be short on the dollar. It does not seem to be wrong to be short on the dollar when you sell at a high and buy at a low.

Mr. FLORIO. We will hear now from Professor Katz.

STATEMENT OF SAMUEL I. KATZ

Mr. KATZ. Mr. Chairman, there is so much agreement here; if we had as much agreement on budget and fiscal matters as we have on the trade matters we are discussing today, we would have a lower value for the currency.

I will abbreviate my comments. We begin with the fact that Japan is the great success story of all the industrial countries in adjusting to the impact of the second oil price increase. The Japanese have managed to restructure their economy, contain domestic inflation, maintain a good growth rate, and they have a very low rate of unemployment.

How can the currency of a country whose policies have been very effective be weak against the dollar? The statistics for 1982 show that Japan had a trade surplus of $18 billion, a current account surplus of $7 billion, which is the relevant figure, and a long-term capital outflow of $15 billion. It is clear that it is the movement of funds on capital account that is adding to the supply of yen in the foreign exchange market. It is not the cause of the weakness, of course, but it is a symptom that there is underlying in the economic relationship some real problems. They arise I think from a basic contradiction in Japanese policy between the internationalization of their export policies and the domestic protectionist side of their import policies a contradiction that is very longstanding. On the export side, industrial policy in Japan has aimed not to serve the domestic market, but to get international preeminence. On the import side, both government policies and practices have served as effective barriers to inflows both of commodities and of capital.

I thought that Mr. Fites' discussion of the capital side was a very effective summary of the facts. Not only has Japan come to depend on the world for markets for the growth of its industry, but also to absorb part of its domestic savings. The savings in Japan exceed the needs of local industry. If the economy were completely closed, this would lead to unemployment in the short run, because there would not be enough demand, and would lead to low interest rates and an uneconomic use of capital in the long run. By investing those savings abroad, however, Japan has been able to export the savings.

Now, this strategy supports Japanese growth, for the capital exports help to depress the market value of the yen, which helps to create an export surplus on trade account, and thus to maintain a level of domestic growth and employment.

Japan is highly dependent on this liberal trading system, and measures taken by Japan to open up its economy seem to me not to be concessions to their trading partners, but measures of prudent self-interest for Japan's own well-being.

What practical steps can be taken to strengthen the yen in the short run? Certainly anything that will encourage the movement of

funds into Japan, such as Mr. Fites has discussed, would be highly helpful.

This brings to mind the experience of Germany in the 1960's as an example. The German mark was as strong and as undervalued in the sixties as the yen is today, but at that time the DM was under continuous pressure from foreigners who were trying to acquire what they saw as cheap German assets—goods, securities, and plant. It all ended, as you recall, with so much pressure that the DM appreciated sharply.

Another step, of course, would be as a temporary measure to try to limit the export of long-term capital from Japan.

Now, we also have a role to play because U.S. policies are fundamentally responsible for our own interest rates. The exchange rate is high because interest rates are high because the budget deficit is high.

I thought I might respond to your comment earlier about the administration's thinking on the relationship between high interest rates and the high exchange rates. Mr. Chairman, by calling your attention to statements made by Dr. Feldstein in a speech, "The Dollar and Exchange Market Intervention," in Paris on April 27, 1983, when he was discussing the question of the high dollar exchange rate and the importation of capital. He said that:

> A weaker dollar and a smaller trade surplus would also mean less capital inflow from the rest of the world and therefore a lower level of domestic investment in plant and equipment and in housing. The rise in the dollar is a safety valve that reduces pressure on domestic interest rates; the increase in the trade deficit allows the extra demand generated by the budget deficit to spill overseas instead of crowding out domestic investment.

Behind his thinking is the fact that, with no legislative changes, deficits will be around 6 percent of GNP, and our private savings are only 7 percent.

> The question of whether it would be desirable from the U.S. point of view to have a lower-valued dollar is equivalent to asking whether it is better to allow the temporary increase in the budget deficit to reduce domestic investment and interest-sensitive consumer spending or to reduce the production of goods for export and of goods that compete with imports from abroad. The answer to this question is clear in principle: it is better to reduce exports and increase imports. (p. 12)

I am concerned about effects of the U.S. policies on interest rates because, even after interest rates eventually decline once the budget impasse is resolved, it seems to me there are at least three factors that are going to continue to induce capital inflow into this country and keep the dollar exchange rate up.

One is the safe-haven factor. We are going to become increasingly attractive in an uncertain world. We have the attraction of political and social stability, legal restraints on arbitrary Government action, the demonstrated flexibility of our financial institutions and Government-guaranteed deposits. These are very attractive assets.

Second, our financial markets have performed well. If we continue a reasonable domestic and a prudent monetary policy, it may very well be that individual investors both domestic and foreign will find that American financial markets are going to be the good performers of the 1980s, just as they found that housing was the good investment of the 1970's.

Third, I would think it reasonable to expect a reduced outflow on commercial bank account. The commercial banks have been sending out a good part of the money that has been coming in; if they do cut back on their lending this could mean a stronger U.S. capital account and a stronger dollar.

Let me make two general remarks about the international monetary system in general. First, it is difficult to see how you could get any relief—that you could ease the problem of the high dollar rate—merely by changes in the exchange rate mechanism unless there are changes in the Japanese and American policies we have discussed. Second, there is not any realistic alternative to the floating system at this moment. It has had to absorb, and it has absorbed reasonably well, both external shocks of all kinds and bad or misdirected national policies.

There is hope for improvement along two lines. People talk, on the one hand, about improved policy coordination. National policies have been preoccupied primarily with domestic concerns. It is a weakness of the floating system that in practice national policies which are otherwise uncoordinated cannot be satisfactorily reconciled through fluctuations in currency values alone. We already have established mechanisms for consultation, and we may need to use them more effectively than we have been using them.

Finally, there is the question of coordinated official intervention, Mr. Southard has already discussed it; I was a member of the committee we spoke of and I share the general thrust of its report.

I would like to close by suggesting that this country has, and I am really thinking along the lines of Mr. Liney, this country has a special interest in participating in multilateral consultation about exchange-rate matters. For two extended periods since the 1950's, U.S. commercial firms have found themselves having to live with the competitive burden of an overvalued dollar; that is, in the 1960's—as Mr. Southard mentioned and over the past few years. These episodes demonstrate that the commercial community has a direct interest in supporting a leadership role for the United States in international monetary discussions.

[Mr. Katz' prepared statement follows:]

Statement of Samuel I. Katz, Professor of Economics, School of Foreign Service, Georgetown University, Washington, D. C. before the Sub-Committee on Commerce, Transportation and Tourism of the Committee on Energy and Commerce, U.S. House of Representatives, May 25, 1983

The principal way in which the current exchange rate system has been an impediment to U.S. trade is through the high value of the dollar in the foreign exchange market. There is agreement that the dollar is high but disagreement about how the rise in the value of the dollar should be interpreted.

Consider these facts. On a trade-weighted basis, the value of the dollar against all currencies was higher in April 1983 than it was before the first devaluation of the dollar in August, 1971. Over the last 30 months, the dollar has appreciated in real terms about 35% relative to all other currencies. Back in the 1978 to 1981 period when our inflation was at its peak, the dollar rose against the yen by about 21%, even though the Japanese inflation rate was about 20% below the rate in this country. Finally, since 1980, the Japanese and German current accounts have improved but that of the United States deteriorated, yet the dollar has appreciated against each of their currencies.

How to interpret the facts about exchange rate and international payments data is the subject of debate. There is a majority view that the dollar is presently overvalued, just as it was undervalued during the 1978-79 period. A minority view, primarily held by advocates of floating exchange arrangements, suggests that, because exchange rates are set in free markets, we cannot be certain that the market price is a

"wrong" price. How can an economist know better than the market what the "right" price should be?

Economists within the current administration have challenged the view that the dollar is overvalued. In the Economic Report of the President for 1983, for example, the argument is made that "the actual behavior of the Japanese balance of international payments (BOP) and the exchange rate does not support the view that there is any special under-valuation of the yen."1/ More recently, Dr. Feldstein remarked, "I find the notion of an overvalued dollar very difficult to define and even more difficult to defend." 2/

There are good reasons for economists to be cautious in accepting price and cost data to support conclusions about whether a currency is over- or under-valued at any time. It is often uncertain what the statistical series usually employed measure, whether the time periods selected are appropriate and how the results should be interpreted.

But these difficulties do not warrant conclusions, such as those expressed in the Economic Report that "the main sources of the US trade deficit are to be found not in Paris or in Tokyo, but in Washington." (p. 67). There is evidence to suggest, in my view, that exchange rates do seem to be misaligned, and that the misalignment has become a major source of disturbance in the world economy.

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1/ "Economic Report of the President", February 1983 (GPO: Washington, D. C., 1983), p. 65.
2/ Martin Feldstein, "The Dollar and Exchange Market Intervention", a speech before the French Institute of International Relations, Paris, France, April 27, 1983, p. 3).

In particular, the high value of the dollar has been a drag on the US business recovery and placed a heavy competitive burden upon commercial firms, both in foreign and in domestic markets. The recent statement by an experienced American specialist on Japan, Dr. Eleanor R. Hadley, that, because of the yen-dollar exchange rate, "no matter what we do, no matter what the Japanese do, we are uncompetitive" 3/ helps to explain why we are experiencing the most widespread revival of protectionist sentiment in this country since the Smoot-Hawley era.

Strong dollar/weak yen

There are at least three analytical grounds for the view that the appreciation of the dollar against the yen has been excessive. The [illegible] rise in the dollar is not consistent with those factors commonly accepted by economists as the determinants of underlying currency values -- that is, the trade and current accounts, productivity trends, the general performance of the economy, price and cost movements and so forth. Secondly, the yen-dollar rate has not been an appropriate basis for normal commercial competition, a distortion felt particularly by producers in the smokestack sectors of our economy. Thirdly, the appreciating dollar has been a movement opposite to the adjustments required to bring US-Japanese payments into better balance.

Data from the Japanese BOP for 1982 suggest that the yen has been pushed down by a large deficit in long-term capital movements. The 1982 results were: a trade surplus of $18.2 billion; a current-account surplus of $6.9 billion;

3/ "Commentary: Interview with Eleanor R. Hadley", Japan Economic Survey, November 19, 1982, p. 7.

and a net deficit of $15.0 billion on long-term capital account. In terms of the foreign exchange market, it would appear, foreigners offered $6.9 billion of dollars to pay for the current-account surplus; by contrast, Japanese residents offered $15.0 billion of yen to pay for the long-term capital outflow.

The capital account deficit is not the "cause" of the weak yen in any fundamental sense. Rather, it can be regarded as evidence that underlying factors are inducing much larger capital outflows from yen to dollars than from dollars to yen. These fa ctors are of course the national policies of Japan and the United Sta tes, and it is to those policies which we must turn to explain why the yen has failed to achieve in the exchange market a strength commensurate with the fundamental strength of the Japanese economy. We will consider first how Japanese and then how United States policies appear to be contributing to the weakness of the yen.

Why a weak yen?

The first question to ask, in my view, is: Why has the dollar been strong against the yen despite the remarkable adjustment Japan has made to the 1979-80 higher oil prices? For Japan -- alone among the industrial countries -- has been able to achieve a substantial restructuring of its manufacturing plant, a low domestic inflation rate, a resilient growth rate and a low level of domestic unemployment, all in the face of the second major oil price increase.

The causes for the yen's weakness, I would suggest, can be traced back to a longstanding contradiction in Japan's economic strategy: the contrast between the international thrust of its export, and the protective character of its import, programs. In the export area, industrial policy in Japan has long aimed not at the domestic market but at a pre-eminent position in world markets. In the import area, by contrast, government policies and the practices of private business have together created effective barriers to foreign inflows, both of foreign goods and of foreign capital. Examples of the barriers are restrictions on farm produce, an inward-looking wholesale and retail distribution system and varied obstacles to foreign capital inflows.

Broadly speaking, Japan has come to depend on the world economy not only for markets for its growth industries but to absorb part of its very high domestic savings.4/ These savings are in excess of the needs of local industries. Had the Japanese economy been entirely closed, the savings would have produced unemployment in the short run and a wasteful level of investment in the long run. By investing abroad, however, Japan has been able to export the savings.

Note how this strategy has supported Japanese economic growth. For the capital exports depress the market value of the yen, which helps to create an export surplus on trade account and thus to maintain a high level of domestic growth and employment -- in a period with other industrial countries have been unable to reduce their own considerable unemployment.

Because it has become so dependent on a free world

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1/ Henry C. Wallich, "Budget Outcomes, Debt and Monetary Policy", Washington, D. C., December 2, 1982, p. 6.

trading system, steps taken by Japan to be open its economy are not favors bestowed on her trading partners. On the contrary, they appear to me to be acts of prudent self-interest to strengthen liberal trading arrangements which are indispensable to Japan's economic well-being. Japan has made progress in such liberalization, but the weak yen can be offered as evidence that this liberalization still has appreciably farther to go.

Consider, for example, the experience of Germany during the 1960s when the DM was also an undervalued currency. At that time, the DM was kept under continuous upward pressure, pushed up by foreigners who wished to acquire bargains in undervalued DM assets -- merchandise, securities and industrial plant. These pressures eventually led, as you remember, to a sharp appreciation of the mark. Why do not foreigners find Japanese assets equally attractive, especially at current relative currency values?

In my view, the yen could be strengthened promptly if measures were taken by Japan to encourage foreign purchases in its economy. Consider direct investment. In 1982, there were outflows of $4.2 billion and inflows of only $400 million. Surely the modification of government and/or private barriers to such purchases would make the movements on direct investment less one-sided.

The trade in securities during 1982 is more balanced: foreigners bought $7.5 billion of Japanese securities and Japanese residents bought $9.7 billion of foreign securities. Remedial measures could be designed, on the one hand, to facilitate non-resident purchases of Japanese securities and, on the other, to impose temporary restraints on foreign security purchases by Japanese residents.

Why a strong dollar?

Heavy Japanese security purchases bring to the fore the second policy area helping to keep the yen weak: the high level of US interest rates. The mechanism by which present US policies are harming US commercial interests is familiar: the exchange rate is high because US interest rates are high because the Federal budget deficits are high. Until we find a way to resolve the budget stalemate, it is reasonable to expect a burden on US commerce from a high dollar rate. The urgency cannot be overstated, both for the US and for the world economy, that this country agree on serious measures to reduce the budget deficit. A practical outcome would be a compromise program in the budgetary area comparable to the Social Security package worked out by Mr. Greenspan, Senator Dole and Speaker O'Neill and others.

Let me add a word of caution. The United States could continue to be a recipient of foreign funds on a significant scale, even after that looked-for day when the budget impasse is resolved and interest rates recede from recent levels. There are at least three factors which may stimulate further capital inflows into this country.

First, there is the "safe haven" factor. Increasingly, in an increasingly unsettled world, non-residents may want to place resources in this country. Consider our political and social stability; our legal restraints on arbitrary government action; the demonstrated flexibility and resilience of our financial institutions; and the offer of deposit claims with government guara ntee.

Secondly, our financial markets have performed well recently. If our domestic economic policies work out reasonably well, and we continue a prudent monetary policy, individual investors -- both domestic and foreign -- may find US financial markets to be the "good performers" of the 1980s, just as they found housing to be the good investment of the 1970s.

Thirdly, it is reasonable to anticipate a diminished flow of American bank lending abroad. In the past, bank loans have helped to offset foreign capital inflows and cushion their effects on the dollar exchange rate. Thus, a reduced commercial bank outflow could mean a stronger US capital account and a higher exchange value for the dollar.

What about the exchange-rate mechanism?

Two general remarks need to be made about the role of current international financial arrangements as an impediment to US foreign trade. First, it is difficult to make a case that the high dollar would be reduced if there were changes in the exchange-rate mechanism without any changes in the Japanese-US policies we have discussed. Secondly, there is at this time no realistic alternative to current floating currencies, however well or however badly the arrangements may function.

In general, the floating mechanism has absorbed external shocks in the world economy and the effects of narrowly-focused national policies of the industrial countries on international transactions. The resilience of the floating arrangements has been tested, and they have stood the test reasonably well.

Nonetheless, efforts should be made to strengthen the system -- in particular, by attempting to diminish the current misalignment of currency values. For misaligned exchange rates add to the number of those who would turn to trade protectionist measures, and to the credibility of their arguments.

One might hope for improvements along two general lines. First, policy coordination among the industrial countries needs to be improved. National policies, too preoccupied with domestic objectives, have become disruptive in an interdependent world economy. The effects on our trading partners of the fiscal policy we havechosen to accept illustrates this disruption. It is a weakness of floating exchange rates in practice that national policies -- which are otherwise uncoordinated -- cannot

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be satisfactorily reconciled through fluctuations in currency values. We have mechanisms for international monetary consultation: we need to use them more effectively and more sensitively than we have been using them.

Secondly, proposals for coordinated official intervention in exchange markets are being studied. Mr. Southard has already discussed with you the Report by the Atlantic Council's Working Group on International Monetary Affairs of which he is Co-Chairman. As a member of the group, I share the general thrust of the Report's recommendations.

Let me suggest, in closing, the special interest the US has in participating in multilateral exchange-rate consultations. There have been two extended periods since 1950 when US commercial firms have found themselves having to accept the competitive burden of an overvalued dollar: that is, during much of the decade of the 1960s and over the past several years. Surely these episodes show that it is not in the US interest for American officials to withdraw from active participation in international monetary management, or to be slow to respond constructively to difficulties created for our trading partners by policies we adopt for domestic purposes.

These episodes also have a special meaning for the US commercial community: that they have a direct interest in what happens in the international monetary area and should support an active leadership role for US officials in such international matters.

Thank you.

Mr. FLORIO. Thank you very much, professor. We have a vote at this point. The committee will stand in recess for approximately 10 minutes, come back, and then we will commence the questioning.

[Brief recess.]

Mr. FLORIO. The committee will reconvene, and we will be joined in a few minutes by Mr. Lent and Mr. Ritter.

While we are waiting for them, I have a question that I would like to ask all three of the panelists. We have heard from not only the panelists today, but from witnesses at different hearings, astute analyses about where we are and why we have all the problems.

I was talking to Mr. Ritter, on the way over to vote, about my recollections about the Carter years here. At that point, we were all lamenting that the weak dollar was having a favorable impact on exports.

This committee has jurisdiction over tourism; there was a tourism boom; people were coming here because of the weak dollar.

At that point, the interest rates were higher than they are now, which would seem to dictate the inflow of capital to take advantage of those high interest rates.

The deficits were modest by comparison to what we are talking about now.

How is it that we have the opposite situation, and yet we still don't have a trade surplus being adjusted?

One would think it would be the flip side of the situation you have now.

Would you share with us your thoughts on how it is that under the opposite conditions we did not have a beneficial situation? We were all very much concerned about the weak dollar and how, I recall, many of our businesses were talking about how the weak dollar was contributihg to the problems associated with the trade situation.

Is it that we are talking about two extremes?

Mr. SOUTHARD. Mr. Chairman, I think during the period of the middle 1970's, 1975 on up through 1978, we had—when the dollar did tend to be weak, the balance of payments on the invisible side was weak, part of this was the result of the extreme dislocations that were taking place during that period as a result of the first big jump in oil prices, the 1974-75 oil shock.

Part of it was due to the fact that, particularly in some of the European countries, there were some very real opportunities for capital flow. There was a considerable amount of shifting of reserves out of dollars into other strong currencies. There was quite a bit of diversification of dollars as against the period in which almost 100 percent of official reserves were carried in dollars.

Now, during that period, of course, the U.S. exports did respond. As the previous—as Mr. Liney said, quoting the 1980 figures for Ingersoll-Rand exports, the general calculation that the people in the International Monetary Fund have made is that it takes about 2 years in a big economy like ours, or Germany's, or the United Kingdom, or even India, it takes about 2 years for a major change in exchange rates to work their way through the whole structure of costs and prices.

There are a lot of long-term contracts already in existence. Imports tend to respond more quickly than exports. There is no good

short-run adjustment to an exchange-rate change. But there will be an adjustment, no question about it. There have been endless studies that have shown that a change in the exchange rate up or down, if that new rate is allowed to persist long enough, it will have a plus or minus effect on the country concerned: a plus effect if it is a declining rate; a minus effect if it is a rise in the rate.

Mr. FLORIO. How would one deal with the question with regard to the yen and the dollar on the inflow of capital from Japan to our Nation? How does one account for the fact that when the interest rate in this country was much higher, we did not seem to appreciate the problem as much as at least we are talking about it now, when it would seem that at that point the interest rate, being higher, would have facilitated more capital flow into our country, which would have resulted in the dollar being overpriced at that point, when, in fact, the dollar was underpriced at that point?

Mr. SOUTHARD. On the whole, in the last few years, there has been a persistent inflow of capital, partly sparked by interest rate differentials, but, as Mr. Liney pointed out, the interest-rate differentials are not all that clear, and a good deal of the capital flow into this country is safe haven, and is seeking investment opportunities which look attractive and are not affected by interest rate differentials.

A fair amount of it coming from the oil states is very definitely safe haven. They are hunting for someplace they can put their huge earnings, and they are not unduly influenced by precise interest rate differentials.

Now, the shortrun organized market, particularly the Euro-currency market, is interest-rate sensitive. There, if you get a 1 or 2 percent different margin, you will get a short-term movement of funds responding very quickly.

Mr. FLORIO. Is there any validity to the concept—perhaps the professor can address this point—is there any validity to the concept that seems to be evolving about real interest rates as being defined as the difference between the interest rate and the inflation rate, and saying, and this provides at least a plausible explanation for the inconsistency of higher interest rates with a devaluded dollar as opposed to now lower interest rates with a higher valued dollar, in the Carter years, you had higher interest rates, but you had higher inflation, and, therefore, the real interest rate was lower, rather narrower, than it is now, because you got lower interest rates, but not as low as they should be with regard to the inflation rate, which is now substantially lower. Can you comment on that?

Mr. KATZ. This is a difficult area you are raising. We need to look at the facts pretty carefully, but I will speak just offhand. You are talking about different kinds of capital. I think in the 1970's you are talking about short-term money, because our short-term rates were quite high.

Today's money is coming in in the form of purchase of securities, long-term assets and manufacturing plants. There has been a change in the whole perception about the merits of financial assets beginning with the change in monetary policy in 1979. Before 1979, yields on all of our securities were really negative. That is, interest

rates were below the rate of inflation for mortgages, for bonds, and what have you.

Since 1979, we have had positive yields on financial assets; and the real yields you are talking about simply reflect very large gaps, gaps that are historically very high. We have never had them quite so high. But what this meant was that in the 1970's foreigners were, as you remember, were not finding that the place to put money was in long-term financial assets. The stock market showed very little gain in the 1970's; it was in housing and antiques and durables of all sorts that profits were to be made.

The great transformation that has occurred with the change in monetary policy is that financial assets are now good investments.

Mr. FLORIO. It is my understanding that net capital investment, particularly in the Nation's productive facilities, was actually less in 1982 than it was in 1981 and is anticipated to be less in 1983. So, we are talking about financial instruments, but that is not translating into capital investment, which is supposed to be the rationale for the administration policies. If we are maintaining a strong dollar for the purposes of inducing capital to come into the Nation, and it is not coming in for the reason it is supposed to be, a higher degree of productivity in the economy, what is being achieved?

Mr. KATZ. That is a fair point. It reflects, in part, a recession. You have not gotten the investment boom that we are looking for and hopefully we will get as the recovery progresses.

Mr. FLORIO. Can I get your thoughts on the prospects of that actually materializing?

Mr. KATZ. I cannot add to the wealth of information from competent forecasters. The consensus is that we are going to get a recovery; that it will be slower than normal. The administration people think it is going to be well sustained and solid.

Others who are concerned about the financial impact of the deficit are worried that it will be choked off by rising interest rates.

Mr. FLORIO. Mr. Liney is cautioning us about that. Unless we change or intervene in some way his company and others would consider that it would be prudent economically to invest overseas rather than to expand their facilities here.

Mr. KATZ. But this gets back to the budget position. We simply have to come to a better resolution than we have because it is hurting us not only in foreign trade but in domestic investment and employment.

Mr. FLORIO. The irony is that a few years ago we had deficits that are modest by comparison with what we have now, which goes to the heart of fiscal policy, and, at that point, everyone was indicating that our economic fortunes were not optimistic, and now with these large deficits, the recovery contemplates 10 million people out of work in 1984, but it is a newly defined recovery.

Mr. SOUTHARD. Mr. Chairman, we have to confess that the balance-of-payments figures that we are dealing with are extremely unsatisfactory and worrisome. If you take the 1982 figures, the current account was estimated to have been in deficit by $8 billion.

But, the total private capital flow was minus $26 billion. Both of them are minus. There was $11 billion-plus on direct investments, but $44 billion-minus in bank flows.

Therefore, there was an errors-and-omissions item in 1982 of $25 billion on the plus side.

Now, Rimmer DeVries, in World Financial Markets, speculates as to how can this be. You cannot have a current account deficit which includes trade, and some other factors, and big trade deficits, and then, at the same time, have a huge deficit on the capital account. It cannot be.

Therefore, you end up with errors and omissions, and you have to assume that that money is an inflow of capital; but nobody knows. He suggests it must be safe-haven money, money coming into the stock market not recorded; so the whole thing is extremely chaotic. All we can say is that, with the kind of deficit we have been running on the current account, we had to have a sizable inflow of capital.

Mr. FLORIO. One of the interesting points that this committee has observed is that though the business community, as you do, laments the accuracy of the data that is there, when we have tried to in some legislative proposals, tried to facilitate greater capability on the part of the Government to have information-gathering capabilities, to have accuracy of numbers—the abstract of some in industry support the idea that we should have accuracy of numbers, but the mechanics designed to get the numbers always causes difficulties.

Mr. SOUTHARD. Certainly the crisis in international indebtedness that you are familiar with, an estimate of $640 million in external debt of the so-called nonoil, less-developed countries, has revealed to the people who are trying to concern themselves with this in the Fund and in the big banks and in the U.S. Government and the Federal Reserve, how poor the figures are. Every time they try to deal with a particular country like Argentina or Brazil, about every third day we get new figures because there has been no accurate recording of the debt.

So, there is now a concerted effort being made within the BIS, and the Fund, and the World Bank to try to improve these figures, but certainly they are not good.

Mr. LINEY. I would like to make a comment on this matter of the decline in exports and increase in imports, because I think it is the underlying problem that we, as businessmen, see, that it will eventually have disastrous consequences. I think some of these analysts put too much emphasis on the short-term aspects.

Now there is jubilation that the estimated current account deficit would be less than expected, but if you look at the figures, and I have in front of me figures issued last week by Morgan Guaranty, they show clearly that the exports are going down very, very rapidly.

If you look at the slope of the curve at the end of 1982 for exports, it is the steepest slope I have ever seen. And they are also saying, well, imports are not going up that fast. One of the reasons why is because the dollar is so strong. You can now buy things in Europe and in the rest of the world for 20 to 30 percent less than you paid 2 or 3 years ago.

So, I think if you take out the effect of the strong dollar in the import figure, it would show a much more dramatic change. But the figures confirm that the exports are going down rapidly and

our imports are increasing equally fast, and that is exactly what we are experiencing.

We think that there is a mad scramble on the part of most U.S. industry to replace U.S. components and parts with foreign-sourced components and parts, and we think that the sum of the two would be disastrous.

Mr. FLORIO. The strength of the dollar has been associated by some with the fiscal policies of the administration. Those policies, of course, have been supported by many in industry, and I suppose the logical conclusion is that some cannot have it both ways.

I mean to the degree that the policies have been designed to provide for looser fiscal policy, and that has been supported ostensibly on the idea that you are putting more tax money back into the private sector for the purpose of reinvigorating the economy, but it has also resulted in the growth of the deficit and all the other pressures that have the net impact of driving up the dollar.

Someone may very well have to make some choices as to how to go about correcting the fiscal policy ramifications that have resulted in the dollar-strengthening results, and that may very well mean undoing some of the fiscal policy directions that the administration has undertaken.

Mr. SOUTHARD. Mr. Chairman, I would like to mention one thing that troubles me very much in this whole business.

We have been told, and it has been reiterated in the past week both orally and in the press by the Secretary of State and the Secretary of the Treasury, that you really cannot do anything about this overevaluation until we get a harmonization or synchronization of monetary policies in the world.

Now, we have been living with the system for 10 years. We have had instability of rates day-by-day and week-by-week, sometimes as much as 5 percent in a day.

We have been seeing periods when the U.S. dollar was more undervalued than it should have been, periods when it is more overvalued than it should have been. We have seen various leading currencies jumping all around. For 10 years, we have been told that you cannot do anything about this until we get synchronization of fiscal and monetary policy.

We are not going to get synchronization of such policies unless there is some kind of positive pressure on countries to take into account the importance to them of the external sector. You are not going to get it.

Mr. FLORIO. Isn't that what the labor people are saying about domestic-content legislation; that is, it is designed to attract somebody's attention so as to induce the Japanese specifically to open up their capital market?

Mr. SOUTHARD. Yes, but if we have to go down that road, then you have got a whole series of bilateral relationships. The dollar and the yen have one overevaluation; the dollar in sterling, another; the dollar in French francs, another; the dollar in Sweden, another.

If you try to move in, as we did in August 1971 for a temporary period with some kind of uniform surcharge, and pick a figure of 10 percent, it has no chance of equating these differentials. It will help in one direction, but not in another. It arouses intense objec-

tions because you are putting on trade restrictions, and you are doing it in an arbitrary way without consultation. The only real way to get an adjustment of these nonfundamental differentials is to adjust exchange rates—of course, U.S. companies cannot compete because their factory costs are higher than the factory costs of their competitors, that is another matter.

Mr. FLORIO. I think Mr. Liney pointed to the opposite, saying that some of the American factories were more effective.

Mr. SOUTHARD. The only way that we can remove this financial disadvantage that the exchange rate is imposing, is to get some kind of exchange-rate adjustment which will, for a series of these leading countries, begin to equate the basic fundamental factors.

Now, we had that in the pre-1971 Bretton Woods system. At that time, countries were obliged to maintain their rates close to the par values, and if fiscal and monetary policies, any rates of inflation got out of line, they had to change the exchange rate and go on to a new level. The European monetary system is doing that today.

Mr. FLORIO. Is it doing it well?

Mr. SOUTHARD. The system is working, even with out-of-line France in it. France has had to devalue three times since the Mitterand government came in.

Mr. FLORIO. I thought in your testimony you said in an ideal world it would be nice to have a par value system with narrow margins, but it would not be realistic. We are talking about three power centers in Europe.

Mr. SOUTHARD. They have actually maintained narrow margins. The reason I don't think we can have plus or minus 2-, 3-, 4-percent margins in a larger grouping is that our determination of a reasonable band is not going to be very precise. It is going to have to be worked out as best technical people can do it, and it is going to have to have readjustments over a period of several years as it moves along.

So, I would think you would have to start out plus or minus 5 percent either side of the band. And then try that with coordinated intervention, and, of course, I am a strong believer in the usefulness of intervention. There is nothing wrong with it. But coordinated intervention is far more effective than single-country intervention, for obvious reasons.

Germany sells dollars; we buy marks—you are doubling the impact and reducing the financial load on the participating countries. I think the goal ought to be to get back to something where the margins are very close. But what we have—we have lulled ourselves, in my view, into a system where we are escaping the problem by saying we first have to coordinate our basic monetary and economic policy.

That is a formula of despair, in my view.

Mr. FLORIO. Professor.

Mr. KATZ. It seems to me that it would be preferable if we could do something on the exchange rate, the financial monetary system, rather than to try to remedy the situation through protective legislation, including import regulation.

Mr. FLORIO. Do you regard the import surcharge on currency differentials as a proper nonprotectionist median lateral approach that could or should be taken?

Mr. KATZ. Mr. Fites wants to use it as a bargaining tactic. Nobody wants to keep it on a permanent basis, and the question of how you bargain is a very difficult thing.

We really have two choices. One way is to proceed on a global basis as we did with the par value system and try to get everybody to agree on a general scheme. This is a very difficult road. It is not easy to see how you can get a formula that would be widely accepted at this time.

There is another alternative, and that is for us to try to identify a small number of countries that are important, and try to work out very close relationships with them. For example, at the moment, the ones that are most interesting to us would be the DM and the yen. The European system is essentially a DM system with the smaller European countries a part of the system and France going out and coming back in as conditions permit.

I don't know whether we can make any progress in global monetary reform. There are two fundamentals. One, countries have to recognize that they have an interest in a well-functioning international system and must accept the need for accommodating national policies. That means that the American fiscal record is not adequate. Foreigners have found that the combination of budget deficit and monetary policy has been harmful to them. That is what we would mean by coordination. The United States is not the only one at fault, but that is an example of it.

Mr. FLORIO. Isn't it inherent in our structure? We are lamenting the Japanese success and the Japanese success in large measure is because of a much greater capability of governmental direction and control that I suspect most of our friends from business would never tolerate or certainly would not be advocating in this Nation, and yet if it can be concluded, and I think it can, that in large measure the success that everyone points to in Japan is a direct result of governmental intervention and control to a much greater degree than we are thinking of supporting in this Nation, you are almost saying that you like the results, but you don't like the things that have caused the results.

I think it almost gets to the point that people are going to have to acknowledge the fact that there is a greater need for a public sector presence in the private sector operation than we have traditionally been willing to accept.

Mr. KATZ. I would add another factor; I don't think Japan has had a Cordell Hull. It was a deliberate choice on our part to decide that we had an interest in developing an export market and a liberal world economy, and we somehow were able to get those people harmed by a more liberal import policy to go along.

That is what the Hull program was. I am sure that the Japanese export sector would like to see a more open economy at home; but politically it seems difficult to sell these policies to local interests in Japan.

Mr. FLORIO. One of the witnesses maintained that the Japanese economy does not need externally generated capital for their domestic capital needs; that they generate internally. That goes to a

whole question of lifestyle and social values that are able to result in that internally generated capital being available such that they can espouse policies facilitating the exporting of capital and they can take advantage of the opportunities that come with that.

The administration has been talking about espousing policies to enable us to generate more capital. The failure is that the capital being generated is not being put to the uses for which the program was designed.

Mr. KATZ. This country has been the leader in promoting liberal trading arrangements; if we give up the momentum of that leadership, I would not want to back the possibility of other countries coming and supporting these kinds of measures.

Mr. SOUTHARD. I would like to say a little more about the questions of choice of some kind of surcharges as against trying to work at the imbalance of the exchange rates, themselves. There have been references made here and in other cases to the August 1971 action in which the Nixon administration not only closed the gold window, but put on a 10-percent surcharge from imports except for certain Latin American countries. At that time, what the United States said was we are doing this because we don't really know what the exchange rate structure ought to be. We have abandoned par values. And foreign objections to the surcharge were met by saying when and if we can agree on a set of rates we will take the surcharges off, and that was done at the Smithsonian Conference only 4 months later.

Now, for various reasons that I don't want to bore you with, the Smithsonian realignment did not hold. I think it could have been made to hold if there had been any kind of determination on the part of the U.S. Government in the following months. What I am saying is this: What is going to be our declared motivation? If we leave the exchange rate situation alone with continued overevaluation and underevaluation, are we going to say we are going to deal with this problem by putting on local content restrictions or surcharges; what would we do if there was no overevaluation or underevaluation? What is going to be the criterion for deciding what the surcharges should be? For us to go down that road alone with no effort to deal with the exchange rate problem, I think, is going to be an extremely difficult and perilous road.

Mr. FLORIO. The same argument was made on domestic content. People say it is valuable as a threat, but we cannot do it. After a while, the threat does not constitute a real threat. If you advertise that you have no intentions of doing things, people discount the threat because it does not amount to much.

I will ask perhaps, in conclusion, what your thoughts are as to the best things that could happen out of the Williamsburg Conference on this subject and what you foresee as actually going to happen?

Mr. SOUTHARD. You mean this one?

Mr. FLORIO. This one.

Mr. SOUTHARD. As far as I am concerned, the best thing that could happen would be for the committee to focus on the grievous problem of overevaluation and underevaluation—that is particularly why I like Mr. Liney's statement, particularly the danger that we are losing third markets.

Mr. FLORIO. I am talking about the Williamsburg Conference.

Mr. SOUTHARD. I am not optimistic, but I would hope that that conference on the financial side would recognize that there is an exchange rate problem; there is a problem of instability in the exchange system which those countries are determined, without delay, to tackle.

That does not mean calling for a Bretton Woods Conference, because that will be 3 years down the road, if at all.

We are talking about now. If that were recognized by these countries, including the United States, that would be a big help. Of course, they can say, as they will say, because it is the easiest thing to say, that we want to have better coordination of our financial and economic policies.

They don't ever do it, but it is easy to say that.

Mr. FLORIO. The sense of the Congress, as I perceive it, whether in this area or when we had the GATT Conference of last November, the feeling is that there is not much hope for multilateral agreement on many of these issues, and that the only way to induce that type of agreement is unilateral action.

I suspect in the Congress there is great support in trying to initiate some attention-getting actions that will induce more cooperative agreement working from the feeling that absent anything to attract someone's attention, nothing will happen, inertia being the easiest thing to prompt.

Mr. SOUTHARD. Then is the Government going to say, all right, now we have done these things, let's get busy on finding better solutions?

Mr. FLORIO. I don't speak for the whole Government.

Mr. SOUTHARD. I am talking about the executive branch. So far, there is very little sign of that.

Mr. FLORIO. On behalf of the administration, as I understand their position, giving it the best color, they seem to be saying that they have not great confidence in mechanical structures, and that they would feel better about the marketplace forces working things out.

I suspect between the two extremes of someone sitting down and calculating a formula which everyone will agree to or just letting chaos reign, there has to be some midpoint position where the Government can become involved in inducing action and having some cooperative discussions take place without setting in concrete some sort of mechanical formula for these types of things.

To the degree that that is the consensus potential between the executive branch and the Congress, that probably is the end goal that probably is in the public interest.

Gentlemen, I appreciate your participation today. It has been very helpful to the committee. Thank you.

The committee stands adjourned.

[Whereupon, at 11:50 a.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

GENERAL TRADE POLICY

Trade Reciprocity Legislation

WEDNESDAY, JUNE 22, 1983

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE,
TRANSPORTATION, AND TOURISM,
Washington, D.C.

The subcommittee met, pursuant to call, at 9:30 a.m., in room 2322, Rayburn House Office Building, Hon. James J. Florio (chairman) presiding.

Mr. FLORIO. The subcommittee will come to order.

Mr. Lent is inavoidably detained, but he is on his way.

STATEMENT OF HON. NORMAN F. LENT

I would like to welcome the witnesses to this hearing this morning.

We are all too aware of the pressures that the Congress is under to pass protectionist legislation.

I need only mention that the Committee on Energy and Commerce acted yesterday to report H.R. 1234, the auto domestic content legislation, to make this point.

In view of this and the increasing proliferation of trade barriers abroad, I believe that we need to consider the trade reciprocity legislation pending in the subcommittee most carefully.

There is no doubt, as under Secretary Olmer will be testifying shortly, that: "U.S. business will be looking for action if their confidence in the present trading system is to be restored."

I welcome this opportunity to review this legislation today.

Mr. FLORIO. We will commence out of respect for the witnesses. I would like to welcome everyone to our continuation of the subcommittee's ongoing set of hearings dealing with this Nation's trade policies. Today we will be looking at reciprocity legislation now pending before this subcommittee.

The principle of reciprocity has been a cornerstone of U.S. trade policy since the enactment of the Reciprocal Trade Agreements Act of 1934. Since that time, the United States has sought to establish fairer and more equitable trade relationships with other countries through the negotiation of agreements providing for a mutual and equal reduction in trade barriers.

Because the United States has always had more open markets than most other nations, we have paid very dearly over the years for the concessions we have won from our trading partners. Many U.S. businesses and industries have complained recently that the United States literally cannot afford to continue this approach in dealing with problems of international trade.

As a result, proposals have been brought forward that would cause the United States to impose restrictions on foreign imports to counter unfair trade practices of other nations, with or without GATT approval. Other proposals have been made to clarify and expand the President's existing authority in this area. Proponents of such proposals argue that the United States must be more aggressive and willing to take unilateral action in order to force our trading partners to open their markets to our products.

Today the subcommittee will hear testimony on a number of these proposals, the legislation that is pending before our committee as well as pending before other committees. We are very happy to have distinguished witnesses before this committee. We are happy to welcome the Honorable Lionel Olmer, the Under Secretary for International Trade, Department of Commerce. Your statement will be put into the record and you may feel free to proceed as you see fit.

STATEMENT OF LIONEL H. OLMER, UNDER SECRETARY OF COMMERCE FOR INTERNATIONAL TRADE, DEPARTMENT OF COMMERCE

Mr. OLMER. Thank you, Mr. Chairman. I briefly propose to comment on my written testimony and then try to respond to any questions that you have.

The administration has tried to advance the concepts of equitable market access and market opportunities for American suppliers. We agree that those principles are at the foundation of the multilateral trading system, but we have not gotten our way in achieving that equitable status that we seek. Over a period of years we have sought to convince our trading partners to take account of various kinds of barriers. I think gradually we have worked successfully for their elimination.

There are three basic kinds of problems. One is the fact that in recent years as the easier barriers to trade were eliminated people go underground and it is harder to get to the root of the problem. It is more difficult to develop proof of unfair trade practices as successive negotiations have achieved their basic purposes.

Second, there are limitations to the multilateral system, particularly the multilateral trade laws that exist. For example, the GATT dispute settlement mechanism is not the strongest means by which a complainant can get his complaint heard and acted upon even when he proves his case.

The third set of problems is the fact that in a number of areas international disciplines simply do not apply. That is of course the subject of one part of the various bills that are before the Congress in the area of services, trade, direct investment, and specifically trade in high technology. We would maintain that our trading partners today have a clearer understanding than they ever have had before of the importance to the continuation of the multilateral trading system because of those three different kinds of problems. We have had commitments made at the ministerial level and at the head-of-state level, one a couple of months ago, the Organization for Economic Cooperation and Development in Paris, and

more recently at the Williamsburg summit, and those are encouraging signs.

I do not want to downplay the significance of the high-level political commitment, but in fact as you well recognize U.S. business is going to look for action if their confidence in the system is to be restored and maintained. In the area of action the results of the last couple of years have been at best modest. But I cannot imagine that an effective multilateral system could emerge unless there is a willingness at the top and that that willingness at the top is stressed through the political and bureaucratic levels. We are working on that. Progress is slow, but I do not think one can deny that that is the necessary way to proceed even when progress is made modestly.

The administration has made clear it does support legislation to strengthen our hand in dealing with our trading partners, and we have worked closely with the Congress in the last 2 years to translate that expression, those objectives, into legislation. We believe that H.R. 1571, the so-called Jones-Frenzel bill, does reflect a positive approach to the problem of attaining equitable market opportunities for American companies. It is similar to Senator Danforth's bill, which the administration has come out affirmatively in support of. There are some differences between those bills, and we will be working even more closely with the Congress to try to resolve some of the differences in language and one or two gaps that exist in which some of the things that we think would be useful are not covered.

H.R. 1571 does provide for negotiating objectives as well as the authority to pursue trade liberalization in the area of services and foreign investment. One could be a little cynical and say why do you need specific authority, can you not do it without it, and the answer is yes, you could, but here is a case in which the Congress working with the administration does strengthen the administration hand by having a strong idea of the legislature's desire. The negotiating mandate on trade and high technology would provide the administration with authority we think is necessary to convince our trading partners we want to achieve a discipline in the area of high technology.

Mr. FLORIO. Mr. Secretary, the authority that exists now under 301 is not being used. Why is it that one thinks that if you expand the scope of the authority by including services and investments, is there some reason to believe that that would prompt greater use of the authority?

Mr. OLMER. I think so. I think the feeling is that by mentioning it specifically our trading partners will recognize that it is not just a negotiating element of the U.S. Government, that is the executive branch, that seeks it. Oftentimes negotiators refer to the Congress as being the stimulus for the achievement of certain objectives, and here we would have a specific expression of congressional desire. I think it would help.

Mr. FLORIO. I am not sure I understand how that follows that if you have got authority to pursue 301 actions now in certain fields and they have not been pursued, now we are going to expand the scope of the ability—you almost are reinforcing the idea that it is pointless because the Congress has spelled out authority, 301 ac-

tions in some fields, and the fact of nonuse just sends the message that you do not have to take this very seriously, does it not?

Mr. OLMER. No, I was thinking of inclusion of specific language to pursue trade liberalization in the area of services and investment in language that expresses a congressional desire to achieve disciplines in that area. That kind of language is presently absent. I think you are referring to the flip side of 301, that is the potential authority or the authority to potentially retaliate for failure to provide the equivalent market access.

Mr. FLORIO. You are saying the mere statement of inclusion of services in 301 might induce GATT to move forward rapidly?

Mr. OLMER. It would help. It would not be a very large club, but it would be a help. As I say, my own experience, and USTR are the principal negotiators, but in my own experience both in the private sector and in government, we frequently refer to Congress sometimes as the bad guys. If you do not do this then you are likely to see protectionist legislation emerge with the evening tide, or something like that, and it does carry some weight, and I think it would be useful to specifically express a congressional desire to see a trade discipline emerge in the area of services.

Mr. FLORIO. Does that not have to be packaged with some overt use of the existing 301 authority in this new field of services as well as in the existing field that 301 complaints can be used in? My point is that not using it as has been the history in the recent past is almost setting up a straw man, and that any trading partners are going to say well, they are just fooling around because nobody uses the authority even when it is there, why should we be intimidated by an expansion of the field within which the authority could be used?

Mr. OLMER. I guess I would say to that that there are few countries that would admit to being intimidated, and there are fewer countries that are in a position to be intimidated even if that were a negotiating objective of ours, and it should not be. You do not get a reciprocal trading arrangement by intimidating one side. Either there is mutual benefit or there is not, in which case you generally do not have an equitable trading arrangement. I think that is at the heart of the rationale for the administration's nonsupport of broad retaliatory authority.

Mr. FLORIO. We are going to be hearing from some organizations today that are going to suggest that there are unfair practices that are being perpetrated by our trading partners on their particular industry. It is my understanding that one of the organizations is about to file a 301 case against Japan. You feel when you say that people are not inclined to be intimidated, do you feel that that action if it is pursued and ultimately followed up upon would have an impact in inducing changes of policy on the part of some of our trading partners?

Mr. OLMER. I think that if a case could be made on the merits that there is an unfair trade practice, then there is sufficient authority for the administration to take action to repair the injury which has been caused as a consequence of that unfair practice. I just mean that you do not go into a negotiation with the intention of intimidating the other side or you are not likely to wind up with

a package that you are going to find will be satisfactory over the long run.

Mr. FLORIO. You are probably saying you do not go in with the intent of intimidating, but you do go in with the intent of inducing action on the other side, and if you do not use the process, no one is really going to take one seriously so as to induce a change.

Mr. OLMER. I guess I would have to look at the allegation of unfair trade. I go through this quite frequently with members of the American business community, and I know there are limitations in our antidumping countervailing duty law, which is within my direct purview, and I know already limitations within other unfair trade remedies that are available, but by and large I think the American business community does have open access to the American Government, the American Government does have adequate tools in the quiver to deal with most unfair trade practices which emerge. The ones which I was addressing here are really not covered by international disciplines yet. In some cases we are not quite sure of what sorts of disciplines ought to apply, as for example in many of the service sectors. We do not know how we would write laws specifically to govern trade in banking, accounting, engineering services and the like, or what we mean by a discipline in high technology beyond—and I do not mean this in the pejorative sense, the rhetoric about maintaining an open market for the free flow of technology, but whether or not you would require a specific law to cover trade in high technology, beyond the laws that presently exist, is as yet unclear.

So I would not want to see us now at the beginning saying we need retaliatory authority if you do not give us what we think we are entitled to, free access in technology to be identified by us at a later date, we are going to come at you with a big club. I think a little club is sufficient. That little club is expressed in a strong congressional commitment to achievement within a time frame if you choose of an international discipline.

I just have a couple of other comments. The provisions finally in 1571 we believe would clarify section 301 of the existing trade laws regarding the coverage of services and investment. That was the point that I was trying to make. I think it would strengthen our ability somewhat measurably to defend our interests without yet resorting to protectionist measures. H.R. 2203 is a broader bill seeking to address the domestic as well as international elements of U.S. competitiveness. Similar to H.R. 1571 and S. 144, that bill, H.R. 2203, does identify the need for fair access to foreign markets, and it sets out a comprehensive system for the collection of information about the trading practices of our partners. The specific provisions of these various legislative initiatives do differ, and we want to work with the committee regarding the bills in more specific detail.

I would like to comment on section 9 of H.R. 2203, which does deal with the topic specifically at issue at this hearing, the subject of equitable market access. I appeared before the subcommittee on March 15 and expressed the view that the administration does not support the broad retaliatory provisions of that section. We will not ignore market access barriers. We have made it clear that we will not. And we do say we need leverage to convince our trading part-

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ners of the need to negotiate rules, but we think that sufficient leverage does exist in section 301, and while we agree and submit that 301 should be amended to clarify its applicability to the services sector, we do not favor a retaliatory provision.

Having summarized my statement and in response to your question, Mr. Chairman, I am available for any further questions, you may have.

[Mr. Olmer's prepared statement follows:]

TESTIMONY OF LIONEL H. OLMER
UNDER SECRETARY OF COMMERCE
FOR INTERNATIONAL TRADE
BEFORE THE
SUBCOMMITTEE ON TRANSPORTATION
AND TOURISM OF THE HOUSE COMMITTEE ON
ENERGY AND COMMERCE

WEDNESDAY, JUNE 22, 1983

I AM PLEASED TO APPEAR BEFORE THIS COMMITTEE TODAY TO DISCUSS OUR VIEWS ON H.R. 1571 AND CERTAIN COMPARABLE PROVISIONS OF H.R. 2203. THIS ADMINISTRATION HAS MADE THE IMPROVED OPERATION OF THE TRADING ENVIRONMENT ONE OF ITS KEY INTERNATIONAL TRADE POLICY OBJECTIVES. THROUGH BILATERAL AND MULTILATERAL INITIATIVES WE HAVE TRIED TO ADVANCE THE CONCEPTS OF EQUITABLE MARKET OPPORTUNITIES AND ACCESS. THESE PRINCIPLES ARE THE FOUNDATION OF THE MULTILATERAL TRADING SYSTEM. THEY NEED TO BE IMPLEMENTED MORE EFFECTIVELY IF WE ARE TO PRESERVE THAT SYSTEM.

RECIPROCITY, IN THE SENSE OF EQUITABLE OPENING OF MARKETS ON A GLOBAL SCALE CONTINUES TO BE A CENTRAL GOAL OF THE ADMINISTRATION. WE HAVE SOUGHT TO FASHION A BILATERAL AND MULTILATERAL POLICY RESPONSE WHICH WILL CONVINCE OUR TRADING PARTNERS TO TAKE ACCOUNT OF THESE BARRIERS AND, MORE IMPORTANTLY, TO WORK FOR THEIR ELIMINATION.

WE HAVE IDENTIFIED BARRIERS TO LEGITIMATE COMMERCIAL OPPORTUNITIES FOR U.S. FIRMS IN FOREIGN MARKETS. AMONG THOSE ARE: (1) THE EMERGENCE OF OBSTACLES MORE DIFFICULT TO IDENTIFY WITH PRECISION AS SUCCESSIVE NEGOTIATIONS HAVE PEELED AWAY TRADITIONAL AND MORE READILY PROVABLE TRADE PROBLEMS; (2) THE LIMITATIONS OF CURRENT MULTILATERAL RULES, ESPECIALLY IN THE AREA OF AGRICULTURE; AND (3) THE LACK OF INTERNATIONAL DISCIPLINES IN THE AREA OF SERVICES TRADE, DIRECT INVESTMENT AND TRADE IN HIGH TECHNOLOGY PRODUCTS.

WE HAVE MADE IT CLEAR THAT THESE BARRIERS CANNOT BE IGNORED IF THE INTERNATIONAL TRADING SYSTEM IS TO FUNCTION PROPERLY.

WE BELIEVE THAT OUR TRADING PARTNERS HAVE A CLEARER UNDERSTANDING THAN BEFORE OF THE IMPORTANCE OF THE ISSUE. THE COMMITMENTS MADE AT THE OECD MINISTERIAL AND, MORE RECENTLY, AT THE WILLIAMSBURG SUMMIT ARE ENCOURAGING SIGNS THAT THERE IS A POLITICAL COMMITMENT TO ACHIEVE A MORE OPEN, FREER WORLD TRADING SYSTEM. THE WILLIAMSBURG SUMMIT DECLARATION, IN PARTICULAR, RECOGNIZED THE IMPORTANCE OF NOT MERELY MAINTAINING THE STATUS QUO BUT OF CREATING THE NECESSARY MOMENTUM FOR FURTHER TRADE LIBERALIZATION BY DISMANTLING TRADE BARRIERS. IT ALSO RECOGNIZED THE IMPORTANCE OF MOVING AGGRESSIVELY ON MULTILATERAL WORK PROGRAMS IN THE HIGH TECHNOLOGY AND SERVICES AREAS.

WITHOUT DOWNPLAYING THE SIGNIFICANCE OF SUCH POLITICAL LEVEL COMMITMENTS, U.S. BUSINESS WILL BE LOOKING FOR ACTION IF THEIR CONFIDENCE IN THE SYSTEM IS TO BE RESTORED. IN THE AREA OF ACTION, THE RECORD OF THE LAST YEAR HAS BEEN MODEST. THE SITUATION IS FAR FROM SATISFACTORY.

THE GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) EMBODIES THE RULES OF THE INTERNATIONAL TRADING SYSTEM. COUNTRIES MUST BE PREPARED TO ADDRESS ISSUES SUCH AS PERFORMANCE REQUIREMENTS, SERVICES, AND AGRICULTURAL EXPORT SUBSIDIES; IT IS HARD TO IMAGINE THAT TRULY EFFECTIVE MULTILATERAL RULES CAN EMERGE UNLESS THE WILLINGNESS TO ADDRESS THESE ISSUES IS EXPRESSED AT A POLITICAL LEVEL AND CARRIED THROUGH TO THE WORKING LEVEL. THE GATT DISPUTE SETTLEMENT PROCESS NEEDS FUNDAMENTAL STRENGTHENING. STRONG RULES ARE USELESS UNLESS THERE IS A CREDIBLE PROCESS FOR RESOLVING DISPUTES AND A COMMITMENT BY ALL PARTIES TO ABIDE BY THE JUDGMENTS WHICH EMERGE FROM THAT PROCESS.

BILATERALLY, THE JAPANESE GOVERNMENT UNDER PRIME MINISTER NAKASONE HAS UNDERTAKEN SEVERAL SIGNIFICANT TRADE LIBERALIZATION MEASURES. MOST IMPORTANT OF THESE WAS THE RECENT PASSAGE OF AMENDMENTS TO SIXTEEN LAWS DEALING WITH STANDARDS AND CERTIFICATION. WHEN FULLY IMPLEMENTED, THESE CHANGES COULD REMOVE SIGNIFICANT IMPEDIMENTS TO U.S. SALES TO JAPAN.

DURING HIS RECENT TRIP TO JAPAN, SECRETARY BALDRIGE DISCUSSED THE NTT AGREEMENT. THE JAPANESE RESPONDED THAT SIGNIFICANTLY INCREASED PURCHASES FROM U.S. COMPANIES SHOULD RESULT FROM AN INTENSIFICATION OF NTT'S EFFORTS AND FROM INCREASED EXPERIENCE OF PROSPECTIVE U.S. SUPPLIERS. NTT SUBSEQUENTLY PARTICIPATED IN SEMINARS AROUND THE U.S. TO EXPLAIN THEIR PROCUREMENT PRACTICES AND HAVE ALTERED SOME OF THOSE PRACTICES TO INCREASE THE ACCESS FOR FOREIGN FIRMS. WE WILL BE WATCHING THE RESULTS OF THESE CHANGES FOR U.S. FIRMS; AND I FOR ONE HAVE MORE OPTIMISM NOW THAN AT ANY TIME SINCE THE AGREEMENT WAS SIGNED NEARLY THREE YEARS AGO.

THE COMMITMENT OF PRIME MINISTER NAKASONE TO MORE OPEN MARKET ACCESS IS TO BE APPLAUDED AND ENCOURAGED. BUT THE JAPANESE GOVERNMENT MUST UNDERSTAND AND, I BELIEVE, IT DOES SO UNDERSTAND THAT WE WILL CONTINUE TO CONSULT WITH AMERICAN BUSINESSMEN REGARDING THEIR EXPERIENCES IN JAPAN SO THAT WE MAY GAIN AN ACCURATE MEASURE OF THE IMPLEMENTATION PROCESS IN THE AREAS OF STANDARDS, CERTIFICATION AND PREFERENTIAL BUYING PRACTICES.

THE ADMINISTRATION HAS MADE IT CLEAR IT WOULD SUPPORT NON-PROTECTIONIST LEGISLATION WHICH WILL STRENGTHEN OUR HAND IN DEALING WITH OUR TRADING PARTNERS. WE HAVE WORKED CLOSELY WITH THE CONGRESS OVER THE LAST TWO YEARS TO TRANSLATE OUR OBJECTIVES INTO LEGISLATION. WE HAVE BEEN GUIDED BY FOUR PRINCIPLES IN THIS EXERCISE:

(1) WE WILL MAINTAIN CONSISTENCY WITH OUR OBLIGATIONS UNDER THE GATT AND OTHER INTERNATIONAL AGREEMENTS;

(2) WE WILL STRESS MULTILATERAL RATHER THAN BILATERAL OR SECTORAL SOLUTIONS;

(3) WE WANT TO STRENGTHEN EXISTING INTERNATIONAL AGREEMENTS AND INSTITUTIONS; AND

(4) WE SUPPORT A STRENGTHENING OF THE NEGOTIATING AUTHORITY OF THE PRESIDENT, AND CLARIFYING THE ABILITY OF THE PRESIDENT TO RESPOND UNDER SECTION 301.

I BELIEVE THAT [redacted] H.R. 1571 REFLECTS A POSITIVE APPROACH TO THE PROBLEM OF ATTAINING EQUITABLE MARKET OPPORTUNITIES. INTRODUCED BY CONGRESSMEN JONES AND FRENZEL, IT IS VERY SIMILAR IN STRUCTURE AND PROVISIONS TO SENATOR DANFORTH'S BILL WHICH THE ADMINISTRATION HAS SUPPORTED. WE WILL BE WORKING CLOSELY WITH THE HOUSE TO RESOLVE DIFFERENCES IN THESE BILLS CONSISTENT WITH OUR OBJECTIVES.

H.R. 1571 WOULD PROVIDE NEGOTIATING OBJECTIVES AS WELL AS THE NECESSARY AUTHORITY TO PURSUE TRADE LIBERALIZATION IN THE AREAS OF SERVICES AND FOREIGN INVESTMENT. STATUTORY SUPPORT FOR NEGOTIATIONS TO FORMULATE RULES IN SERVICES AND INVESTMENT WOULD BE USEFUL AS THE U.S. PURSUES THESE ISSUES.

SIMILARLY, THE NEGOTIATING MANDATE ON TRADE IN HIGH TECHNOLOGY GOODS WOULD PROVIDE THE ADMINISTRATION WITH AUTHORITY TO MAKE NEEDED PROGRESS IN THE LIBERALIZATION OF FOREIGN BARRIERS U.S. INDUSTRIES FACE IN VARIOUS HIGH TECHNOLOGY SECTORS.

IN ADDITION, THE PROVISIONS OF H.R. 1571 WOULD CLARIFY SECTION 301 REGARDING THE COVERAGE OF SERVICES AND INVESTMENT. IT WOULD, IF ENACTED, STRENGTHEN OUR ABILITY TO DEFEND OUR INTERESTS WITHOUT RESORT TO PROTECTIONIST MEASURES.

H.R. 2203 IS A BROAD BILL WHICH SEEKS TO ADDRESS THE DOMESTIC AS WELL AS INTERNATIONAL ELEMENTS OF U.S. COMPETITIVNESS. LIKE H.R. 1571 AND S.144, H.R. 2203 CORRECTLY IDENTIFIES THE NEED TO HAVE FAIR ACCESS TO FOREIGN MARKETS IF WE ARE TO TAKE FULL ADVANTAGE OF COMPETITIVE OPPORTUNITIES. IT SETS OUT A COMPREHENSIVE SYSTEM FOR THE COLLECTION OF INFORMATION REGARDING THE PRACTICES OF OUR TRADING PARTNERS AND FOREIGN MARKET CONDITIONS AND STRUCTURES. THE SPECIFIC PROVISIONS OF THESE LEGISLATIVE INITIATIVES DIFFER AND WE LOOK FORWARD TO WORKING WITH THE COMMITTEE REGARDING THE VARIOUS BILLS IN MORE DETAIL.

I WOULD LIKE TO SPECIFICALLY ADDRESS SECTION 9, WHICH ALSO DEALS WITH THE TOPIC AT ISSUE IN THIS HEARING -- EQUITABLE MARKET ACCESS.

I PREVIOUSLY INDICATED MY VIEWS ON SECTION 9 TO THIS SUBCOMMITTEE IN MY MARCH 15 TESTIMONY ON H.R. 794, IN WHICH THE SAME PROVISION APPEARS. IN SHORT, WE DO NOT SUPPORT THE NEW, BROAD RETALIATORY AUTHORITY CONTAINED IN SECTION 9. WE HAVE MADE IT CLEAR THAT WE WILL NOT IGNORE MARKET ACCESS BARRIERS AND THAT WE DO NEED LEVERAGE TO CONVINCE OUR TRADING PARTNERS OF THE NEED TO NEGOTIATE INTERNATIONAL RULES FOR TRADE IN SERVICES. WE HAVE THIS LEVERAGE IN SECTION 301 AND, WHILE 301 MAY REQUIRE SOME AMENDMENT TO CLARIFY ITS APPLICATION TO SERVICES, WE DO NOT FAVOR A NEW RETALIATORY PROVISION.

I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY AND LOOK FORWARD TO WORKING WITH YOU ON THESE IMPORTANT ISSUES.

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Mr. FLORIO. Without a retaliatory provision, what is the sanction?

Mr. OLMER. The sanction is what already exists in 301, which permits the President under discretionary authorities to deny market access to reach out and repair injury done to U.S. companies. That is available to the administration presently.

Mr. FLORIO. Let me ask your guidance, since it has not been used, what is it—if you give us a specific example, of the types of assistance that could be offered to an injured domestic company that would not only make the company whole as a result of the unfair practices, but would inhibit a recurrence of the practice. I mean we could provide assistance to the company, make the company whole, and tomorrow the same thing would happen and we would be in this process. I would have thought a more laudable goal would be to be of assistance to the company, but from a public standpoint in a broader scope than just remedying the injury to the company. We should be trying to disallow the conditions that resulted in the unfair practice being perpetrated upon the company.

Mr. OLMER. There is a section 301 case now pending before the administration involving the specialty steel industry, and I can tell you that it has indeed gotten the attention—no decision has been made yet either as to whether a remedy is warranted, and if a remedy is warranted, what ought to be the form of the remedy. No decision has been made on that by the President, but the fact that the inquiry has been under way and the fact that the administration is considering an appropriate remedy, I cannot emphasize enough, has gotten the attention of all of our trading partners that deal in the specialty steel industry and has made it a great deal easier for Ambassador Brock's staff to negotiate on that issue.

Mr. FLORIO. Of course that is the same argument proponents of domestic content make, that the fact this legislation is being actively considered and has the potential for being enacted into law is focusing some of our trading partners' attentions on the need——

Mr. OLMER. It has indeed. I think it has. Let me give you an example that is covered in my statement for the record. NTT—no one has filed a case against NTT, no dumping case, countervailing duty case, no 301 case alleging market access difficulties. We have been negotiating with NTT for years, not only the 2½ years of this administration, but for a couple of years preceding that. We are beginning to make some progress. The fault has not entirely been NTT's historically. There are signs—there are clear signs and there is a clear demonstration of an opening process, and I would maintain that if we 1 year ago or 2 years ago had entered into those negotiations in a threatening way saying unless you do this by 90 days from now or 6 months from now, we are going to do thus and so to the market access opportunities for your suppliers, meaning that we would foreclose American markets to Japanese manufacturers who also supply NTT—it would have been an unhealthy environment in which to negotiate, and I think it is far preferable the way it is coming out now. I do not mean all problems have been solved, but I think there is clear evidence of progress being made, in a way that the American business community privately to me has said they applaud.

Mr. FLORIO. Some point to the value, the real value of 301, inasmuch as it has not really been enforced, is providing U.S. parties with a process by which they can invoke the GATT dispute settlement procedures. Of course Mr. Jones and Mr. Frenzel would expand 301 to go into services, but that justification would be of no value; that is, the justification of 301 into services would be of no value, because GATT does not include services. Is my analysis correct that if that was to be the exclusive value of 301, to expedite the GATT dispute settlement process as to services, that would not be a valid justification for it?

Mr. OLMER. I think the authority on that subject would rest within the USTR's office, and I would defer a declarative statement on that score to I believe one of your witnesses, the general counsel of USTR. But my feeling is that not everything under 301 needs to be GATT-compatible. If the lawyers say that it does, then perhaps legislation might make it clear that it does not, and that indeed it would enhance the speed at which GATT might be willing to consider a work program in services or to pursue that work program in services as well as in high technology.

Mr. FLORIO. Will you share with us the latest up-to-the-minute position of the administration on the reorganizational effort? Has there been a House sponsor?

Mr. OLMER. There is a House bill. The Roth bill has been introduced in the House—Senator Roth's bill has been introduced in the House. Congressman Bonker has introduced the Roth bill in the House. Secretary Baldrige is testifying this morning in the Senate on the reorganization. The administration is pursuing it vigorously. We believe that support for the reorganization will pick up. It has, in my own view, not an official position, my own view is that there has been a certain amount of apathy. No substantive opposition so much as well, there is an awful lot of very important legislation on our agenda, and gee, this makes sense, but I have got other busy things to do. I happen to believe that because there seems to be little if any substantive objection to it that support is going to pick up as the bill proceeds. Senator Roth intends to have the bill on the Senate floor in September for a vote. I cannot give you a more precise answer on the House side. The odds seem to be that it will be difficult to move it as far as the Senate—as far and fast as the Senate, but Secretary Baldrige is testifying.

Perhaps the one substantive objection I have heard is here is protectionism, that the slimmed down and more comprehensive and more coordinated Department of International Trade and Industry would give rise to protectionist sentiments, and the opportunity for a strengthened protectionist hand. Clearly we deny that as a realistic possibility, and we have argued against it, but that has been one argument made.

Mr. FLORIO. Mr. Richardson.

Mr. RICHARDSON. Thank you, Mr. Chairman. I apologize for being late. Shortly I have to leave. I hope to be back around 11 o'clock to resume questioning of the witnesses.

Mr. Chairman, I want to commend you for holding these hearings and also for focusing on this issue of international trade in our subcommittee. I have a strong interest in this issue, not just because of my district and some of the problems we are having, espe-

cially in the mining industry, but because I feel that we need some strong reciprocity legislation. I think the Jones-Danforth bill is a good start. I personally would like to extend it to other areas. I particularly regret that I will not be able to hear some of the testimony by the semiconductor industry. I want to voice my support for your efforts in this area and tell you that I would like to be an integral part of whatever legislation you prepare.

Mr. Olmer, I wonder if it might not make more sense to give one individual sole authority, to enforce section 301. It seems whenever we try to decide trade policy, we get too many people involved and we never get anything done. 301 is ultimately at the discretion of the President, and I wondered if it would not make more sense to give this authority to somebody else. Maybe to be the new czar of the Department of Trade should it be established or to the head of SDR or somebody else at the White House. I have long felt, as I think many others have, that our trade policy is hampered by any kind of central focus and authority. I wondered what you felt about that.

Mr. OLMER. Mr. Richardson, you make a very strong case for the establishment of a central department, and I applaud your argument. I agree completely with the thrust of it, that is that various trade laws that exist are spread around several different agencies and departments. One example you point out is that section 301 is coordinated by the Office of the USTR, which is charged with aggregating administration positions on it and then making a recommendation to the President. The antidumping and countervailing duty laws, which are the responsibility of the present Department of Commerce and fall within my area of the Department, I think represent—you may, and I am sure you will, find issue with the way in which we have administered the law. I mean everybody finds fault with it. The importers and exporters, the petitioners and the respondents do. You simply could not satisfy everyone, but at least I believe there is a shared view that the process is one that is administered in a somewhat more precise, measurable fashion. That is to say relatively junior people analyze the facts, make the recommendations, and at a middle level judgments are made regarding the findings. I happen to think that is a healthy process.

Mr. RICHARDSON. Do you think the Department of Trade would be a step in the right direction?

Mr. OLMER. I definitely do. I see the brokering—two things. First, the brokering of trade policy in which the lowest common denominator is often the course chosen, and second, reducing opportunity for window shopping by foreign governments in particular would be I think a blessing.

Mr. RICHARDSON. I think we tried this approach long ago with SDR. SDR was supposed to be the central authority and focus for U.S. trade policy. I personally think it has not done that, and I am concerned that unless we have some strong trade reciprocity legislation, we are going to drift into more protectionism. I voted yesterday in our committee for the domestic content bill, and I did so reluctantly. I do not think that is the answer. But I, like many others, voted for domestic content to send a signal to the administration that our attitude in terms of trade reciprocity is just much too weak. I am pleased the Japanese Premier was here and the

meeting in Williamsburg was very good and that he was very positive on security issues. But I think we have just got to have some kind of trade reciprocity legislation on the books. Then maybe you can say it is the Congress' fault that we are doing all these things.

Mr. OLMER. We do that a lot. Might I say one thing about the reorganization rationale. It is our strong view that it is time that trade was not brokered, but advocated, and it is just an obvious fact that only in the area of trade is there a split responsibility between the formation of policy and the implementation of policy. If you look at the Defense Department, and the Defense Department both formulates defense policy and implements it. The same thing is true with respect to the Treasury and the State Department. It is only in the area of trade that every cotton-picking, chicken-plucking person has a view on trade and gets that view expressed, and then the Department of Commerce tends to be the central agency responsible for implementing it through trade promotion on one hand and through the antidumping countervailing duty law. It is not enough.

Mr. RICHARDSON. I urge you to staff this new Department with businessmen, representatives from the service industries, with the main objective being the protection and promotion of American business abroad and if that will strengthen your hand in creating a new Department, and I will support it. But if you just bring the Foreign Service in to run it I will vote against it.

Mr. OLMER. I will cite you as the authority for the personnel hiring practices, Mr. Richardson.

Mr. RICHARDSON. All my 5 months of seniority.

Thank you, Mr. Chairman.

Mr. FLORIO. Before recognizing the gentleman from Pennsylvania, I observe that I think it was the last time you were here we observed that the Department of Defense had just initiated what appeared to be a unilateral policy of targeting supercomputers for their purposes to try to insure the ability of this country to have defense computer technology, and we observed at that point that that might have been something that Commerce or the trade people might have been doing. So to the degree that Mr. Richardson is concerned about State Department personnel not being aggressive in pursuit of trade considerations, one can also make the point that vis-a-vis the Defense Department, the Commerce Department seems to be less than aggressive in emphasizing our own national interests, and that maybe we should discount Commerce people, business people, and State Department people and put the generals in charge of our effort to try to be more aggressive in promoting and protecting our own investments.

Mr. OLMER. Well, I think that you will find that there is hardly a weapon system in existence today that embraces the most modern technology available in the private sector. So Defense's reaction to the Japanese drive for technological dominance is to be applauded, it really is.

Mr. FLORIO. Since your appearance here last, is there anything that has happened, because if my recollection is correct, I think it was that you were here and the Trade Representative's representative was here and both seemed to be surprised about the article

that appeared that day in the newspaper announcing this Defense Department initiative.

Has there been—you had indicated there is a task force that ostensibly is supposed to communicate with all the parts of the trade establishment, and that communication appears to have broken down in that instance inasmuch as the Commerce Department and the Trade Representative didn't have any knowledge about what the Defense Department was doing in this very important facet of trade?

Have there been communications since then on this particular targeting initiative of the Defense Department?

Mr. OLMER. Well, the Defense Department is doing it not to sustain a particular segment of the American industry—it is doing it because, as a matter of fact, it sees the development of super computers in a way somewhat different than the Japanese do, and wanted to propose some $25 million to the process of assuring the development in the United States.

There are very few American companies who are in the super computer business—two. For example, IBM has kept out of it, doesn't believe there is a sufficient market, and until and unless it sees the development of market opportunities, it is not going to get into the business of producing super computers. There is the Cray Corp. and there is Control Data Corp.

Mr. FLORIO. The super computers are not just exclusively for defense.

Mr. OLMER. Not at all, but the main customer for super computers is the Defense Department. There are only in the whole world, I think, 25 of them.

Mr. FLORIO. You are saying there is not sufficient nondefense utilization capability so as to justify the Commerce Department or the Trade Representative being intimately involved in formulating a targeting strategy to insure that that whole industry is not totally assumed by another nation?

Mr. OLMER. Well, Mr. Chairman, with the amount of money available to the Commerce Department in its trade promotion activities, we couldn't do very much. What we have done is bring in for a full day of discussions with the Secretary and other senior members of the administration, including the Justice Department, representatives of the computer industry and the robotics industry and talked to them about problems which they see in the future relative to their competitiveness. In fact, I think we have sent to you, and if we have not, it is an omission that I will quickly repair, a compilation of those discussions.

There were four separate days in which we met with four separate industrial sectors talking about problems which they perceived both on the Government side and on the unfair side. It makes for very interesting reading.

A word again about the super computer situation. We happen to have two companies who are far and away technologically superior to anything produced anywhere in the world. In part, that is because there is only one other place in the world which is now emerging as a supplier of super computers, and that is Japan. DOD has got some ideas in mind which go well beyond present state of

the art, and they are looking at it not from the point of view of its commercial application, but clearly from a defense point of view.

The sorts of functions that a super computer is now being used for relate to weather predictions, to nuclear weapons targeting. In the private sector, the dominant use, I believe, is in the area of forecasting opportunities for oil and gas exploration. A number of calculations that can be performed in a shorter period of time make it particularly useful in that respect.

We have talked about the idea a great deal. We have explored the limitations or the shackles which the business community feels now exist on their ability to remain competitive. But we stop short of, as you put it, targeting super computers as something which the Federal Government has a direct role in assuring for American companies in the future.

Now, Dr. Keyworth, the President's Science Adviser, has a lot of ideas about the restoration of areas that we are presently weak in, and about the maintenance of areas that we are particularly strong in; for example, education.

Mr. FLORIO. Not only the tenor of your comments, but other things that have been brought to my attention lead me to really question why everyone from the administration is not up here banging on our door asking us to pass something like H.R. 2203, a bill that would provide you with the resources and the centralized capability to try to develop those strategies, to emphasize the appropriate actions that should be taken to protect our domestic industries.

Mr. OLMER. Every time I meet with a leading member of the private sector in a particular industry, I am struck by the fact of how ineffective a bureaucrat in Washington would be to tell that guy how to suck eggs. We don't have people clever enough to point to a senior VP or an operating manager of Control Data, or Digital Equipment, or IBM, or three dozen other American companies and say: "Here is how you ought to be successful 10 years down the road in the area of super computers." Most of the people in the Federal Government couldn't define what a super computer is or what the technical characteristics of the present day super computer are.

What we can do is evaluate on the one hand the macroeconomic conditions that make it more difficult for an American company to be competitive, and on the other hand, work with our foreign trading partners to assure the opportunity for our suppliers to compete in their marketplaces.

We have some serious problems, for example, with the Japanese in the area of super computers in their desire to build a super computer capability. It is my perception—they deny it and criticize me for criticizing them—they haven't been willing to buy American super computers pending the availability of a Japanese design, and I don't think that is appropriate. I think that is something we have to work at to get them to back off of. I have some evidence that they will.

Coming back to retaliatory legislation, I don't think it would help if I said, "If you don't do that, I am going to do this," because I am not sure what the "this" is and whether the "this" wouldn't be more harmful in the long run.

Mr. FLORIO. What if the "this" were automobile domestic content?

Mr. OLMER. I think domestic content to date has certainly encouraged the Japanese to be more introspective, and that that has not been entirely harmful to our efforts to open their market. I know that the Prime Minister has gone way beyond just defense policy in the ways in which he is taking steps to make Japan's market more reciprocal, more in balance with the opportunities Japanese suppliers have had for many years in this country. He has that political commitment. It is in the process of being implemented.

At one level, laws have been passed. The next level has to be their implementation and the experience of U.S. business is going to be the proof of that pudding, but progress has been made, and it has been made not as a result of the domestic content legislation debate. That has been a factor, but more the Prime Minister's own recognition of the desirability of doing it, the desirability of having a multilateral trading system and the possibility of achieving that without essentially equitable treatment on both sides and that Japan hasn't been in the past as open and that he is trying to change it.

We may argue over the speed at which it is being done, the depth at which it is occurring and it is up to us to point out areas in which it is not moving along swiftly enough.

I think we are making progress and I don't think it would be helped by threatening or further intimidating our trading partners either in Japan or elsewhere. Many of them will just thumb their noses at us.

Mr. FLORIO. Mr. Ritter.

Mr. RITTER. I thank the chairman. I commend the chairman for holding these hearings and for his line of questioning because I think there are a number of areas in which we agree. I voted for domestic content and frankly not so reluctantly. I really believe it strengthens the hand of the President and the Special Trade Representative in dealing with the Japanese. Not directly by any means, but it is a political contribution, it is a contribution to the overall climate in which difficult, tough negotiations are conducted.

Frankly, I think Nakasone is a fine gentleman. I think he has a magnificent understanding of how the world works, but if he doesn't have some motivation back home to encourage his business and labor and political community to move toward a fairer policy with the United States, I don't think he would be effective.

The chairman had mentioned defense. Incidentally, before going to defense, there are people in American industry that are in the export industry that decried domestic content, and yet, many of those industries, we are beginning to see some of the same problems of defining free trade and fair trade and how it works around the world, even in our newest, most competitive electronics industry, and I would say to those gentlemen and ladies that the passage of the domestic content is probably in their favor, again as a political contribution, as a contribution to the climate in which these hard and tough negotiations are taking place. I would appreciate your response to that.

Mr. OLMER. Well, I have indicated that the debate surrounding domestic content has been helpful to the process, Mr. Ritter, but it is a dangerous game, because I do believe that domestic-content legislation would be extremely detrimental to our trading interests.

Mr. RITTER. If enacted?

Mr. OLMER. If enacted, and so—you know, the debate is useful, and the debate has caused a lot of arguments to emerge that might have been submerged had not the legislation been pending. It seems to me that a number of Members of Congress and the administration have made a pretty persuasive case that domestic-content legislation is economically unsound, and that is useful. That is very helpful and I hope that it is sufficiently persuasive at the time, the 11th hour, the 12th hour, when the bill comes to a vote. But I think that it has its limits, and the limits have been reached.

I think the Japanese have that message, and I think there is a commitment on their part to take a number of different actions.

Mr. RITTER. I would like to just go into this defense question for a moment. We are engaged in a debate with the Japanese over the percent of the GNP, their GNP, that goes into defense. We all know about the political—domestic, political exigences that any Premier of Japan would face. But I have got to wonder, not only just over the last 10 years, but over the next 10 years, whether we are engaging in a defense buildup of an existing absolute value of defense expenditures far in excess both percentagewise and total with the Japanese—we have got to wonder about the free ride that the nation of Japan is getting with regard to defense.

You know, I don't know how you can characterize it any other way. It is a free ride. They are sitting off the coast of the Soviet Union, of Communist China, they have got missiles in place in their Kuril Islands which the Soviets have never given back to them. We gave them back the whole nation and they won't even give back three islands.

Given the domestic, political exigences they face, how do we somehow equalize or have them assist us to equalize investments in domestic sectors of our economy as opposed to military? More and more I believe that they won't be able to make massive jumps in defense development because of the politics, but then more and more I believe that they owe us one, maybe two, maybe three. They owe us a bunch of domestic technology investments of domestic investments in the United States of America, investments in modernization of the automobile industry, perhaps, investments in various other sectors of the U.S. domestic economy, but while we are subsidizing their long-range protection and providing them with the finest defense umbrella that American tax dollars can buy throughout their Southeast Asia, and East Asia, and North Asia coprosperity sphere, they owe us a lot.

I am just wondering how this kind of longer range, perhaps somewhat academic view, how this fits in with new directions in international trade and development for this country vis-a-vis the world's most activist economy?

Mr. OLMER. Well, it fits, I think, quite directly. We have been working very hard to create opportunities for direct American development in Japan. Progress has been quite slow, but there are examples of American companies being allowed to invest in Japan

in high technology in particular in the last several months. It is a slow process, sir, and——

Mr. RITTER. What are some examples of this?

Mr. OLMER. A semiconductor manufacturing company from New Jersey was given about 1 month ago—it is called Electronic Materials, Inc., and it makes machines to make semiconductors. It was given a loan from the Japanese Development Bank and it was given the same kinds of preferential tax treatment that would be given to an investor in the United States and the man is delighted. It took him about 2 years to negotiate, but that is not terribly unusual. Clearly it was enhanced by the debate surrounding a lot of different things in terms of trade.

Most major American semiconductor manufacturers themselves have various kinds of plants in Japan. Texas Instruments, IBM, Motorola, Intel, National Semiconductor, some of them have designers, others have production facilities. It isn't a two-way street yet, but the traffic is picking up on the road to Japan and it is being helped by the debate which, I think the comprehensive debate, about United States-Japanese relations. I clearly am not the one to talk to about specific strategic policy, but I would like to say just one word in that respect.

Mr. RITTER. If I may interject, I think that it is absolutely essential that the people who are talking about specific strategic policy and defense policy and defense development are communicated with people like yourself, they are talking about other kinds of domestic advancements.

Mr. OLMER. I do keep up, but I want to refrain from commenting with the appearance of authority in an area outside my responsibiity. But the one sentence that I leave you with is that the American interests are served by the maintenance of a strong Pacific defense force. We are not doing it only for the Japanese. We are doing it for our own interests. And how much those interests are worth and how much we expect the Japanese to contribute is a matter for some debate.

I clearly agree——

Mr. RITTER. I will flat out say that from the American Pacific defense force, the Japanese have more to gain than we do. We have an enormous amount to gain, but they probably have more because of their proximity and their almost total integration into those markets.

Mr. OLMER. That is the point at which I would like to bow out of the debate.

Mr. RITTER. But this new trade initiative and this new trade department takes into account the imbalance in investments in defense, and somehow, without trying to force 1.5 percent down the throats of the Japanese, which we feel is domestically very difficult for them, we try and balance the ledger in some other area of investments, and Japanese investments in the United States of America—how are they progressing? Are they progressing with this debate?

Mr. OLMER. One observation I would make that you touched upon, Mr. Ritter, and that is in Asia, the fastest growing economies in the world are the newly industrializing nations particularly in Southeast Asia, and the competition from Japanese companies,

both heavy construction as well as high technology is awesome. The competitiveness of American companies—it has been a while since I have been in the lower half of Southeast Asia, about a year and a half ago, but we have some very effective foreign commercial officers in that area who do report on, if you will, the imbalance in efforts being put forth by the Japanese relative to their American counterparts, and there are certain places in that part of the world where American suppliers are rarely seen.

My concern is that the Japanese will reach a position of market dominance that would be extremely difficult, maybe impossible, for an American supplier to overcome, as, for example, in systems which get put in place for 20 years, in which there is a resupply, and maintenance, and a contract that goes along with it, as a telephone system or something of that sort. Countries do not replace them every few years, and we are seeing that happen. And we have just got—our companies have to do a better job over there than they have been doing and we have got to do a better job at figuring out how to deal with some of that very tough competition.

Mr. RITTER. Their thrust is toward market shares as opposed to our thrust toward the balance sheet at the end of the year. It is a very difficult problem.

Mr. OLMER. Yes.

Mr. RITTER. I thank the chairman.

Mr. FLORIO. Let me ask one or two more questions. I understand today a group called the Trade Reform Action Coalition, which is a labor and industry coalition, is announcing a package of proposals to reform the U.S. trade remedy laws, including changes in 301, the question of causation, time limits, and changes in the definitions of unfair practices. Are you familiar with some of the changes that they are advocating?

Mr. OLMER. It was just delivered to me this morning and I have not had a chance to read it.

Mr. FLORIO. We would like your views when you do get a chance.

Mr. OLMER. Absolutely. [See p. 675.]

Mr. FLORIO. One of the points that is also incorporated into the modifications of the 201 tests elimination of recession depression as a factor. I wonder if you have given any thought to the desirability of import injury aside from economic conditions, that is to say, that there can be absolute levels of import injury that flow regardless of the macroeconomics of the time. Have you got any thoughts or observations on that?

Mr. OLMER. Strictly my own views, I would like that. I think that is preferable. I happen to be an advocate of a stronger application of the threat of injury rather than the demonstration of past injury. I know that the provision is in the law which authorizes the ITC to make a finding on the basis of threat of injury, but it is rarely used, and I think that that may be so because of definitional problems. Perhaps more needs to be done to develop an articulate case in writing as to what we mean by threat of injury, what conditions would give rise to a finding of threat of injury, because it could clearly be abused. But I think that is an area that we could work on profitably. Again, that is my own view.

Mr. FLORIO. You know the domestic content bill that passed out of the committee yesterday effectively had the impact of legislative-

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ly stating that there is import injury that has taken place if the bill is signed into law by legislative fiat. My interpretation of that is that that would authorize the President, in a sense almost direct the President, to come forward with a package of remedies because the Congress has as a matter of law found that import injury has occurred, therefore automatically triggering 201 remedies, and perhaps the proponents of domestic content might not be as happy as they could be because the President has the ability to fashion a more flexible set of remedies in lieu of the strict terms of domestic content legislation, and inasmuch as the finding is operative upon passage of the law, the President would be able to immediately formulate that package, whereas the recommendation of the Department of Commerce has been that it will take 72 months to go through the whole regulatory process to get domestic content.

So those who are apprehensive about the rigidity of domestic content legislation, that the passage of the bill if it should pass, would not provide for the automatic application of domestic content, it would provide, if my interpretation is correct, for the President to be able to have more flexibility and also to mandate that he come forward with a package of practices that could deal with some of the problems of the domestic automobile industry.

Mr. OLMER. We go back to the basic purpose of unfair trade remedy. It has to be tied to imports abroad—from abroad. And the International Trade Commission is constituted as a bipartisan effort, undertaking, an independent agency constituted for not the sole and exclusive purpose, but one of their dominant reasons for existence is to make determinations of injury on the basis of imports. If you don't have that basic finding either as it is presently defined or worth exploring as to whether or not it is possible narratively to describe a threat of injury criteria sufficient to increase its use—but they have made a judgment that there are other factors that have caused more injury to the domestic automobile industry than imports, and it isn't just the cyclical conditions of the economy.

It has to do with having insufficient numbers of small cars, inadequate quality of automobiles, and enormous price differential between domestic automobiles and the available foreign alternative. And if we want—I mean as a government—to bail out an industry, that is one thing, and that has been done. I don't know that this administration would entertain it. I doubt that very much. At least that is one sort of set of problems.

If you want to do something to repair injury because of imports, then you have to find somebody to make a judgment that the injury has been caused principally by those imports, and that hasn't been done yet.

Mr. FLORIO. I would just try to expand the scope of the discussion beyond the narrowest interpretation of the injury flowing from imports by saying that policies that may be pursued overseas are contributing to the attractiveness or the marketability of the imports, and we talked about the voluntary trade restraints, and I am sure that you are aware of the fact that even though they have been on market share, it has increased. During the period when they have been on it, price differential has worked to expand to the benefit of the Japanese, and the argument has been made, and I think with

validity, that the dollar-yen factor contributes to one-third of the price differential.

Preferential tax policies that the Japanese pursue work to their benefit in our market for their products, and that the arguments are made that domestic content is not going to address either one of those two problems, so that if we want to make the automobile market more competitive, we have to start focusing on the real problems that are impacting adversely on our competitiveness. Therefore, I and others argue that we have to provide—this is an argument I suppose for centralization and the restructuring mode that you are talking about—for someone to have some degree of control, to eliminate the interagency consulting that results in bland, nonrecommendations coming out and then for someone to have the control, and I am not talking about picking winners and losers, but for someone to have a degree of control to make coherent the various parts of our trade policy that impact on trade, have someone with some degree of planning capability so as to make our trade policy a trade policy as opposed to just segments of a trade policy that don't act.

Again, I get back to H.R. 2203 and say that I think that legislation provides for the process to start doing some of those things, and would hope that the administration would start looking a little more favorably on that type of approach.

Mr. OLMER. With respect to the automobile industry, I think it is a fact that the Japanese kept foreign automobiles from entering the Japanese market very effectively in the formative years of their own industry's development. That was the time to get tough and to say, "We demand access for our automobiles." And that probably would have meant a great deal to Detroit, both in the development of an automobile suited for the Japanese market, and it would have anticipated the energy crisis in this country and therefore models would have been available of sufficient quality at a competitive price.

Mr. FLORIO. Let me interrupt—except everything you say, and I think you are correct, doesn't that dictate that we do that now with regard to super computers—

Mr. OLMER. We are doing it. We are doing it without the kind of leverage that is proposed in the bill. We are doing it and we are having some degree of success. Now, where our industry doesn't feel we are making sufficient progress, let them file a case. I mean, I have worked with a number of these high-technology industries for several years, and I know that a great deal of the argument that they make is enough to get everybody worked up, to get a sort of a stiffen your spine when you got over to Japan. Well, it has had that effect, and I think they are achieving more success with the present authorities that are available to us than is often given credit.

Mr. FLORIO. Do you—this will be my last question—do you regard the practices that have been associated with targeting by the Japanese as practices that constitute unfair practices? If someone files a complaint and they allege all the specific components of targeting, there is no statutory definition of what is unfair. Who makes the distinction of what legitimate industrial policy is and some are now saying, well, we have been trying to induce our trading partners to

follow our philosophy of free markets, open markets. That doesn't appear to be working so maybe we ought to start pursuing their policy of being of assistance to our Nation, cutting off access to our markets and our formative industries, maybe our automobile industry is now the equivalent of a fledgling industry for a new era, and perhaps we should protect our new automobile industry until it gets on its feet, so to speak.

Mr. RITTER. If the gentleman would yield, precisely as the Japanese did as their automobile industry went from fledgling to forceful.

Mr. FLORIO. My real question is the question of targeting. Is that regarded as an unfair practice sufficient to sustain a 301 complaint if it were to be filed on that ground?

Mr. OLMER. Mr. Chairman, that is a heck of a question to make your last question, because that goes to the heart of—I would say less a debate than an issue—that is being explored in depth both on our side and jointly with the Japanese. Clearly there are a lot of practices that are intended on the targeting concept. There are a lot of things that get done that could be called a targeted effort of a government. I would like to say that our high-technology industry is now superior to anyone's anywhere on this Earth, and it got that way not because the U.S. Government targeted it. It got that way because, A, the free market system existed, B, there was a large market in this country, and not finally, because I am sure there are a lot of other reasons for it, we happen to have the best innovative minds in the world.

Mr. FLORIO. That is all very true——

Mr. RITTER. Wait a minute.

Mr. FLORIO. That is very true. We have emphasis on small business in this country as a matter of economic policy. That is the innovative component of our economy, and what we have been doing is getting the benefits of that innovative component of our economy only to see those innovations taken somewhere else, sheltered, then used to put our basic economy out of operation. And unless we make some modifications, we are just going to keep seeing that same thing happen again and again.

I emphasize the need to make some policy decisions on targeting because there are two alternatives. If we maintain and come to a conclusion that targeting as practiced by the Japanese, as an example, is an unfair practice and there are remedies taken and corrections are made, that is fine. Then we are on a so-called even field. On the other hand, if that is not going to be the result and no one is going to conclude that it is inappropriate, it seems to me that dictates a policy on our part to start formulating the ability to do the same thing.

Either someone changes their policies to comply with our thoughts or we change our policies to comply with their thoughts, but one or the other has to result.

Mr. OLMER. There is a third. That is that the targeting policies are really of little consequence in terms of their effect on the competitiveness of the targeted industry sectors. I don't happen to subscribe to this notion, but it is a conceivable third alternative that no matter that the Japanese do, we will continue to have a preeminent computer industry ad infinitum. I don't happen to share that

view. It doesn't make a difference what they do, and what we do we ought to continue doing.

Mr. FLORIO. Won't history dictate to the contrary?

Mr. OLMER. I happen to agree, yes.

Mr. FLORIO. Mr. Ritter.

Mr. RITTER. I thank the chairman. The gentleman has mentioned that the high-tech industry has flourished in this country for a variety of reasons. He went through A, B, and C. I would say that D, which is a vast market created by the Federal Government in defense and aerospace, provided for really the initial markets for the development of many of these technologies. I was at MIT in the sixties, in the early to midsixties, and I was part of a small company and we were all watching things happen out on Route 128, which is their high-tech belt. The vast majority of money out there was coming from the Federal Government, and the Palo Alto area, and Stanford, the area in and around the University of Chicago, the vast majority of initial markets for these high-tech products in electronics and aerospace were National Government, Federal dollars, taxpayers' dollars, and that can be viewed as a form of targeting.

Now, the difference as I see it today is that we are continuing—getting back to my original argument—we are continuing to make these kinds of investments, again in defense and NASA and aerospace-oriented, defense aerospace-oriented areas, and they are making them in domestic consumer-oriented high-tech industries and products, and that is the difference in targeting. We are putting vast resources into development of new technology from taxpayers' dollars, but we are putting them into a defense orientation and they are benefiting from the defense umbrella and at the same time, they are putting them in the consumer market sales product orientation and benefiting from the increasing market share in consumer products. And that, I submit, is an unsolved problem that we have got to grapple with.

Mr. OLMER. Part of the reason for that, Mr. Ritter, is that the world has turned in the last 10 years. The Defense Department is no longer responsible for spawning the leading edge of technology. It is the private sector. And it may be consumer pull as much as it is export push.

Mr. RITTER. Again, our targeted investments are still going into defense while the market areas of the truly vital and vibrant ones, the consumer market and domestic market areas, their investments are going into the consumer and domestic market areas.

Mr. OLMER. One of the things that I think is anomaly, although I don't propose that we stop the practice, we do have open access to our technology in this country and there are foreign scientists who are free and encouraged to work at the National Institutes of Health in which many, many breakthrough inventions are being patented in the area of biotechnology and genetic engineering; 1 in 100 inventions is ever commercialized, perhaps even less than that. What has happened is a number of, principally the Japanese are able to come in and as a scientist described it for me, not in my words, cherry pick, pick and choose from the inventions which have been developed, many of them because of U.S. Federal money, and then commercialize a product which then gets exported, where-

as we do that relatively infrequently in this country—infrequently. And that, I think—and we are working on that.

That is another area of our efforts, but what we are trying to do is to stimulate ways of expediting the flow of new technology from the laboratory to commercialization, and we are trying to provide incentives for the inventors and for contractors who are willing to take the risks, and there are very high risks, in that process, and not leave it to foreign manufacturers who have a long-range vision and maybe a more benign in terms of its attitude toward these high-risk ventures and turn it to their benefit. But perhaps that is the subject of another hearing.

Mr. FLORIO. Mr. Secretary, we appreciate your presence. I look forward to your testimony here. It is always very helpful to us.

Thank you very much.

Mr. OLMER. Thank you, sir.

Mr. FLORIO. The committee will stand in recess for approximately 10 minutes while we vote on the rule for the appropriations for the transportaiton bill. When we return we will hear from Mr. Gingrich.

[Brief recess.]

[The following information was received for the record:]

COMMENTS ON THE RECOMMENDATIONS OF THE
TRADE ACTION REFORM COALITION FOR
REFORMS OF U.S. TRADE LAWS

The proposals of the Trade Reform Action Coalition (TRAC) for changes in the antidumping (AD) and countervailing duty (CVD) laws are numerous and wide-ranging.

The objectives TRAC identifies are unassailable; make the laws: (1) less complex, (2) less expensive, (3) less arbitrary, (4) more expeditious, (5) more fair, and (6) more effective.

We have been conducting our internal review of ways the policies and procedures of the antidumping and countervailing duty laws could be changed to achieve these objectives. In many instances, the TRAC proposals address problem areas which we were already reviewing, although TRAC's proposals differ from those we have been discussing. Among the areas of common concern is the need to ensure that the costs of antidumping and countervailing duty proceedings do not become an obstacle to these laws, especially for small businesses. We think that general efforts to simplify procedures and standards under both laws can reduce the costs associated with these laws and may be more effective than various proposals for direct assistance which have been circulated. We also think that simplification of antidumping and countervailing duty methodology can be accomplished without sacrificing the integrity of the process. The annual review procedures are burdensome and impose those burdens year after year.

Other areas at which we are looking include:

(1) The process for releasing information under administrative protective orders (we think much can be accomplished by regulatory, rather than statutory, change);

(2) The rules on what groups have standing to pursue action under the laws;

(3) The method of making adjustments in AD cases (the TRAC proposal enhances our ability to computerize); and,

(4) The opportunities for judicial review.

We are still analyzing the other specific TRAC proposals regarding their contribution to the efficiency, equity and predictability of these statutes. We will also be looking at the consistency of alternatives with our international obligations under the General Agreement on Tariffs and Trade. We were a leading advocate for the negotiation of both the International Antidumping Code and the Countervailing Duty Code and intend to abide by those rules in the administration of these laws.

Mr. FLORIO. The subcommittee will come to order.

We are pleased to have Mr. Claud Gingrich, the General Counsel for the Office of the U.S. Trade Representative. Welcome to the committee. We appreciate your testimony.

Your statement will be made a part of the record in its entirety. You may feel free to proceed as you see fit.

STATEMENT OF CLAUD L. GINGRICH, GENERAL COUNSEL, OFFICE OF THE U.S. TRADE REPRESENTATIVE

Mr. GINGRICH. Thank you, Mr. Chairman. In view of the time and in view of the fact that my testimony is repetitive of Mr. Olmer's, I will submit it and be prepared to answer any questions you may have.

[Testimony resumes on p. 688.]

[The prepared statement of Claud L. Gingrich follows:]

STATEMENT OF
CLAUD L. GINGRICH
GENERAL COUNSEL
OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE

MR. CHAIRMAN, I AM CLAUD GINGRICH, GENERAL COUNSEL TO THE UNITED STATES TRADE REPRESENTATIVE. I AM PLEASED TO HAVE THE OPPORTUNITY TO CONTINUE THE DIALOGUE YOU BEGAN WITH AMBASSADOR BROCK IN APRIL ON TRADE BY TESTIFING ON THE CONCEPT OF RECIPROCITY IN TRADE.

RECIPROCITY IS THE CORNERSTONE OF THE INTERNATIONAL TRADING SYSTEM WHICH THE UNITED STATES HAS HELPED MOLD. SINCE THE RECIPROCAL TRADE AGREEMENTS ACT OF 1934, THE UNITED STATES HAS BEEN AT THE FOREFRONT OF EVERY MAJOR MULTILATERAL TRADE NEGOTIATIONS AIMED AT OBTAINING THE MUTUAL LIBERALIZATION OF TRADING PRACTICES AND POLICIES. THE HEART OF THESE NEGOTIATIONS, INCLUDING THE KENNEDY ROUND IN THE 1960S AND THE TOKYO ROUND CONCLUDED IN 1979, HAS BEEN THE RECIPROCAL LIBERALIZATION OF TRADE.

WHILE THERE HAVE ALWAYS BEEN AND ALWAYS WILL BE PRESSURES FOR SHORT TERM SOLUTIONS TO ECONOMIC PROBLEMS, WE ARE FIRMLY RESOLVED TO CONTINUE MORE VIGOROUSLY THAN EVER BEFORE OUR EFFORTS TO ENSURE A FREER WORLD TRADING SYSTEM. WE WILL NOT CHANGE COURSE NOW.

"AS PRESIDENT REAGAN ANNOUNCED IN THE JOINT STATEMENT AT THE CONCLUSION OF THE WILLIAMSBURG SUMMIT:

> WE COMMIT OURSELVES TO HALT PROTECTIONISM, AND AS RECOVERY PROCEEDS TO REVERSE IT BY DISMANTLING TRADE BARRIERS. WE INTEND TO CONSULT WITHIN APPROPRIATE EXISTING FORA ON WAYS TO IMPLEMENT AND MONITOR THIS COMMITMENT. WE SHALL GIVE IMPETUS TO RESOLVING CURRENT TRADE PROBLEMS. WE WILL ACTIVELY PURSUE THE CURRENT WORK PROGRAMS IN THE GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) AND ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT INCLUDING TRADE IN SERVICES AND IN HIGH-TECHNOLOGY PRODUCTS.

THAT STATEMENT IS CONSISTENT WITH THE GOAL AND INTENT OF MANY LEGISLATIVE PROPOSALS. THAT IS, TO MAKE CERTAIN THAT TRADE IS A TWO-WAY STREET. FAIR AND EQUITABLE MARKET OPPORTUNITIES FOR U.S. EXPORTERS, INVESTORS, AND SERVICE INDUSTRIES HAS BEEN AND WILL CONTINUE TO BE A GOAL OF THIS ADMINISTRATION. THIS CONGRESS AND THIS ADMINISTRATION ARE BOTH EXAMINING WAYS TO BETTER ACHIEVE THIS GOAL, AND AMBASSADOR BROCK AND I WILL WORK WITH THIS SUBCOMMITTEE IN THAT ENDEAVOR.

WE MUST CONTINUE TO DO THIS WITHIN THE CONTEXT OF OUR OVERALL POLICY AND OUR INTERNATIONAL OBLIGATIONS. THIS DOES NOT MEAN THAT THE TRADING SYSTEM IS PERFECT, OR THAT WE SHOULD NEVER QUESTION OR SEEK TO IMPROVE ANY PROVISIONS

OF OUR INTERNATIONAL OBLIGATIONS. HOWEVER, WE MUST AVOID A DISTORTED USE OF RECIPROCITY THAT COULD UNDERMINE AN ALREADY VULNERABLE MULTILATERAL TRADING SYSTEM, TRIGGER RETALIATION ABROAD, AND FURTHER DEPRIVE THE UNITED STATES OF EXPORT OPPORTUNITIES AND ERODE, IF NOT ELIMINATE, OUR ROLE AS THE WORLD LEADER IN LIBERALIZING INTERNATIONAL TRADE.

ADHERENCE TO A FREE TRADE POLICY REQUIRES US TO ENFORCE STRICTLY EXISTING TRADE AGREEMENTS AND DOMESTIC LAW IMPLEMENTING THOSE AGREEMENTS, AND TO SEEK EXPANDED COVERAGE OF TRADE ISSUES UNDER THE MUTUALLY ACCEPTED INTERNATIONAL FRAMEWORK OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE (THE GATT).

WE MUST NOT LOSE SIGHT OF THE FACT THAT THE UNITED STATES AND ITS TRADING PARTNERS WORK WITHIN THE FRAMEWORK OF OUR INTERNATIONAL OBLIGATIONS. THE REASON THE GATT CAME INTO BEING LAY IN THE DESIRE TO ELIMINATE THE DESTRUCTIVE RETALIATORY TRADE PRACTICES OF THE TWO DECADES PRECEDING WORLD WAR II. IT HAS WORKED TO OBTAIN THE EXPANSION OF WORLD TRADE OVER THE PAST THIRTY-FIVE YEARS. THE INTERNATIONAL

PROCESS FOR DEALING WITH NEW FORMS OF BARRIERS TO TRADE DISTORTIONS IS SOMETIMES FRUSTRATINGLY SLOW, BUT THAT IS NO JUSTIFICATION FOR THE UNITED STATES TO ABANDON ITS COMMITMENT TO FREE TRADE. QUITE THE CONTRARY, IT IS CLEARLY OUR BEST REASON FOR RENEWING OUR EFFORTS TO STRENGTHEN THE INTERNATIONAL RULES OF THE ROAD AND MAKE THEM WORK.

IT IS FROM THIS VANTAGE POINT THAT WE MUST VIEW THE MANY PIECES OF TRADE LEGISLATION THAT HAVE BEEN INTRODUCED IN THIS CONGRESS. IN PREVIOUS ADMINISTRATION TESTIMONY ON TRADE RECIPROCITY, FOUR PRINCIPLES WERE STATED THAT MUST GUIDE OUR APPROACH TO ANY NEW LEGISLATION.

FIRST IT MUST BE ABSOLUTELY CONSISTENT WITH OUR CURRENT OBLIGATIONS UNDER THE GATT AND OTHER INTERNATIONAL AGREEMENTS.

SECOND, IT MUST ADDRESS MULTILATERAL RATHER THAN BILATERAL OR SECTORAL SOLUTIONS.

THIRD, IT MUST FOCUS ON STRENGTHENING INTERNATIONAL INSTITUTIONS AND EXPANDING INTERNATIONAL AGREEMENTS TO INCLUDE THOSE AREAS SUCH AS SERVICES, INVESTMENT, AND HIGH TECHNOLOGY THAT ARE NOT PRESENTLY COVERED.

FOURTH, IT MUST STRENGTHEN THE NEGOTIATING MANDATE AND FLEXIBILITY OF THE PRESIDENT IN HIS EFFORT TO ACHIEVE A MORE LIBERALIZED WORLD TRADING SYSTEM AND A REDUCTION OF BARRIERS AFFECTING U.S. WORKERS AND ENTERPRISES.

THE U.S. TRADE REPRESENTATIVE HAS VIGOROUSLY PURSUED THIS COURSE OF ACTION. SINCE 1975, USTR HAS INITIATED 42 SECTION 301 INVESTIGATIONS FOR UNFAIR TRADE PRACTICES. IT IS INTERESTING TO NOTE THAT IN THE FIRST SIX YEARS OF ADMINISTERING THIS STATUTE USTR INITIATED 21 INVESTIGATIONS. SINCE OCTOBER, 1981, USTR HAS INITIATED AN ADDITIONAL 21 INVESTIGATIONS. THUS, 50% OF ALL INVESTIGATIONS UNDER SECTION 301 WERE INITIATED WITHIN THE LAST 21 MONTHS.

IN ADDITION, WE HAVE ASSISTED MANY SMALLER INDUSTRIES BY PROVIDING TECHNICAL ASSISTANCE ON DIFFERENT PROCESSES AVAILABLE FOR SEEKING RELIEF FROM UNFAIR TRADE PRACTICES OR COMPETITION. IT IS OUR INTENT TO CONTINUE THESE EFFORTS.

HOWEVER, THERE IS STILL MUCH TO BE DONE. HISTORY HAS SHOWN THAT NO NATION CAN LONG SUSTAIN PUBLIC SUPPORT FOR AN OPEN TRADING POLICY UNLESS ITS PEOPLE SENSE THAT THERE IS FAIRNESS AND EQUITY IN THE PRACTICES OF OTHER COUNNTRIES AS WELL AS THEIR OWN; AND THAT THEY SEE TANGIBLE BENEFITS FROM THE APPLICATIONS OF THAT POLICY.

THE FAILURE OF PAST EFFORTS TO TACKLE SOME OF THE MOST RESTRICTIVE PRACTICES AFFECTING WORLD TRADE, PARTICULARLY IN THE AREAS OF SERVICES, INVESTMENT AND HIGH TECHNOLOGY

GOODS IS THE CAUSE OF INCREASING FRUSTRATION FOR U.S. EXPORTERS, THE CONGRESS AND THE ADMINISTRATION. THIS FRUSTRATION UNDERMINES THE CONSENSUS WHICH SUPPORTS THE OPEN TRADING SYSTEM.

EACH OF THESE AREAS: SERVICES, HIGH TECHNOLOGY GOODS AND INVESTMENT WAS A MAJOR ITEM ON THE AGENDA AT THE GATT MINISTERIAL IN NOVEMBER 1982. WHILE WE MADE SOME ACHIEVEMENTS IN GENEVA BY BRINGING THESE PROBLEMS TO THE ATTENTION OF OUR TRADING PARTNERS, THERE WAS NOT AS MUCH PROGRESS AS THE UNITED STATES HAD ORIGINALLY HOPED.

HENCE, THE CHALLENGE BEFORE US OF PRESERVING AND STRENGTHENING THE OPEN AND FREE TRADING SYSTEM IS MORE CRITICAL THAN EVER. OUR FRUSTRATIONS WITH THE GATT PROCESS IN ITS LIMITATIONS TO DEAL WITH NEW FORMS OF BARRIERS AND TRADE DISTORTION IS CLEARLY OUR BEST REASONS FOR RENEWED ÉFFORTS TO STRENGTHEN THE INTERNATIONAL CODES OF CONDUCT AND MAKE THEM WORK.

IN THIS PERSPECTIVE, THIS ADMINISTRATION BELIEVES THAT APPROPRIATE LEGISLATION CAN BE OF GREAT ASSISTANCE IN ACHIEVING OUR INTERNATIONAL OBJECTIVES. AS YOU KNOW, THE ADMINISTRATION

STRONGLY SUPPORTS LEGISLATION INTRODUCED BY SENATOR DANFORTH, S. 144, AND PASSED BY THE SENATE, WHICH IS SIMILAR TO H.R. 1571, INTRODUCED BY CONGRESSMAN JIM JONES, THE BILL BEFORE THIS SUBCOMMITTEE TODAY.

LET ME BRIEFLY OUTLINE THE ELEMENTS WHICH PROVIDE THE BASIS FOR THE ADMINISTRATION'S SUPPORT.

TOOLS TO INCREASE MARKET OPPORTUNITIES ABROAD:

SERVICES:

IN CONTRAST TO TRADE IN GOODS, THERE ARE FEW MEANINGFUL INTERNATIONAL RULES GOVERNING SERVICES TRADE. THIS IS AN AREA IN WHICH THE UNITED STATES IS EXPERIENCING EXPANDING TRADE OPPORTUNITIES AND GROWING BARRIERS THAT INHIBIT THOSE OPPORTUNITIES. IT IS THEREFORE TIMELY FOR LEGISLATION TO ADD SPECIFIC NEGOTIATING OBJECTIVES WITH RESPECT TO INTERNATIONAL TRADE IN SERVICES.

A PRINCIPLE NEGOTIATING OBJECTIVE FOR SERVICES FOR REDUCING OR ELIMINATING BARRIERS TO, OR DISTORTIONS OF, INTERNATIONAL TRADE IN SERVICES THROUGH THE DEVELOPMENT OF INTERNATIONALLY AGREED-UPON RULES WOULD BE AN IMPORTANT AND USEFUL ADDITION TO THE PRESENT NEGOTIATING AUTHORITY OF THE PRESIDENT.

INVESTMENT:

WITH RESPECT TO INVESTMENT, NEGOTIATING OBJECTIVES OF REDUCING OR ELIMINATING TRADE DISTORTING BARRIERS AND DEVELOPING INTERNATIONAL RULES, INCLUDING DISPUTE SETTLEMENT PROCEDURES, WILL HELP ENSURE THE FREE FLOW OF FOREIGN DIRECT INVESTMENT. THIS HAS THE FULL SUPPORT OF THE ADMINISTRATION.

HIGH TECHNOLOGY:

HIGH-TECHNOLOGY GOODS AND SERVICES AND TECHNICAL "KNOWHOW" ITSELF ARE ESSENTIAL TO OUR ECONOMIC DEVELOPMENT, INDUSTRIAL COMPETITIVENESS, AND NATIONAL SECURITY. AS INTERNATIONAL COMPETITION IN HIGH-TECHNOLOGY INDUSTRIES BECOMES MORE INTENSE, THERE IS EVIDENCE THAT THE COMPETITIVE POSITION OF U.S. HIGH-TECHNOLOGY INDUSTRIES IS ERODING. THERE ARE INDICATIONS THAT GOVERNMENTS ARE PROMOTING THEIR HIGH-TECHNOLOGY INDUSTRIES IN WAYS THAT CREATE STRAINS ON THE TRADING SYSTEM AND CAN RETARD THE RAPID PACE OF TECHNOLOGICAL INNOVATION.

THE ADMINISTRATION BELIEVES THAT SPECIFIC NEGOTIATING OBJECTIVES WITH RESPECT TO HIGH-TECHNOLOGY PRODUCTS AND RELATED SERVICES WILL SUPPORT OUR EFFORTS TO COUNTER INTER-

NATIONAL BARRIERS AND DISTORTIONS TO TRADE AND INVESTMENT IN THIS AREA.

PRESIDENTIAL AUTHORITY TO NEGOTIATE THE REDUCTION OF TARIFFS ON HIGH-TECHNOLOGY PRODUCTS IN EXCHANGE FOR EQUIVALENT CONCESSIONS IS ALSO SUPPORTED BY THE ADMINISTRATION.

ENFORCEMENT OF UNITED STATES RIGHTS:

CLARIFICATION OF THE SCOPE OF ACTION UNDER SECTION 301 OF THE 1974 TRADE ACT IN THE AREAS OF SERVICES AND INVESTMENT WILL ALSO BE USEFUL. WE NEED TO DEMONSTRATE TO OUR TRADING PARTNERS OUR RESOLVE TO SEEK FAIR AND EQUITABLE MARKET OPPORTUNITIES FOR U.S. INTERESTS. IT HAS ALWAYS BEEN AND WILL CONTINUE TO BE U.S. POLICY TO WELCOME MARKET ORIENTED DIRECT FOREIGN INVESTMENT TO THE UNITED STATES. IT IS ALSO U.S. POLICY TO OBTAIN FAIR OPPORTUNITIES FOR U.S. INVESTORS ABROAD TO THE GREATEST DEGREE POSSIBLE. THE MOST EFFECTIVE WAY TO DO THIS IS FOR THE U.S. GOVERNMENT TO ENFORCE ACTIVELY U.S. RIGHTS UNDER DOMESTIC AND INTERNATIONAL LAWS, AND TO DEVELOP NEW INTERNATIONAL DISCIPLINES WHERE NEEDED. WHILE THE CURRENT SECTION 301 INVESTIGATIVE AUTHORITY INCLUDES UNFAIR PRACTICES IN THE AREAS OF SERVICES AND INVESTMENT THAT BURDEN U.S. COMMERCE, WE BELIEVE THIS NEEDS TO BE MADE EXPLICIT.

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Administration Would Oppose Any Standard That Would Move us in the Direction of Requring Sectoral Reciprocity

As noted earlier, this Administration welcomes global reciprocity as an objective or principle of overall U.S. trade policy. However, to mandate reciprocity on a bilateral, sectoral or product-by-product basis would result in a counterproductive trade policy. Such a standard for unilateral action would mean that instead of judging the fairness of foreign market access according to internationally agreed standards, we would be required to judge it by the access accorded to foreigners in the U.S. market. In our view, the primary and preferable method for obtaining fair and equitable market opportunities should always be obtaining liberalization of foreign markets rather than raising equivalently restrictive barriers of our own. The appropriate reciprocity legislation will be a valuable tool to use in pursuit of that goal.

H.R. 2203

I WOULD ALSO LIKE TO ADDRESS H.R. 2203, THE COMPETITIVENESS IN INTERNATIONAL TRADE ACT OF 1983. THE ADMINISTRATION RECOGNIZES YOUR EFFORTS, MR. CHAIRMAN, TO OBTAIN FAIR ACCESS TO COMPETITIVE MARKETS, HOWEVER, WE BELIEVE OUR CAPABILITY WILL BEST BE ENHANCED BY RECIPROCITY LEGISLATION LIKE S. 144, THE DANFORTH BILL. WE HOPE TO WORK WITH YOU ON THE SPECIFICS OF THE LEGISLATION IN THE NEAR FUTURE. IN THE MEANTIME, WE ARE NOT POWERLESS TO DEAL WITH FOREIGN BARRIERS, THE ADMINISTRATION WILL CONTINUE TO VIGOROUSLY ENFORCE OUR CURRENT TRADE LAWS TO ENSURE A FREER WORLD TRADING SYSTEM.

CONCLUSION:

AS WE EXPLORE THE ISSUES RAISED BY THIS HEARING, THE UNITED STATES WILL CONTINUE ITS LEADERSHIP ROLE IN PROMOTING FREER AND FAIRER TRADE. AS THE INITIATOR OF EVERY MAJOR NEGOTIATION, THIS IS NOT AN UNUSUAL OR UNEXPECTED RESPONSIBILITY.

THE CHALLENGE BEFORE ALL OF US IS TO DEVELOP AND IMPLEMENT A U.S. POLICY AIMED AT INCREASING RECIPROCAL MARKET ACCESS WITH OUR TRADING PARTNERS WITHOUT TEARING DOWN THE PRESENT INTERNATIONAL TRADING SYSTEM, REVERSING ITS BENEFITS TO DATE, OR STARTING A SPIRAL OF PROTECTIONIST ACTIONS.

THE ADMINISTRATION LOOKS FORWARD TO WORKING WITH CONGRESS ON THIS IMPORTANT ISSUE.

Mr. FLORIO. You were here for most of the Secretary's testimony. I wonder what your thoughts were on the restructuring proposals that have been put forward by the administration. It appears that the structuring proposal will roll the Trade Representative's Office into a new and extended Department of Commerce under a different title. I assume the official position is support. Is there anything you would like to share with us with regard to apprehensions that you may have or that the Trade Representative may have as a result of this new approach to trade?

Mr. GINGRICH. Ambassador Brock was intimately involved in the process that has been going on for some time with respect to proposals to restructure the trade organization in the Government. Beyond saying that he is fully supportive of the President's proposals, at this point I think I had better not go beyond that.

Mr. FLORIO. You heard the discussion this morning about the modifications that are contained in the Jones-Frenzel bill on 301 so as to include service industries and investments as potential areas where complaints of unfair trade practices could be filed. Is that something that the Trade Representative's Office feels comfortable with?

Mr. GINGRICH. Yes, sir. Under 301 presently, any domestic petitioner can file an unfair trade practice complaint with respect to restrictions in foreign countries on any services he wants to offer. As one of your witnesses later today, Dick Rivers, would be able to tell you, he filed a complaint with respect to their inability to get into the Korean insurance industry. No. 301 is fully able to handle service complaints.

It is a little different story with foreign direct investments. The administration believes it would be wise to cover those under 301.

One of the problems with respect to services, however, has been the practitioners' problem that they were uncertain of the President's authority in that area. For instance if a Federal regulatory agency had taken an action, say on permitting the Koreans to sell insurance in this country, if the deomestic industry had been able to show and had proceeded through the process and the President had made a determination that they could not sell insurance in Korea, the question existed could the President then restrict the Koreans from selling in this market after a Federal regulatory agency had permitted them to do. The President's authority was unclear as far as they were concerned. When we worked on the reciprocity bill on the Senate side, that is one of the things we sought to clear up.

Mr. FLORIO. That is an interesting point, because one of the things that the Secretary referred to this morning was saying that yes, 301 provides for the ability to remedy an injury that an American company has sustained as a result of unfair practices, but then he ruled out retaliatory action, and I am just wondering is that your view as well, that retaliatory action would not be authorized under the 301 remedies?

Mr. GINGRICH. No, 301 is very clear. It permits the President to impose fees or restrictions on services in the United States offered by a foreign copany. One of the problems is what the specifics of that authority are.

Mr. FLORIO. So you are saying it is restricted to fees——

Mr. GINGRICH. Fees and restrictions is what it says on services.

Mr. FLORIO. Would not a fundamental restriction be the ability to operate?

Mr. GINGRICH. Absolutely.

Mr. FLORIO. I do not understand the distinction between a restriction that precludes operation and retaliation.

Mr. GINGRICH. There is full retaliatory authority is what I am saying in general, but I will give you an example. Suppose that in the Korean insurance case it had gone all the way through the process and the President decided to retaliate. One of the options might have been to stop permitting the Korean airlines to land in San Francisco. We would just withdraw that privilege. The practitioners were not sure that given the fact that the FAA, or whoever, had issued the permit to the airlines to land in San Francisco, they were not sure that the President had the authority under 301 to withdraw that privilege.

Mr. FLORIO. Because it is the FAA?

Mr. GINGRICH. Yes. They are fairly sure that with respect to future service offers that the President had the authority, but with respect to existing services in this country, it was not clear that the President could withdraw the privilege of providing those.

Mr. FLORIO. As you may know, we have services reciprocity legislation out of this committee which would make it clear that it is the President that has the authority to do that sort of thing, for a number of reasons, one of which is we think that the President has more expertise in the area of trade relations. And over and above that, because it is those agencies that have the trade expertise that would enable them to play a role in making the determination as to whether there are unfair practices which are being perpetrated upon our service industries.

The example always brought to our attention is the ICC and trucking with regard to Mexico, because Mexico prohibits American truckers from going into Mexico; the ICC on a regular basis issues permits for Mexican truckers to come into this country. I understood the Secretary—maybe I did not fully understand—I understood him to say that reciprocity was not something that was desirable with regard to 301, and implicitly in that I thought he was indicating that there was not the ability to exercise reciprocal actions as a remedy under 301. You seem to be saying that it is fairly clear that there is and that the problem may be just the mechanics of it in the service industries, whether it be the States in insurance or whether it be appropriate agencies not having the ability or the authority to yank a foreign nation's service industry's ability to function here.

Mr. GINGRICH. Without attempting to interpret the Secretary's words, there is a difference between the administration position on reciprocity and the retaliatory authority in 301. I think what the Secretary was saying is that the authority to retaliate exists in 301. What the administration does not want to do is exercise that authority or have to exercise that authority every time there is a lack of reciprocal market access, that is product by product reciprocity or sector by sector. We do not want to have a mandate that every time you find trade conditions in a particular product or sector in

any way different with respect to one of our trading partners that you have to retaliate.

Mr. FLORIO. Thirty-seven complaints they have never used it so it is not a matter of being forced to use it in every situation. Where the complaints have been filed no action has been undertaken under 301.

Mr. GINGRICH. On its face that is correct. I think we are up to 42 complaints under 301; 20 of them are in consultation. I will be glad to supply more specifics for the record.

With respect to 15 of the remaining 22 complaints, they have been terminated as a result of bilateral agreements with the particular party in question, or in one case a GATT panel finding, and in another case the President actually did send to the Hill in the broadcasting case, a bill to provide retaliation against the Canadian border broadcasting practice. We have not had cases go all the way through in lockstep fashion and result in visible retaliation, but we feel we have been fairly successful with the use of 301.

Mr. FLORIO. Mr. Ritter.

Mr. RITTER. I will pass, Mr. Chairman.

Mr. FLORIO. Mr. Gingrich, we thank you very much for your presentation.

Mr. GINGRICH. Thank you, sir.

[The following information was submitted for the record:]

STATUS REPORT:
Section 301 Petitions

The following Section 301 petitions have been before USTR during 1983:

Subject	Status
EC export subsidies on WHEAT FLOUR (301-6)	A 3-member Subsidies Code panel issued its conclusions on February 24. The panel report was considered by the Code Committee on April 22 and May 19 and will be taken up again on June 10.
EC tariff preferences on CITRUS (301-11)	GATT Article XXIII:1 consultations were held in Geneva on April 20. We requested a panel at GATT Council meetings on June 29 and July 21. However, since there was disagreement about the propriety of our request, we agreed to attempt conciliation of the case. Conciliation efforts failed. On November 2 the GATT Council agreed to establish a panel. Efforts to establish terms of reference and the composition of the panel have been delayed. The panel is not expected to meet before June.
EC export subsidies on SUGAR (301-22)	We completed the Subsidies Code conciliation phase April 30. On June 28, the President directed USTR to continue international efforts to eliminate or reduce EEC sugar export subsidies, including, if appropriate, resort to dispute settlement under the Subsidies Code.
EC and Brazil export subsidies on POULTRY (301-23)	We held formal Subsidies Code consultations with the EC on February 16. On July 12, the President directed us to examine Brazilian subsidies as well. We held informal con-

	sultations with Brazil on August 30 and March 1, and formal consultations under Code Article 12 were held April 1st. We held further consultations with EC during week of October 4, 1982. We intend to request conciliation in May.
EC export subsidies on PASTA (301-25)	This case is currently before a Subsidies Code panel, which held its first meeting on July 12. On July 21 the President directed USTR to expeditiously complete dispute settlement. A second panel meeting was held October 8. At the EC's request, an additional panel meeting was held March 29. The panel's conclusions were issued April 19 and distributed to the Code Committee May 19. The Committee will discuss the report on June 9.
EC production subsidies on CANNED FRUIT AND RAISINS (301-26)	We held GATT XXIII:1 consultations in Geneva on February 25, 1982 and requested a panel on March 31. The EC requested additional consultations, which were held on April 29. On August 17 the President directed USTR to complete dispute settlement. A GATT Panel met on September 29 and October 29. Due to the illness of one Panel member, the panel report was delayed. We received the factual part of the report on April 19.
Austria, France, Italy, Sweden the UK and Belgium production subsidies on SPECIALTY STEEL (301-27 to 301-31 and 301-33)	On November 16 the President directed USTR to request an ITC investigation under Section 201, to initiate multilateral and/or bilateral consultations, and to monitor U.S. specialty steel imports. On March 24, the ITC found injury on all

	products, and on April 27 issued its report. Meanwhile, bilateral consultations have continued.
Canadian duty remission scheme for FRONT END WHEEL LOADERS (301-34)	Petition was filed July 27, 1982. Petition was amended and refiled on September 13. USTR initiated an investigation on October 28. Public hearing held December 14. Consultations under GATT Article XXII were held December 21.
Brazil, Japan, Korea and Taiwan import restrictions on FOOTWEAR (301-35 to 301-38)	Petition was filed October 25, 1982. USTR initiated investigation on December 8. Consultations were held January 17 with Taiwan, January 27 with Japan, and February 5 with Korea. Consultations with Brazil were held on April 4.
Japan's commitment to restrain exports to the EC of CARBON AND ALLOY STEEL	Petition was filed December 16, 1982. On January 31, 1983, petition was temporarily withdrawn and was refiled on February 23. On February 25 the petition was rejected by USTR without prejudice.
Korea's exports of STEEL WIRE ROPE	Petition was filed March 16, 1983. USTR decided on May 2 to initiate an investigation with respect to 2 of the five allegations in the petition. Public hearing scheduled June 2.
Argentina, Brazil, Canada Malaysia, Portugal & Spain subsidies and restrictions affecting SOYBEANS AND OTHER OILSEEDS	Petition was filed April 6, 1983. On May 23 USTR initiated an investigation. Article XXII consultations requested with Portugal and Spain; Subsidies Code consultations requested with Brazil. Public hearing scheduled June 30.

A summary of each of these petitions is attached.
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SUMMARY:
1983 Section 301 Petitions

Wheat Flour Investigation (EC)

The Millers' National Federation filed a Section 301 complaint against the EC in December, 1975. The complaint alleged that the EC violated its international obligations under GATT Article XVI:3 by using export subsidies to gain more than an equitable share of world trade in wheat flour.

After numerous consultations with the EC, USTR decided to pursue this case under the Subsidies Code in September, 1981. Consultations with the EC were held on October 28, 1981 and the conciliation phase of dispute settlement was completed on December 15, 1981. The case was referred to a three-member panel of the Subsidies Code Committee, which issued its conclusions on February 24, 1983. The panel report was considered by the full Subsidies Code Committee on April 22 and ~~will be taken up again on~~ May 19, and will be taken up again on June 10.

Citrus Investigation (EC)

In 1975, citrus interests in Florida, California, Arizona and Texas filed a petition with USTR alleging that preferential import duties established by the EC for imports of citrus fruit and juices from certain Mediterranean countries have an adverse effect upon United States citrus producers.

During the Tokyo Round of the MTN, representatives of the United States sought reductions in the EC duties on citrus products. The EC agreed to reduce the duty on fresh grapefruit from four to three percent ad valorem but no reductions on other itmes were forthcoming. Following the MTN negotiations, further bilateral discussions were held, and formal consultations under GATT Article XXIII:1 were held in October 1980. In March 1982, the U.S. requested consultations with the EC under Article XXIII:1 of the GATT. They were held on April 20. The U.S. requested a GATT panel at the GATT Council meetings on June 29 and July 21, 1982. However, there was disagreement in the Council about the propriety of the request. The U.S. agreed to attempt conciliation, using the good offices of the GATT Secretariat, but conciliation efforts failed. The GATT Council agreed on November 2, 1982 to establish a panel. We ahve experienced some probelms in establishing mutually acceptable terms of reference and panel membership. The panel is not expected to meet before June.

Sugar Investigation (EC)

A Section 301 petition complaining of EC export subsidies on sugar was accepted for investigation by USTR on October 5, 1981. The petition alleges that EC exports of subsidized sugar are inconsistent with the Subsidies Code. The petition states that the subsidies: (a) cause serious prejudice to U.S. interests, (b) undercut the price at which U.S. sugar is exported, (c) enable the EC sugar industry to obtain more than an equitable share of world export trade, and (d) depress the price of sugar on world markets and consequently, the price in the U.S. domestic market.

A public hearing was held on November 4, 1981 at which interested parties presented their views on the allegations in the petition. Consultations with the EC under the Subsidies Code were held on February 16, 1982, in Geneva. The case was referred to the Subsidies Code Committee for conciliation, and conciliation meetings were concluded April 30, 1982.

On June 28, 1982 the President, upon the recommendation of USTR and the TPC, decided that the appropriate action was to direct the USTR to continue international efforts to eliminate or reduce EEC sugar export subsidies, including, if appropriate, resort to the dispute settlement procedures of the Subsidies Code.

Poultry Investigation (EC and Brazil)

On October 28, 1981, USTR decided to initiate an investigation of EC export subsidies on poultry. This action was taken in response to a petition filed by the National Broiler Council and others alleging that the poultry subsidies programs of the EC and France adversely affect U.S. commercial interests. Consultations with the EC under the Subsidies Code were held on February 16, and October 7, 1982, in Geneva, and USTR is seeking information on export subsidies from Brazil as well. Informal consultations with Brazil concerning its export subsidies on poultry were held in August 1982 and March 1, 1983. Formal consultations with Brazil under the Subsidies Code were held April 1, 1983. The U.S. intends to request conciliation under the Code in May, 1983.

The Broiler Council petition makes two basic allegations: (a) the EC export subsidies on whole chickens violate Article 10 of the Subsidies Code in that the EC, through such subsidies, has obtained more than an equitable share of world trade in whole chickens and has displaced U.S. chicken exports to specific markets, including the Middle East and the Caribbean; and (b) EC export subsidies threaten serious prejudice to U.S. poultry producers in violation of Article 8 of the Subsidies Code, since the effect of the EC system is to cause uncertainty in the world market and threaten displacement of U.S. exports of poultry and

poultry parts to third country markets.

A recommendation to the President regarding the poultry petition was made on June 28, 1982. On July 12, the President directed expeditious examination of Brazilian subsidies on poultry as well as EC subsidies.

Pasta Investigation (EC)

On October 16, 1981, a petition was filed by the National Pasta Association alleging that the subsidies program of the EC adversely affects U.S. commercial interests and violates the GATT and Subsidies Code. USTR initiated an investigation on November 30, 1981, and requested consultations with the EC under the Subsidies Code. However, the EC refused to consult and on March 3, 1982, the U.S. referred the matter to the Code Committee for conciliation. When conciliation failed, the U.S. requested a panel on April 7. The panel met on July 12 and October 8, 1982, and issued the factual portion of its report in January 1983. The EC requested an additional panel meeting which was held on March 29, 1983. The panel's conclusions were issued April 19, and ~~will be~~ distributed to the Code Committee ~~in mid~~-May 19. The full Committee will meet on June 9 to discuss the panel report.

The Pasta Association petition alleges that EC export subsidies on pasta products violate Article 9 of the Subsidies Code in that such subsidies on non-primary products are absolutely prohibited. Although the Article 9 allegations are dispositive of the case, the petition also alleges that EC export subsidies threaten serious prejudice to the U.S. pasta manufacturers contrary to Article 8 of the Subsidies Code, by displacing U.S. manufacturers in their home markets.

A recommendation to the President regarding the pasta petition was made on June 30, 1982. On July 21, the President directed USTR to expeditiously complete dispute settlement.

Canned Fruit and Raisins Investigation (EC)

On September 11, 1981, a petition was filed by the California Cling Peach Advisory Board and others alleging that the EC production subsidies program adversely affects U.S. commercial interests and violates the GATT. On October 22, 1981, that petition was withdrawn for revision and was refiled on October 29. On December 10, 1981, USTR decided to initiate an investigation on the allegations in the petition.

The petition alleges that EC production subsidies on canned peaches, canned pears and raisins have resulted in displacement on U.S. exports of those products to the EC, and have impaired EC tariff bindings on those products.

A public hearing on this petition was held on January 6, 1982, and consultations with the EC, under Article XXIII:1 of the GATT, were held on February 25, 1982 in Geneva. On March 31, 1982, the U.S. requested a GATT panel under Article XXIII:2. The EC requested additional consultations on raisins, which were held on April 29. The panel met on September 29 and on October 29, 1982, and issued the factual portion of its report on April 18, 1983.

On August 17, 1982, the President directed USTR to proceed expeditiously with dispute settlement.

Specialty Steel Investigations (Austria, France, Italy, U.K., Sweden and Belgium)

On December 2, 1981, the members of the Tool and Stainless Steel Industry Committee and the United Steelworkers of America filed a petition under Section 301 alleging that domestic subsidies for the specialty steel industries of seven foreign countries (Austria, Belgium, France, Italy, Sweden, U.K., and Brazil) violate GATT and Subsidies Code obligations, and cause adverse effects to U.S. industry. On January 12, 1982, the petitioners submitted a substantial amount of additional information which constituted a new amended petition. On February 26, 1982 USTR initiated an investigation and requested informal consultations with five countries. These consultations began during the week of March 15, 1982. A public hearing was held on April 14, 1982, on all five cases. Formal consultations under the Subsidies Code were held with Sweden during the week of October 11 with Austria during the week of October 18, and with the EC during week of October 25, 1982.

The countries which were the subject of that investigation were: France, Italy the U.K., Austria, and Sweden. (The complaints regarding Belgium and Brazil were rejected.) The products are: stainless steel sheet and strip, stainless steel plate, stainless steel bar, stainless steel wire rod, and alloy tool steel.

On June 23, 1982, the Tool and Stainless Steel Industry Committee and United Steelworkers of America filed a new petition alleging that production subsidies on specialty steel in Belgium violate the Subsidies Code and cause adverse effects to U.S. industry. USTR initiated an investigation of that petition on August 9, 1982. Formal consultations under the Subsidies Code were held during the week of October 25, 1982.

A recommendation to the President was made in all six cases on October 26. On November 16, 1982, the President directed USTR to (1) request the ITC to conduct an expedited investigation under Section 201 of the 1974 Trade Act; (2) initiate multilateral and/or bilateral discussions aimed at eliminating all trade

distortive practices in the specialty steel sector; and (3) monitor U.S. imports of specialty steel products subject to the Section 201 investigation. Further bilateral consultations were held in January, 1983.

On March 24, 1983, the ITC determined that U.S. imports of all the products listed above are a substantial cause of serious injury to the domestic industry. On April 27, 1983, the ITC issued its recommendations for relief.

Wheel Loader Investigation (Canada)

On July 27, 1982, the J.I. Case Company, a U.S. manufacturer of construction and agricultural equipment, filed a petition alleging that Canada's regulations allowing the remission of customs duty and sales tax on certain front-end wheel loaders and their parts imported into Canada violate the GATT and the Subsidies Code and constitute an unreasonable and discriminatory practice which burdens and restricts U.S. commerce.

The petition was amended and re-filed on September 13. On October 28 USTR initiated an investigation under section 301. A public hearing was held on December 14, 1982. Consultations with Canada under Article XXII of the GATT were held December 21, 1982.

Footwear Investigations (Brazil, Japan, Korea, Taiwan)

On October 25, 1982, the Footwear Industries of America, Inc., and others, filed a petition alleging that tariff and nontariff barriers on footwear in numerous countries have resulted in the diversion of footwear exports to the U.S., and therefore seriously injure the U.S. nonrubber footwear industry. The petition claims violation of various GATT provisions, and alleges that the foreign practices are unjustifiable and unreasonable. The foreign countries named in the petition are the EC (and France, the UK and Italy), Spain, Brazil, Korea, Taiwan, and Japan.

On December 8, 1982, USTR initiated investigations with respect to restrictive practices in Brazil, Japan, Korea and Taiwan, and declined to investigate the allegations of trade diversion and the practices of the other countries named in the petition. Consultations with Taiwan were held January 17, 1983 in Washington, and consultations under GATT Article XXII were held in Geneva with Japan on January 27 and with Korea on February 5. Consultations with Brazil were held April 4, 1983.

Carbon and Alloy Steel Petition (Japan)

On December 16, 1982, the American Iron and Steel Institute and others filed a petition alleging that the commitment of the

Japanese government to restrict steel exports to the European Communities is inconsistent with the MFN provisions of the GATT and the U.S.-Japan Treaty of Friendship, Commerce and Navigation; and that Japan's action is unjustifiable, unreasonable, discriminatory, and burdens and restricts U.S. commerce. The petition claims that the Japanese commitment to the EC has resulted in diversion of its exports to the U.S.

On January 31, 1983 the petition was withdrawn to afford USTR an opportunity to reach an acceptable agreement with the Government of Japan resolving the issues raised in the petition. The petitioners indicated, however, that the petition would be refiled on February 23, 1983 if USTR was unable to reach an agreement satisfactory to the petitioners. The petition was refiled on February 23 and rejected by USTR, without prejudice, on February 25.

Steel Wire Rope Petition (Korea)

On March 16, 1983, the Committee of Domestic Steel Wire Rope and Specialty Cable Manufacturers filed a petition alleging that certain practices of the Republic of Korea Government with respect to exports of steel wire rope are actionable under Section 301 because they are unjustifiable and discriminatory, violate U.S. trade agreements, burden and restrict U.S. commerce, and have caused material injury to the U.S. industry. The factual allegations are that Korean steel wire rope producers/exporters receive substantial direct subsidies both from the Korean Government and from the Pohang Iron and Steel Company, a company owned by the government; that Korean wire rope is improperly marked, impairing U.S. producers' rights in trademarks; and that the implementation of trade restraint agreements between the Governments of Korea and Japan divert Korean wire rope exports to the U.S. market.

USTR decided on May 2, 1983 to initiate a Section 301 investigation with respect to the allegations relating to the grant of direct and indirect production subsidies. A public hearing is scheduled for June 2.

Soybean Petition (~~Argentina~~, Brazil, ~~Canada~~, ~~Malaysia~~, Portugal, Spain)

On April 6, 1983, the National Soybean Processors Association filed a petition complaining of several trade practices in six countries which the petitioner alleges are inconsistent with the GATT or are otherwise unreasonable restrictions on U.S. commerce. The countries ~~involved~~ influence to remain are Argentina, Brazil, Canada, Malaysia, Portugal and Spain. The products covered are soybeans, soybean oil, soybean meal, palm oil, olive oil, sunflower seeds, oil and meal, rapeseed and rapeseed oil and meal. Among the practices complained of are export subsidies, production subsidies, and quantitative restrictions.

~~USTR must decide by~~ On May 23, 1983 ~~whether to~~ initiate a Section 301 investigation with respect to the allegations concerning Brazil, Portugal and Spain; and rejected the allegations regarding Argentina, Malaysia and Canada. Consultations were requested with Brazil under the Subsidies Code and with Portugal and Spain under GATT Article XXII. A public hearing is scheduled for June 30.

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Mr. FLORIO. We now please call as our last witnesses a panel of very distinguished witnesses from the private sector, Mr. James Asher, of the Harris Corp., representing the Semiconductor Industry Association; Mr. Robert McNeill, the executive vice president of the Emergency Committee for American Trade; and Mr. Harry Freeman, senior vice president of corporate affairs and communications with American Express, representing the Coalition of Service Industries.

Gentleman, welcome to the committee. I would ask that Mr. Asher proceed.

STATEMENTS OF JAMES ASHER, ON BEHALF OF SEMICONDUCTOR INDUSTRY ASSOCIATION, ACCOMPANIED BY ALAN WOLFF, COUNSEL; ROBERT McNEILL, EXECUTIVE VICE CHAIRMAN, EMERGENCY COMMITTEE FOR AMERICAN TRADE; AND HARRY FREEMAN, ON BEHALF OF COALITION OF SERVICE INDUSTRIES, INC.

Mr. ASHER. Mr. Chairman, I am James Asher, vice president of group marketing and administration, Harris semiconductor sector, Harris Corp. I am testifying today on behalf of the Semiconductor Industry Association [SIA]. I have served for some time as an adviser from the private sector to U.S. Government negotiators on high-technology trade issues. I would like to report to you on the background and progress of recent negotiations with Japan from the perspective of the U.S. semiconductor industry. With me is Alan Wolff, counsel to the Semiconductor Industry Association. He has served as Deputy Special Trade Representative and General Counsel to the Office of the U.S. Trade Representative, and is prepared to answer any detailed questions that you might have concerning reform of the trade laws.

The U.S. semiconductor industry currently faces very serious trade problems with Japan, which are described in an SIA study we have submitted to your subcommittee, "The Effect of Government Targeting on World Semiconductor Competition." The Japanese have for decades protected their domestic semiconductor market against U.S. imports and investment—and as a result, we currently have a share of Japanese sales that is under 10 percent and declining, as compared with roughly 56 percent of the world market. The Japanese Government has targeted its semiconductor industry for promotion, and has taken a wide variety of measures, described in the study, to enhance the competitive strength of its industry. Japanese semiconductor firms have received subsidies, low-interest government loans, antitrust immunity, and extensive government R&D assistance. This aid has lowered Japanese firms' costs, increased the speed at which they can develop and commercialize new products, and substantially reduced the risk of large-scale investments in production facilities.

Since the late 1970's the Japanese have built up large semiconductor production capacity and launched an export drive that has had a serious adverse effect on the U.S. semiconductor industry. In 1981 and 1982, U.S. firms lost an estimated $144 million on two semiconductor products, the 16K and 64K random access memories [RAM's], which are highly advanced computer memories. A

number of U.S. firms are pulling out of the product areas that the Japanese have chosen to dominate, notably computer memories. In fact, while six Japanese companies are ready to enter the market for the next generation RAM, the 256K RAM, only one U.S. company, Western Electric, is ready to enter the market—and Mr. Chairman, I might add that Western Electric's production base is in your home State of New Jersey, which has one of the highest growth rates in the production of high-technology products of any State in the United States. I wish Western Electric well, but the Japanese policies put even an American company of this size and strength at a disadvantage. I might add further that the targeting practices employed by the Japanese now are rapidly being emulated by other nations eager to duplicate Japanese success.

SIA was formed in large part as a response to this challenge, which we regard as inherently unfair, fundamentally unreasonable, and in violation of the letter and spirit of Japan's trade commitments. We have sought to draw the attention of the U.S. Government to our growing trade problems with Japan. In recent years the U.S. Government, aware of the growing importance of semiconductors to the Nation's economy, employment, and defense, has begun to seek solutions to the challenge posed by Japanese targeting. Beginning several years ago, the U.S. Government entered into a series of discussions with Japan which resulted in the establishment, in early 1982, of a bilateral working group on high-technology trade issues. The activities of this working group are important—in fact, this group is now the basic point of contact between the United States and Japan on the semiconductor trade problem. If United States-Japan friction in this industry is to be resolved amicably, it will probably be within the framework of this working group. If the group is successful, it may form a model for responding to and resolving trade problems generated by other nations' foreign industrial targeting practices. On the other hand, if a solution cannot be found within the framework of this group, it will be a clear indication that the U.S. Government must act firmly, decisively—and unilaterally—to prevent further erosion of one of its key industries.

Because of the importance of this working group, I would like to discuss its background, its objectives, and its achievements to date. I would also like to outline SIA's objectives and our concerns in those areas where we feel more progress is needed. Finally, I would like to discuss how legislation pending before your subcommittee relates to the working group process.

BACKGROUND OF THE UNITED STATES-JAPAN HIGH-TECHNOLOGY WORKING GROUP

In January 1982, with trade friction in the high-technology industries increasing, Japan's Minister of International Trade and Industry Abe proposed a high-technology forum to be held between the United States and Japan. In April the Department of Commerce and the Office of the U.S. Trade Representative reached agreement with MITI to establish a United States-Japan work group on high technology industries (HTWG).

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A series of meetings were held between representatives of Commerce/USTR and MITI during the summer and fall of 1982 to discuss bilateral high-technology trade problems of immediate concern to the two countries, and to develop a second-stage work program which would lay the foundation for resolution of underlying sources of friction in the high-technology sector. A private sector advisory group, consisting of representatives of U.S. semiconductor firms—including myself—has been working closely with the U.S. delegation.

OBJECTIVES

The United States had three basic objectives when it undertook these negotiations. First, the United States sought increased United States participation in the Japanese market in high-technology goods and services. Second, the United States sought national treatment with respect to access by United States firms to Japanese Government programs benefiting Japanese firms—in effect, if they were going to target this industry, we wanted to share in the benefits. Third, the United States sought to establish a lasting framework for fair competitive practices on the part of all competitors—U.S., Japanese, and others—in all world markets.

We faced a number of problems in working toward those objectives. First, no adequate system existed for evaluating semiconductor trade developments. Thus, United States-Japanese discussions frequently bogged down in fruitless argument over whose trade statistics reflected the true competitive situation. Second, our knowledge of exactly what the Japanese Government was doing to promote its industry was incomplete—and in fact the Japanese tended to downplay the significance of these programs. Third, we had no agreed means of establishing the existence of unfair trade practices, such as predatory pricing. Differences in accounting methods and firm cost structures afforded little basis for evaluating dumping or predatory pricing claims.

More fundamentally, we, meaning SIA, were concerned that the Japanese did not take use seriously. Several years ago they described our complaints about unfair Japanese trade practices as merely the "howling of dogs from afar." Semiconductor trade problems had been raised periodically in past negotiations. The result had generally been concessions by Japan that were largely devoid of substance. Our share of the Japanese market did not increase despite various liberalization measures; meanwhile, the U.S. Government moved on to other measures.

Therefore, we hoped that several things would emerge from the HTWG process. First, we wanted to establish a commonly agreed base of current information about this industry—we needed up-to-date data on trade flows, accounting methods, and government programs. This would not only enable us to monitor trends closely, but to respond quickly to problems—such as a predatory export drive—on the basis of a set of agreed facts.

Second, we hoped to resolve existing trade problems. We wanted to remove barriers to our own sales in Japan. We wanted equal access to Japanese promotional programs. We wanted to establish a

trade regime as free as possible from government interference in the marketplace.

Finally, and most fundamentally, we wanted to establish a permanent bilateral structure with Japan for evaluating and addressing high-technology issues and problems on an ongoing basis. We wanted more than an annual meeting of government officials dealing with a long list of issues at which both sides met, argued, and returned home promising to study the problem some more. It was our hope that the HTWG was the first step toward establishing a more permanent, more effective bilateral structure.

THE HIGH-TECHNOLOGY AGREEMENT

In late 1982, the HTWG adopted a series of joint recommendations to the two governments, which consisted of a set of agreed common principles—open access to R&D programs, elimination of trade barriers, and so on—and an outline of a work program designed to move toward the realization of these principles. The United States and Japanese Governments each unilaterally adopted the HTWG recommendations—in effect, endorsing them and committing themselves to the implementation of the recommendations, which, although they do not represent a formal bilateral agreement, have come to be called the high-tech agreement.

The agreement was an important initial achievement, and we were extremely pleased with the work done by the U.S. negotiating team as well as the U.S. Embassy in Tokyo, in securing what we view as a series of key commitments from the Japanese. We see the agreement as important to us for several reasons.

First, the agreement sets forth a number of important common principles endorsed by both sides. For example, it recognizes that governments must safeguard the rules of the marketplace to prevent anticompetitive or predatory practices. It recognizes that programs of each nation which provide particular advantages to the enterprises of that nation should also be open, on a fully equal basis, to the firms of the other nation—and this includes government-sponsored R&D programs. It endorses the concept that each nation's access to the market of the other nation should be substantially equivalent.

Of course, such principles do not mean much to an industry unless concrete actions are taken to back them up. That is why the work program provided for in the agreement was so important.

The agreement provides for the establishment of a joint data collection system which, when implemented, is intended to enable both sides to monitor semiconductor trade flows. The firms of each side will report semiconductor bookings and billings on a monthly basis to a data-collection body which will compile the data and make it available to United States and Japanese firms. If this system works properly, it will enable us to identify to problem areas quickly. It will give both sides a common set of data with which to gauge their performance in the United States and Japanese markets. It should be a procompetitive device, improving the working of a free market. From our perspective, it will enable us to see whether the Japanese are actually acting on their commitment to open markets.

In addition, the agreement provides for a comparative study of United States and Japanese accounting methods. This study, when completed, will make subsequent United States-Japanese discussions concerning possible instances of sales below cost, as we understand that term, as well as the impact of promotional measures on pricing, more meaningful.

From our perspective, an important additional provision was that the Government of Japan would develop possible concrete measures to promote imports of manufactured goods in high technology. We are still waiting to see what these measures will be. We hope that these measures will reflect the spirit of the agreement and will be more than mere cosmetic measures, and that they will produce a more open market environment for our products in Japan.

The agreement also commits both governments to the development of various channels for the exchange of technical and R&D data. Provision is made for open access by the firms of each nation to the joint R&D programs of the other nation. Patent and licensing procedures are to be clarified, government intervention in the licensing of privately held technology is to be minimized, and government-held technologies are to be licensed on an equal basis to the firms of the other nation. From our standpoint these provisions are important, since we feel that while United States technology has been reasonably accessible to Japan, our own access to Japanese technology has been sharply limited.

SECTORAL ANALYSIS

One of the most important work programs provided for in the agreement is for a joint, sector-by-sector study of the high-technology industries by the HTWG, beginning with semiconductors. This is not merely an academic exercise—the purpose of the sectoral studies is to identify and resolve sources of trade friction and to promote industrial cooperation between the United States and Japan. Each sectoral study will lead to a series of recommendations for resolving the problems identified by the study. We see the sectoral analysis as the vehicle by which we can document our problems with Japan, and establish a program for resolving those problems with concrete measures.

The sectoral analysis of the semiconductor sector is now underway. SIA submitted extensive materials to the U.S. delegation to the HTWG documenting what we feel are the main sources of trade friction in semiconductors. We show that the Japanese have protected their home market over a period of several decades. We provide substantial evidence that the Japanese Government has channeled substantial aid—financial assistance, R&D aid, antitrust protection—to its semiconductor industry. Finally, we show that this aid has enabled Japanese firms to launch an export drive, characterized by high volume and very low pricing, which has injured U.S. firms and which is causing disinvestment by U.S. firms in certain product areas, notably computer memories.

We have also submitted to the U.S. delegation our recommendations as to how these problems should be resolved. Contrary to the charge frequently raised by the Japanese, we do not ask for protec-

tive measures. Our primary concern, in fact, is opening up the Japanese market. For the benefit of your subcommittee, I will spell out our recommendations to the HTWG verbatim since they summarize SIA's basic trade objectives.

1. ACCESS TO THE JAPANESE MARKET

The Japanese Government should propose and implement a comprehensive action program to promote sales of U.S. semiconductors in Japan, for example, through formal action of the Japanese Fair Trade Commission, MITI administrative guidance, special financial incentives for imports, et cetera.

The success of this program should be measured in terms of whether U.S. semiconductor product bookings and shipments to Japan expressed in yen grow at a rate greater than the growth of Japanese semiconductor consumption, with initial results evident during 1983.

The Japanese Government should commit itself to support this program on a continuing basis through administrative guidance.

The U.S. Government should inform the Japanese Government that it considers progress in terms of sales of a broad range of U.S. products in the Japanese marketplace as a question of utmost seriousness, and that absence of substantial progress by the end of the calendar year would, in its view, be cause for a review of the matter under the General Agreement on Tariffs and Trade.

2. ONGOING MONITORING

Every effort should be made to perfect the monitoring system and assure its smooth operation in order to make the following actions effective, with as full a complement of U.S. participants as possible and providing estimates where data is not available.

Both governments should agree to review in the HTWG at least quarterly progress toward solutions of semiconductor trade and investment problems and toward realization of the objectives set forth in the HTWG agreement with respect to semiconductors.

Meetings at the subcabinet level should be held at least annually, to assure that political-level attention and support is obtained for progress on these issues. The U.S. Government should designate staff with permanent and ongoing responsibility: First, for monitoring semiconductor trade patterns, and second, for fully exploiting the opportunities opened up for the United States by the high-technology agreement, including the acquisition of information. The U.S. Government should seek a commitment from the Japanese Government to meet regularly at the staff level to address issues of current concern to the semiconductor industries of both countries.

Both governments should continue to encourage participation of industry advisers in this process.

The U.S. Government should inform the Japanese Government that it will independently monitor semiconductor trade trends on an ongoing basis, utilizing the joint data collection system and such other sources of information as are available. The U.S. Government should make it clear that if, based on this monitoring and the joint accounting analysis, the U.S. Government perceives the existence of predatory, unreasonable, or unfair practices, it will immediately

respond, after seeking appropriate remedial steps by the Japanese Government, by invoking U.S. trade remedies, or be seeking relief under the GATT.

It should be clear from these recommendations that we hope to see two things emerge from the HTWG process. First, we want the Japanese to open their market. They have committed themselves to the principle of open markets and to the development of an affirmative program to promote imports. That is a good beginning. Now, we want to see some concrete results—soon. Second, we want the U.S. Government to remain actively involved in this issue on a continuing basis. Too often, foreign governments have taken the attitude toward the United States that all they need do is stall on a particular trade issue—the U.S. Government has a short attention span, and if the foreign government waits long enough, the United States will lose interest and move on to some other issue. In semiconductors, we have made initial progress to date as a result of the HTWG's efforts—and we want to insure that this momentum is not lost. The HTWG agreement needs to be translated into concrete results in the marketplace. The way to do this is to make it clear to the Japanese that the U.S. Government will not lose interest in the trade problems in the semiconductor sector—and that any attempt to avoid solutions at this point simply will not work.

PROGRESS TO DATE

While the high-tech agreement was an important initial step, it remains to be seen whether it can be made an effective instrument for resolving the trade problems faced by our industry. The agreement itself is highly promising, but it can only be meaningful if the Japanese are seriously committed to implementing it. Unfortunately, to date we have seen signs that the Japanese do not yet take at least some of the agreement's provisions seriously.

For example, the agreement provides that the Japanese Government will develop affirmative measures for promoting imports into Japan. We have heard nothing so far from the Japanese on this point. The joint data collection system has not yet been implemented—we are now 3 months behind the schedule provided for in the agreement. In part this has been due to Japanese refusal to agree to a level of specificity in the data reporting which would make the data collection system effective. At the same time, our own statistics show that Japanese semiconductor exports to the United States are increasing rapidly—and that our own participation in the Japanese market, never large, is now declining further. The Japan Economic Journal reported last week that in the first quarter of 1983, U.S. imports to Japan grew by 10 percent over the prior year—meaning a net decline in market share—while Japanese exports to the United States increased by 70 percent. These developments lead us to fear that the Japanese may view the HTWG as little more than a forum from which to lecture us on how we misunderstand the Japanese economic system.

In short, we feel that we still have a long way to go. The U.S. Government has not yet indicated whether it will adopt SIA's sectoral analysis recommendations. It is not clear what recommendations the Japanese will propose, or whether any meaningful meas-

ures will be taken as a result of the sectoral analysis. We do feel, however, that our ultimate progress directly depends on the degree to which the Japanese feel the U.S. Government is serious in its intent to resolve the basic trade problems which confront this industry.

THE ROLE OF NEW LEGISLATION

You currently have pending before your subcommittee several bills which would substantially strengthen the ability of the U.S. Government to address the kinds of problems which I have discussed today. These include the Reciprocal Trade and Investment Act of 1983, H.R. 1571, introduced by Representative Jones, and the Competitiveness in International Trade Act of 1983, H.R. 2203, introduced by Representative Florio. I would like to explain briefly why this legislation is important.

To begin with, the problems which the high-technology industries face today are not going to be eliminated overnight. The Jones bill gives the U.S. Government a permanent negotiating mandate to seek the elimination of barriers to U.S. investment and exports in the high-technology sectors, and the amelioration of the market-distorting effects of foreign industrial policies on U.S. high-technology firms, section 5. In effect, this section provides a statutory foundation for an ongoing U.S. Government involvement in high-technology trade problems. There is an inevitable tendency for negotiating efforts to lose focus over time in the absence of such an underlying statutory mandate. However, if this bill were to become law, we feel we would be much less likely to face the problem of the U.S. Government blowing hot and cold on particular high-technology problems. The Government could more readily justify the sustained commitment of time and resources needed to keep the pressure on the Japanese in this critical trade area. Such a mandate would also help convince Japan we are serious about establishing and maintaining conditions of fair competition for our high-technology industries.

Second, both the Jones and Florio bills provide for the gathering of needed data on foreign industrial practices and their effects on U.S. industries. The Jones bill directs the executive to report to Congress analyzing factors which significantly affect the competitiveness of U.S. high-technology industries, section 3. This section provides the basis for continuing congressional oversight of high-technology trade problems—enabling the Congress to insure that the negotiating mandate contained in section 5 is actually being carried out. In the context of our relations with Japan, for example, this provision would help Congress monitor Japanese adherence to the commitments made in the "high-tech agreement." This oversight provision will keep the Congress informed, on a continuing basis, and may identify areas where new legislation is needed.

Similarly, the Florio bill provides for a comprehensive program to be undertaken by the Department of Commerce, redesignated the Department of Domestic and Foreign Commerce, to strengthen the competitiveness of U.S. firms in the face of foreign industrial promotional programs. Under this legislation the Secretary would undertake a thorough country-by-country survey of foreign promo-

tional programs and an evaluation of the effect of these programs on the competitiveness of U.S. industries. The Secretary would receive substantial information-gathering power, including subpena power, to conduct these studies. We frankly question why the bill has this emphasis on subpena power. On the basis of these studies, the Secretary will recommend comprehensive strategies, including the enactment of new legislation, for enhancing the competitiveness of U.S. firms. If this legislation were enacted, information gathered—and problems identified—through the HTWG process could be addressed in the context of a comprehensive U.S. strategy to offset the effects of unreasonable foreign promotional practices.

Third, this legislation strengthens the statutory tools available to the executive branch for taking direct action against unreasonable foreign practices, in the event that negotiations do not produce concrete results. The U.S. Trade Representative would be authorized to self-initiate a section 301 investigation, and to delay consultations with a foreign government up to 90 days. The President is directed to take into account the impact of any action taken under section 301 on the national economy, including employment, inflation, industry rationalization, and consumer costs. While we believe that the sources of trade friction between the United States and Japan can be resolved within the framework of the high-tech agreement, it is important that the U.S. Government demonstrate its willingness to act to protect the interests of its industries in the event that such a resolution of differences cannot in fact be achieved. This new legislation offers an opportunity to send a signal that the United States will be prepared to act unilaterally where necessary and appropriate to restore conditions of fair competition.

Finally, the Florio bill provides a series of measures designed to enhance the competitiveness of U.S. industries. These initiatives include measures to improve training and education needed to maintain or expand competitiveness, measures to promote regulatory reform, and the establishment of an Office for the Study of Productivity. In addition, provision would be made to ensure the appropriate emphasis on market forces to enhance U.S. competitiveness—but at the same time, the antitrust laws would be clarified to expedite clearance of joint R&D projects which promote U.S. competitiveness. These measures are welcome, and we feel would be beneficial to the semiconductor industry and other technology industries.

CONCLUSION

The U.S. semiconductor industry has shown in the past that given conditions of fair and open competition, it can outinnovate and outcompete all of its foreign rivals, including the Japanese. The Japanese Government's large-scale intervention in the marketplace on behalf of its industry threatens to alter the competitive balance. We are asking the U.S. Government, in effect, to negotiate with Japan a means of dealing with these interferences in the marketplace, and to persuade the Japanese to open their domestic market. We will do the rest—we have no doubt about our ability to go head to head with the Japanese in the marketplace, and to come out on top.

The high-tech agreement, and the High-Technology Working Group, offer the U.S. Government a structure through which it can in fact respond effectively to the Japanese Government's promotional initiatives and to Japanese protectionism. H.R. 1571 and H.R. 2203 provide a basis for further strengthening that structure, and to ensure that the opportunity which now exists to begin to establish conditions of fair competition in this industry is not lost.

Thank you.

Mr. FLORIO. Thank you very much.

Mr. FLORIO. Mr. McNeill.

STATEMENT OF ROBERT L. McNEILL

Mr. MCNEILL. Thank you, Mr. Chairman. Good morning. I have a very brief statement. I shall not read it in light of the lateness of the morning, but rather just talk for a minute or two.

I am here on behalf of the organization that employs me, the Emergency Committee for American Trade. We are an organization of the chief executive officers of 63 large American companies with very substantial overseas business interests. While I do not have 1982 data, in 1981 our members collectively had worldwide sales of $700 billion and employed 5 million workers. We thus have a deep and abiding interest in the functioning of the international economic system, and have particular interest in H.R. 1571, which I am here to testify in support of.

We find the 301 provisions of the Jones bill of great interest to us because we are very concerned that foreign direct investment is an area that is not adequately covered by any existing international agreements, and our investments abroad therefore do not have the protection afforded them as the GATT affords protection to the goods and merchandise that our members trade internationally. We have been very concerned for example with the FIRA regulations in Canada whereby in order to invest in Canada you must have government approval. The Canadians can freely invest in our country subject to Federal and State restrictions. There is nothing really that the President can do with respect to that Canadian investment restriction. We have a 301 case pending before the GATT on it. I do not know how that will come out.

Our President is relatively powerless in trying to negotiate an international investment agreement because he does not have authority. By granting to the President the retaliatory authorities—to use that word that you were questioning Mr. Gingrich and Mr. Olmer about—to have that authority would put the President in a position where he could use the 301 as a stick, if nothing else, to try to get our trading partners to come to the table and negotiate with us acceptable bilateral and international rules on investment.

Second, we welcome the bill's requirement that there be a compilation of data as to foreign restrictive practices on the part of our trading partners. We think the annual report to Congress required in that bill would be useful. It would provide an incentive to our Government to try to negotiate liberalization of foreign restrictive barriers against our trade and our investment. We also welcome the part of the bill that makes it more clear how 301 would pertain to international services.

We do not have a position on your bill H.R. 2203. I am concerned about that part of your bill which would grant to the President what I deem to be an unlimited ability to restrict foreign trade in disregard of all our other international trade statutes. I find that a potential problem.

Thank you, sir.

[The prepared statement of Robert L. McNeill follows:]

TESTIMONY OF ROBERT L. McNEILL, EXECUTIVE VICE CHAIRMAN, EMERGENCY COMMITTEE FOR AMERICAN TRADE, BEFORE THE SUBCOMMITTEE ON COMMERCE, TRANSPORTATION, AND TOURISM OF THE HOUSE COMMITTEE ON ENERGY AND COMMERCE HEARING ON H.R.1571,THE RECIPROCAL TRADE AND INVESTMENT ACT OF 1983, AND H.R.2203,THE COMPETITIVENESS IN INTERNATIONAL TRADE ACT OF 1983
Wednesday, June 22, 1983

Thank you for the opportunity to appear before you today to express the support of the Emergency Committee for American Trade (ECAT) for H.R.1571, a bill to expand merchandise and services trade as well as investment opportunities. I am Robert L. McNeill, Executive Vice Chairman of ECAT, which is an organization of the heads of 63 large U.S. firms with extensive international business interests. In 1981, ECAT firms had worldwide sales of close to $700 billion and over five million employees.

Not as academic theorists but rather as practical businessmen, the members of ECAT firmly believe in expanding international trade and investment because they see in such expansion benefits for the United States and the world economy as well as for their own firms. For this reason, ECAT has strongly supported efforts of our government seeking more open markets. ECAT also has encouraged businessmen overseas to support policies that ensure fair treatment of U.S. goods in foreign markets and to oppose restrictions on U.S. foreign direct investments. These have been the objectives of ECAT from the beginning and they remain ECAT's objectives today.

Increasingly, ECAT members see that the world trading system is not working satisfactorily. Despite the success of

the Tokyo Round of multilateral trade negotiations, barriers to trade appear to be proliferating. Some of these barriers are clearly illegal under internationally agreed upon trading rules and can be dealt with under existing domestic law and rules of the world trading system. It is important that the Administration identify such illegal practices and vigorously seek their elimination through the processes of consultation, conciliation, and, where necessary, resort to the dispute settlement procedures of GATT. Nothing less will sustain confidence in this country that the existing system of reciprocal rights and obligations serves our interests.

ECAT members do not wish to see the trade pendulum swing toward bilateralism and protectionism. They do want to see increasing openness in foreign markets and increasing acceptance of the most-favored-nation principle. Among other things, ECAT members would like to see negotiations on the abundance of nontariff trade barriers in the investment and services sectors; on the imbalance between the benefits received from and the support provided to the international trading system by Japan and by many of the newly industrializing countries; and on the growing reliance on subsidization of agricultural and other products by many of our trading partners. In dealing with these trade and investment problems we must take into account our overall national interests, ranging from national security to maintenance of the health of the international economic system.

ECAT recognizes that current rules and enforcement proced-

ures are either inadequate or nonexistent for trade in agriculture, services, and foreign direct investment. In these areas, we must provide our government with authority to negotiate appropriate bilateral and multilateral agreements.

The private sector and the government have available to them a wide range of international trade statutes designed to provide relief from both fair and unfair foreign trade practices. Many of these laws appear to be underutilized. The reasons for this are many and varied. Among them are the economic costs involved in processing trade complaints with the administering agencies; limited government resources; conflicts between domestic and foreign policy objectives; and the failure to anticipate problems in time for the ameliorating statutes to be of help.

While impressed with the variety and scope of U.S. international trade statutes, we nevertheless believe that there are gaps in domestic trade law, particularly in the areas of foreign direct investment and international trade in services. Accordingly, ECAT is supportive of the provisions of H.R.1571 since they appropriately address these gaps.

Foreign investments are of vital importance to the U.S. economy and to U.S. firms. The development of appropriate international rules on foreign direct investment, therefore, is of prime importance. Hopefully such rules can be worked out in the GATT, the OECD, and in other international bodies.

At present, the President has very little negotiating authority that can be utilized in furtherance of U.S. inter-

national investment interests. We, therefore, particularly welcome those provisions of H.R.1571 establishing negotiating objectives for international investment. The extension of Section 301-304 authorities to foreign investments should help the President in defending U.S. investments against unjustifiable foreign restrictions by authorizing him to retaliate against such restrictions. The existence of this authority would grant the President a significant negotiating instrument that should help him in seeking international investment rules in the GATT and elsewhere, as well as in negotiating bilateral investment treaties with our trading partners. We strongly agree with the provisions in the bill that in exercising his Section 301 authorities the President take into account U.S. obligations under trade agreements as well as taking into account the impact on the U.S. economy of any prospective Section 301 actions.

As in the case of foreign direct investment, we welcome the similar legislative improvements in H.R.1571 concerning international trade in services. Without such services it is hard to contemplate that there could be any significant volume of international trade in goods. The world explosion in such knowledge industries as telecommunications, for example, call for the development of viable international rules. The negotiating authorities in H.R.1571 should greatly help the President in seeking such international understandings.

ECAT also supports the sections of the bill calling for compilation of inventories of foreign barriers to U.S. trade in

goods, services and investment, together with a program of action to alleviate or eliminate such barriers.

Mr. Chairman, ECAT does not have a position on H.R.2203, the "Competitiveness in International Trade Act of 1983." On a personal basis I have difficulty in disagreeing with the bill's purpose of acquiring knowledge. I am, however, troubled by the central purpose of the bill which appears to be to have government officials fashion national economic strategies and policies on the basis of the information they are required to compile by H.R.2203. Basing national economic policies on bureaucratic guesses about the future is a scary thing to me.

I also find the granting to the President of authority, notwithstanding any other provision of law, to impose "such terms, conditions, or limitations, as he deems appropriate, under which foreign suppliers shall be eligible to engage in interstate commerce in the United States" a very questionable grant of authority. It would appear to give the President unlimited power to restrict international trade in disregard of other international trade law so painstakingly fashioned over so many years

We in ECAT prefer the approach to U.S. international competitiveness embodied in H.R.1571. It is in accord with our traditional domestic and international economic policies.

I thank you for the opportunity to have been with you today.

Mr. FLORIO. Mr. Freeman.

STATEMENT OF HARRY FREEMAN

Mr. FREEMAN. Thank you, Mr. Chairman. I will read a summary of the main points I want to make this morning. I represent the Coalition of Service Industries. We have 30 members at present, all from the service sector. I think the two pieces of legislation under consideration today are relatively quiet bills. They don't seem to attract large headlines, but I think nevertheless they are tremendously important.

Foreign trade is more important to the U.S. economy now than at any time in recent memory. About 22 percent of the GNP and the jobs that go with it are dependent on export of goods and services. While this figure is getting more and more into our consciousness, our trade policy and trade organization of the Government does not reflect this change at all.

Many of you are aware of the alarming deficits in trade and the current account. It deserves serious attention. Services, of course, as you have indicated, has emerged as one of the most competitive and dynamic American export sectors. We now estimate that around 21 percent of world exports of services came from the United States in 1981 and that is growing very, very rapidly.

As far as H.R. 1571 is concerned, it has not received that much attention, but it is terribly important. It is not a dramatic protectionist measure and hence it doesn't seem to gather the media attention it deserves. It adopts, we think, precisely the right approach.

The bill seeks fair treatment in international markets, including the service sector and calls on the Government of the United States to promote fair trade policy in imports and exports. Rather than closing off our market to imports, H.R. 1571 promotes the opening of foreign markets. We believe this is the best approach to trade policy. Too much emphasis, we think, has been placed on closing American markets, and we should concentrate instead on opening foreign markets.

H.R. 1571 is a marketing bill and if we had our druthers, we would like to have it passed into law by noon today. As you know, the Senate, I think last week, passed a version of this bill. In fact, I think it was the third time the Senate passed it. It was attached as an amendment to the bill which would repeal withholding of taxes on interest and dividends. We don't know what will happen in the conference committee. We are trying to work to see whether the amendment can be retained as part of the legislation. We hope so on that.

With respect to H.R. 2203, the organization that I represent has not had an opportunity to review it, so my statements have to be personal.

There are important pieces of it. Let's take data collection as an example of the problem we face. I think data is very important. Before we can formulate and implement a realistic foreign trade policy, indeed an industrial policy—that seems to be a favorite word in economic circles—we must have an accurate picture of the

world of trade. The problem is we do not have such a picture presently. Our statistics have become quite unreliable.

The other day I was fascinated reading the latest bank letter from Morgan Guaranty Trust. I quote:

> The reported U.S. current account deficit taken by itself is a misleading summary of the balance of payments. The account deficit is seriously overstated in the public figures by about $20 billion.

The deficit is overstated. The overstatement is a lot of money. Much of that is attributable to the understatement of services. Twenty billion dollars is a lot of money. That would be a swing to a positive current account. The problem is not a lack of competence in the Department of Commerce and other federal agencies. I think they need the little bit of money that your committee passed a month or two ago and a couple of people to change it.

Its clear we are dealing with figures that are really inaccurate. The point is this: How can we have an effective trade policy or industrial policy when we lack an accurate picture of what is going on? It is like trying to perform surgery in pitch darkness. It is quite risky. The service sector bill you recently passed would take care of it. H.R. 2203 would do the same thing. This bill puts us on the right road to developing accurate statistics on international trade. Section 9 gives discretionary power to the President and his designates.

I am not as troubled as other people by that. I think it is time to do these kinds of things. I have just come back from Paris and earlier Geneva where I had meetings at the OECD and GATT. My chairman has just returned from a worldwide trip and gave a trade speech in Japan. I think we are really, I think this is the best word, dithering on our trade policies and our trade legislation. We can't seem to enact legislation which we are very concerned about. The debate surrounding section 301 of the Trade Act seems to be getting awfully legalistic. I don't think anyone is against clarifying 301, whether for the sake of services or anything else. I think there is no question that GATT would assume jurisdiction one services trade. Where else can you go? We might have the option of going to UNCTAD. I don't think our trading partners would like that.

With regard to the proposed trade department reorganization, we don't have a strong trade minister or strong state secretary. Debate is raging around the administration proposal. I think other countries are looking at us and saying, you sent two trade people to Geneva, Secretary Baldrige and Brock. But three trade ministers is an odd way to conduct our business.

Last week the Prime Minister of the United Kingdom combined the Trade Department and the Industry Department. They just did. And I think we ought to reorganize our own executive branch which was organized to meet the problems of the sixties and here we are at 1983, and our executive branch, notwithstanding the very good people we have in it, is peculiarly organized for the kind of problems we are having right now.

We need a strong authority in the executive branch and I think that we are arguing over how many angels there are on the head of a pin on some of this trade legislation. For example, in the area of international telecommunications, which I realize is probably

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TESTIMONY OF HARRY FREEMAN

COALITION OF SERVICE INDUSTRIES, INC.

Before the House Subcommittee on Commerce, Transportation and Tourism on H.R. 1571, the "Reciprocal Trade and Investment Act of 1983" and H.R. 2203, the "Competitiveness in International Trade Act of 1983"

June 22, 1983

Good Morning, Mr. Chairman

I am Harry Freeman, Senior Vice President of American Express Company. Joining me at the table today is the Coalition's Counsel, Richard R. Rivers, of Akin, Gump, Strauss, Hauer & Feld. We welcome this opportunity to appear on behalf of the Coalition, the only nationwide federation representing U.S. service companies. Our member companies are drawn from the entire range of services available in the private sector economy, including banking, investment, insurance, communications, retailing, advertising, shipping and construction. A list of our member companies is attached to this testimony.

Mr. Chairman, on behalf of the Coalition's members, I want to commend this Subcommittee for turning its attention to services and to the difficult problems faced by U.S. service industries in international markets. The Coalition enthusiastically endorses your efforts, Mr. Chairman, to correct the intolerable imbalances in market access to trade in services. Following on the heels of the General Agreement on Tariffs and Trade Ministerial ("GATT") last fall, where the U.S. achieved

not under this subcommittee's jurisdiction, we have been working for 2½ years to figure out how to organize the executive branch. They are working on that in the Senate. We seem to get hung up in searching for perfection in these areas when we need to be more decisive and perhaps take some risks.

Everybody supports the bills, but they have a qualification. You have to change this or that, solve this problem and so forth. My view, frankly, is that perfection may be a little elusive. I don't want to see our country spend another year or two trying to find some common consensus of perfection, which I think is impossible. I think we have to take some risks and act.

I think our trading situation has deteriorated and, therefore, I urge that we move along on these bills and the other bills that the committee has cleared. I think the time for action has come. I think some of these issues are raised by good people getting awfully technical. I think it is time to roll on and do these things. They may not be perfect, but it is a matter of debate.

Let's do it, take some risks and go.

[The statement of Mr. Freeman follows:]

a measure of success in bringing services within the negotiating framework, H.R. 2203, the "Competitiveness in International Trade Act of 1983," sends precisely the right signal to our trading partners. Without a positive legislative response to our achievements during the GATT Ministerial, and especially to the admirable stand taken by USTR Bill Brock, our trading partners are likely to resist further liberalization of trade in the service sector. Enactment of strong trade legislation containing adequate remedies will put our trading partners on notice that the Congress of the United States has thrown its full weight behind the American service sector and supports the efforts of the Executive Branch to bring services under the same liberal international rules of trade as presently apply to goods.

The Coalition also strongly supports H.R. 1571, the "Reciprocal Trade and Investment Act of 1983." This bill, introduced by Representative Jim Jones with bipartisan cosponsorship, incorporates amendments that we supported in a predecessor proposal and that have already been agreed to by the Ways and Means Trade Subcommittee in the last Congress. In addition, H.R. 1571 contains many provisions similar to those in S. 144, the "International Trade and Investment Act of 1983," which passed the Senate last week.

H.R. 1571 proposes measures that accomplish several high priority objectives of the service sector. Its major provisions are: (1) a new set of negotiating objectives conforming the

treatment of service and investment to that already accorded merchandise under our trade laws; (2) a broader grant of presidential authority to identify unfair foreign trade practices and to take appropriate remedial action; (3) a speedier and more flexible system for reacting to unfair trade-practices by authorizing fast-tract legislation as a Section 301 remedy; (4) an improved procedure for opening Section 301 cases by permitting the U.S. Trade Representative to initiate investigations; and (5) a substantially improved information-gathering procedure that authorizes the USTR to report regularly on barriers to U.S. trade and investment.

Apart from supplementing our activities under GATT, H.R. 1571 proposes to augment the President's negotiating objectives related to trade in services. Armed with this expanded authority and a clear Congressional mandate to pursue reciprocal agreements, the President's negotiators will be able to attack foreign barriers to liberalized trade in services at the source and search out reasonable compromise on either a bilateral or multilateral basis. In the context of multilateral negotiations particularly, H.R. 1571 takes the correct approach in authorizing the President to begin to develop internationally agreed rules, including dispute settlement, applicable to the service sector. This new rule-making authority will no doubt enhance our ability to negotiate more effective rules within the framework of GATT, whose trade ministers already agreed at the Ministerial last fall

to examine service issues at a national level and to exchange the information necessary to expand reciprocal market opportunities in services-related trade.

In addition to expanded rule-making authority, S. 1571 adopts the credible position that a "fast tract" legislative remedy in the appropriate response to quickly changing circumstances in the area of unfair trade practices. The Section 151 "fast tract" provision proved its value in the Tokyo Round of Multilateral trade negotiations and this bill would extend similar expedited treatment to Section 301.

Mr. Chairman, I want to emphasize the Coalition's firm conviction that Section 301, the unfair trade practices provision of the Trade Act of 1974, should be applied to services. H.R. 1571 declares in unambiguous terms that Section 301 covers services, including overseas investments necessary for the export and sale of services. The Coalition especially supports this provision in H.R. 1571 because Section 301 is the most effective remedy available under our trade laws for the various types of unfair trade practices with which service industries are faced.

On the issue of reorganization of trade responsibilities, an area in which H.R. 2203 and H.R. 1571 differ, the Coalition has not formally adopted a position. The Coalition does believe, however, that a central coordinating body is essential to the coherent implementation of a services trade policy. At the same time, the Coalition emphatically supports broadening the grant of

authority to the Commerce Department in order to expand service industry opportunities abroad and to improve service sector data collection and analysis.

As you know, the importance of the service sector to our overall domestic economic health has grown dramatically in recent years and is, to a large and important degree, the most vibrant area in our economy. Services now account for fully 67 percent of GNP. In 1981 alone, services exports produced more than $54 billion in services trade surplus. In the crucial area of domestic employment, over half of all private sector jobs are produced by service industries and, if government workers are added, that figure rises to 70 percent of all jobs in the U.S. economy. Services comprise, therefore, the largest single share of the total domestic economy. To illustrate graphically the importance of services in producing revenues and jobs in the U.S., we have attached to this testimony three charts showing the dramatic growth achieved by services industries over the last few years.

Not surprisingly, at a time of difficult domestic economic transition, national attention has focused on services as the one relatively bright spot in this nation's economic future. But services are also confronted with numerous challenges in the form of anticompetitive foreign practices. In the guise of developing effective internal economic policies, many of our trading partners have resorted to a wide variety of non-tariff barriers

designed to enhance their developing capacities in high-value, technology-driven service industries. As a result, we find our efforts to penetrate foreign markets stymied by a rising tide of policies and practices that do not conform to the principles of reciprocity and unrestricted international trade. For instance, Canada requires that all foreign banks maintain and process data within Canadian borders. Australia forbids the screening of television commericals filmed abroad, and Norway has not licensed a foreign insurance company in four decades. We must work vigorously to restrain these types of services trade barriers and prevent their future growth. Therefore, although we in the Coalition strongly oppose retaliatory protectionism in any form, we urge this Congress to enact legislation, consistent with our international rights and obligations, which will discourage foreign trade-distorting activities and assist U.S. industries in gaining equal access to foreign markets.

Finally, the Coalition strongly supports a return to the principle of reciprocity in the traditional, liberal sense in which that term has been employed since this country first began to pursue the "Reciprocal Trade Agreements Program" in 1934. In the Coalition's view, reciprocity means the mutually advantageous exchange of bargained-for concessions; these encompass the broad range of trade principles from unconditional most-favored nation accords and national treatment to international economic relations based on a negotiated balance of trade. The importance of reciprocity is further illustrated by the fact that it is also the foundation of GATT and the basis on which international trade agreements have operated throughout the post-war period.

Again, Mr. Chairman, the Coalition appreciates your invitation to participate in these hearings. Mr. Rivers and I will be pleased to answer any questions you might have.

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Mr. FLORIO. Phisophically, part of the problem in terms of the world perception of the United States flowing from the operative philosophy that is prevailing in Washington now, which is advocating minimizing governmental involvement in the economy in general and particularly with regard to trade, when every other industrialized nation of the world has a very active catalytic role for the Government to play in trying to hold pieces together, private, public sector, labor, management, and that if that is the thing that is needed to mobilize resources, to be an effective competitor in the world and the administration's philosophy is the very opposite of that, to figure out ways that we can get the Government out of any involvement with the economy or minimal involvement with the economy, it would seem to be a fairly logical conclusion that our trading partners might conclude that we are really not serious about playing a real role in the world market.

Mr. FREEMAN. The way our Government is organized does send off conflicting signals and we have different policies eminating from the Hill and different parts of the Hill and the executive branch. Take one example right now. The administration has come up with the famous trade reorganization proposal. Now, that is a subject of great debate around Washington. I think the Post had an article on it a couple of weeks ago. Those that favor it tend to be the farthest away from Washington. There is a lot of truth in that because the debate in Washington happens to be turf over considerations. What is going to happen to the Trade Office?

I think it is high time to get on with it. I think there could be a consensus between the various ideologies around on our international and economic trade matters to the point that we would have a stronger single voice in speaking abroad. That would remove some of the confusing signals we are sending.

I don't think we are going to reach perfection in eliminating the large number of different signals coming, but reorganization is one step that could help.

Mr. FLORIO. Perhaps, shifting to Mr. Asher, again to point out what Mr. Freeman is talking about as the inconsistency in our own positions, I just noted that you have expressed some apprehensions about the policies of the Japanese over the last number of years with regard to your own industry, and it is also my understanding that your organization is considering filing a 301 case charging the Japanese with unfair trade practices. Is that the case? Are you evaluating that?

Mr. ASHER. We are evaluating that situation, Mr. Chairman. We are right now involved in the next session of the high-tech working group meetings, which are scheduled to occur in early July. I believe you go back to the fact that we are trying to resolve these issues at a level essentially government-to-government with strong support from both industries in both countries such that they do not become and get raised to a larger problem area, a bigger problem area to deal with that forces different kinds of decisions on different issues.

Right now we are at a point in the high-tech working group where the initial objectives have been established. In my testimony, I think I have identified the progress we have made and the point that we have gotten to. But basically where we stand right

now is in a position where the objectives have been established, milestones, particularly relating to monitoring, which is a key to implementing other objectives of the high tech agreement, is running well behind schedule. We were scheduled to be on line in monitoring in March. We have yet to actually accomplish that. And consequently, as we come up to July in this series of meetings, there are several major issues that we hope to see resolved in these discussions.

Depending on the results of that meeting in July, we will then consider whether to proceed with such an action.

Mr. FLORIO. I wonder if you feel at all uncomfortable in being critical of the Japanese practices, the targeting practice, so to speak, and yet advocating today that we give consideration to reviewing our antitrust laws, presumably to allow our companies to share data in a way that is not permitted at this point and advocating other things that essentially would allow us to do the same thing that the Japanese have done.

Are you offering that as an alternative, that unless they change their policies, we would adopt the same policies that we are complaining about or do you offer that as an affirmative suggestion that we should do regardless of what the Japanese have done in the past?

Mr. ASHER. At least in the area of the antitrust legislation as it relates to joint ventures, for instance, I think that is somewhat of an independent issue from the standpoint, first of all, that the areas that we are addressing deal with what we believe to be primarily clarification of existing law and negative clearance in some cases, but basically the ability for a set of companies to join together in joint R&D under the existing law and under the intent of the law, knowing that they have in fact met the requirements of the law and not have to be continually looking over their shoulder or continually being concerned about exposure.

I might add there that in this area beyond just the R&D policies that the Japanese Government has put into place, the cost of R&D is skyrocketing today. It increases continuously. The cost of developing an integrated system that was $100,000 a few years ago now can run well over $1 million in microprocessors. So the collective cost of developing technology is becoming substantial for even the larger companies. So, consequently, under the existing law, what we are looking for is the ability to put together joint venture R&D that the resources can be combined in a legal manner that will to some extent answer the problem created by the Japanese practice, but not as a retaliatory measure.

We believe that is necessary independent of the Japanese actions.

Mr. FLORIO. Independent of any Japanese action. What is your thought or any of the panel's thoughts about the decision that in the area of infant industries, whether they be high-technology industries that are just developing or if we regard the automobile industry as an infant industry in its second coming, the desirability of sheltering those infant industries for a period of time to allow them to develop in the way that other nations have done—is there any desirability of doing that aside from whatever the Japanese have done, particularly in the area where we are talking about

capital-intensive infant industries, where one has to have the ability to utilize the massive amounts of capital to develop in the early stages the products so as to be able to market them in volume at a later point to conserve capital?

Mr. ASHER. I believe that with regard to the economy as it stands right now, and particularly in the high technology area, there is still ample area for the evolution and the development of infant high tech industries based on the continually expanding specialized requirements that tend to spin off, technology supporting a particular area of requirement and subsequent growth. And I believe the open market economy tends to provide the capital necessary for that kind of development.

Our problem comes primarily when a government, such as Japan, in its targeting policy applies resources to a particular given technology that far exceeds anything that could be put together by any single, large company in this country, and I think that is precisely where you get into the problem area, when you have now passed the point that the normal market capital, capital provision system can provide those kinds of funds. That problem is further aggravated when in fact certain provisions of the targeting policy in essence allow an industry in a targeted area to produce below cost, at least by our standards, for a significant period of time, has different means and different measures of recouping and writing off R&D such that you can be in an uncompetitive situation and late stages of a product life cycle to the development and investment made at the front end of some of these companies.

Mr. FLORIO. Would you advocate then a statutory or regulatory definition of targeting and what constitutes targeting that would define certain practices as unfair for purposes of not only 301 but for other retaliatory actions?

Mr. ASHER. We believe that the study that we have prepared, should we decide to proceed with it, forms the basis for a legitimiate 301 action.

Mr. FLORIO. Of course you heard the secretary this morning not be as clear as you are as to what he thinks is inappropriate. You may very well have your study and that would prompt you to file your complaint, but there isn't a clearly defined statement, administrative statement or legislative statement as to whether those policies that you are pointing to that the Japanese have engaged in would be defined as being unfair and hence you would go through the process, the process could legitimately result in a finding that there was no unfairness, even though one might concede that there had been cooperation that would violate our antitrust laws among Japanese companies, that there had been targeting of developmental resources for the purposes of developing under cost productivity that could be used to capture overseas markets.

I am suggesting that you can make your value judgment that those practices are unfair as you see it, but until there is a national policy as to what constitutes unfairness, no remedy is going to be dictated by the filing of a complaint or any other action that would under your approach be a retaliatory action.

Mr. ASHER. Mr. Wolff.

Mr. WOLFF. I think the section 301—the problem with section 301 in part is the fact that it is so broad. The question is what is unrea-

sonable under the statute. That is a very difficult burden on the petitioner to prove to the satisfaction of the U.S. Government agencies administering the statute that in fact something has taken place that requires a response.

Mr. FLORIO. Particularly if those agencies are not philosophically inclined to want to. I mean if they are inclined to feel that the international free market forces will work out in some respect, they are not going to be looking to have an interpretation that is compatible with your own.

Mr. WOLFF. Also, the fact that the statute really says two things, section 301; the President can take whatever action he is currently authorized to take under existing powers, in which case one doesn't need this statute, or he can impose import restrictions, tariffs, or quotas. That dichotomy is so stark that there is no middle ground for the President to take.

Often, in the case of an industrial-policy problem, a targeting problem, really what has to be done is to work out something with the foreign government as to ameliorating the adverse effects. Maybe the amelioration would include allowing American firms to participate in foreign joint research and development, facilitate foreign direct investment abroad. There is no authority under the section as constituted to allow any middle ground approach. It is either you retaliate by closing the U.S. market or in effect you do nothing. And every administration has now operated the do-nothing approach.

Mr. FLORIO. So you conclude that if there was more variety of options in terms of the sanctions, that that might prompt entertaining in a favorable way 301 complaints that are now not being acted upon?

Mr. WOLFF. That would be a distinct possibility. It is now viewed as solely a retaliatory mechanism, and the U.S. Government will not retaliate very readily against a foreign government where it does not have a clear international right to do so. This morning's testimony by Mr. Gingrich and Under Secretary Olmer were to the effect that we ought not to retaliate where it would violate U.S. obligations. Every administration will take that point of view. Therefore, what should the United States be doing? There ought to be intermediate options.

Another problem with the statute which you pointed out this morning is the fact that the authority is solely in the President's hands. That makes that a costly step to take, because it is a Presidential action rather than as countervailing duties or antidumping duties are, it is not an administrative matter, not something that is routine. It is a step taken by the head of state of the United States against a foreign nation's basic policies. We have to depoliticize it in order to get some effective responses.

Mr. FLORIO. But as a practical matter, and I am inclined to agree with you, but to play the devil's advocate, as a practical matter if that authority was given to someone of lesser stature than the President, how can we be sure that other considerations would be rolled into the deliberations of the person exercising that authority?

Mr. WOLFF. You could still have an interagency process, but make it an advisory process rather than every agency in effect

having a veto over our action. Right now it is a very cumbersome process. Every agency is putting themselves in the shoes of the President and making a final recommendation as to whether retaliatory action ought to be taken rather than saying a valid problem has been presented, what is it that the United States can reasonably do to effect relief and bringing their expertise to the table.

The decision—a decision by committee is a very difficult way to operate. Those inputs are needed but the decision ought not to be left as a joint recommendation to the President. It ought to be put in the hands of a Cabinet officer. You asked a question earlier about reorganization of the trade functions. The major question not addressed by the administration's proposals—one of the major questions is what authority would this new Cabinet officer have? How does he have a special role vis-a-vis the other members of the Cabinet? And Under Secretary Olmer said the Department of Defense makes a substantial amount of our defense policy decisions.

Here is a trade statute that is one of the major authorities, although unutilized, of the executive branch's trade responsibilities, and all that the U.S. Trade Representative is is the chairman of a committee advising the President as to how he might use this authority. In any new organizational structure, the Cabinet officer responsible for trade ought to be responsible for trade activities, including this one.

Mr. FLORIO. Mr. Ritter.

Mr. RITTER. Thank you, Mr. Chairman.

I thank the witnesses for their excellent testimony. I hear the comment that basically we should be trying to speak with a single voice on trade or more of a single voice on trade, but just listening to your comment—I can just envision a Cabinet-level meeting that the Department of Agriculture Secretary, the Department of Defense Secretary, talking about electronics materials that are capable of being applied to military functions abroad or shipped to hostile nations, and I suppose—this is a comment, but I guess speaking with a single voice on trade is probably very difficult to achieve, and that is why we have not arrived there yet. Now, does this new Department, if the statutes do not change, does this new Department potentially run into the same problems as an STR runs into right at the moment?

Mr. MCNEILL. Could I respond to that? I was the Executive Secretary of the President's Trade Policy Committee back in 1960, 1961. That was a committee that was chaired by the Secretary of Commerce and was responsible for doing part of what Bill Brock now does, that is, advising the President after the interagency consultation process has been concluded as to what the President should do in the trade field. That committee proved quite unsatisfactory, because the Secretary of State had a legitimate interest different from the Secretary of Commerce, and the Secretary of Agriculture's was different than the Secretary of Commerce. These divergent interests made it very difficult for one Cabinet officer coequal in the Cabinet with other Cabinet officers to really coordinate policy.

At that time the Commerce Department was in considerable daily conflict with the Department of State for primacy in the field of the conduct of U.S. trade. The battle was so bloody that the

Trade Expansion Act of 1962 established the Office of the Special Trade Representative in order that the President's office could be the place where things were brought together and that the coordinating responsibility in effect would be the voice of the President.

I do not see how you can do an awful lot better than the present system. By reconstituting an existing Department as the Department of Trade might lead to more interagency conflict than you have presently.

Mr. FREEMAN. If I may make a brief comment. I respect Bob McNeill's views, but perhaps you should have someone on the other side. I think that probably the elimination or consolidation of some of the trade functions would be probably a better step to, as you put it very well, Congressman, in a sense of improving the mix of our signals and comments on international economic or foreign trade policy. We have to ask ourselves is the present system the best we can do, is there something better, rather than is there something ideal we can construct? I would argue that consolidation somewhat along the lines of the administration's proposal would probably improve things. Given our trade posture as it is right now, and given no improvement in the next couple of years, something is in order right now.

There is another area that has not been mentioned, and this came up about 2 weeks ago. Japan is the second largest service economy in the world. They are very anxious to start talking with us either bilaterally or through GATT on a trading regime in services, and I think that is a good idea. The chairman of my company made a trade speech in Tokyo 2 weeks ago saying our two countries have been arguing on a number of points lately; cars, textiles, et cetera. We have a lot in common on services, however, and maybe we ought to start talking about that. The speech was extremely well received.

I think without any derogation to what has been said here this morning, we have some real problems with Japan, I think it might be very useful to start talking to the Japanese in this area where we have something in common we should try and erect a positive regime in that area so that in 5 or 10 years we won't find our services trade souring as well. A couple of things would happen. It might be more beneficial, and any kind of discussion between the Japanese and the United States on services is going to cause some hesitation on some of our European trade partners to drop. They will just jump in.

Mr. RITTER. I think that is a reasonably good idea. The other single voice that I hear the chairman talking about is that we should try to get more of a voice on industrial policy as a single voice is a more unified approach to basic industries or aging industries which are being born again—what did you say—experiencing the second coming. I wonder how you would feel about that second single voice, how this industry feels. We have services, we have goods, we have high-tech electronics and stuff—how do you feel about industrial policy as a positive impact on improving our trade position with our competitors?

Mr. FREEMAN. Let me start with just a few general observations. Industrial policy, which is sort of a chameleon term these days, is a very pervasive kind of thing. To me industrial policy is what we

are talking about this morning. It can be as specific as amending section 301. That is one definition of industrial policy. I rather think that the broad idea of the Federal Government creating something like a RFC, a corporation making loans and so forth, is probably not the right approach. It is an awfully simplistic approach to a very complex problem. I think in the current debate there is a serious omission of the roles of the cities and States, particularly cities and regions. I think this problem could start being attacked in such areas as the area of New York, Greater New York City and other regions. The subject usually gets around to structural unemployment and training or retraining. To me the notion of abstract training financed by the Federal Government is very odd, because the best kind of training is usually by the prospective employers, and maybe that can be done more effectively at your regional and city and State level.

The debates that I have read—there was a major article in the New York Times last Sunday on this, all used to be in terms of the Federal Government, always in terms of loans and making choices as between companies. I think that the very specifics of industrial policy is again, a piece of legislation here, a piece of legislation there, there are some job retraining bills, partnerships between the private sector and the public sector. We are in a growing industry in my company. We are starting to train an awful lot of people. Perhaps we should join with some of our competitors in industry to train people.

I also think there is an underemphasis on the inherent migration of American workers. The greatest migration of American workers that occurred was in 1941, 1942, and 1943. There was a massive shift of employees and workers from basically the South to the North, to the northern industrial cities. We have a real problem in human suffering in the large areas of unemployment. That is a real problem. It can be attacked, but I do not think it can be attacked in the context of the static retraining or saying somebody here or even in the State capital thinks might be a growing industry. There has to be input from the specific growing companies and growing industries.

Mr. RITTER. In a way we have had industrial policy at the Federal level and we tend to focus on these high-paying areas. We tend to look toward bailing out losers. There is an experience in Pennsylvania where right in our own steel industry, just political forces got together and subsidized a brandnew Japanese-built French technology rail mill of a company that was at the low end of the ladder to shift them up to the top end of the ladder and that constituted a kind of industrial policy.

I guess what we can't do is somehow say, "Well, Japan has an industrial policy and therefore we should have one," because we are not Japan. We are a different culture.

Mr. FREEMAN. Let me give an example of what I am getting at. I am not that familiar with this proposal, but I was reading a few weeks ago in Hoboken, N.J., some developers wanted to take some of the piers there, and put up what we call backup data-processing facilities for companies such as mine that are basically in Manhattan. Everybody in the securities business, and we are the second

largest stockbrokerage firm, has to have a backup operation that has to be on a different electrical grid.

So the idea is let's have a facility, whether it is our company or some of the others, sitting there very close by in Hoboken, convert some of the piers, to train a lot of people in data processing. We are not the developer. There are probably tax rebates involved and all kinds of other things involved. But that is the kind of thing I think we have to think about when we think about industrial policy.

Mr. McNeill. Just an observation. The greatest practitioners of industrial policy are the planned economies in Eastern Europe. The French and Italians also have their own industrial policy. I think it isn't fair to look at only Japan.

Mr. Asher. One thing that at least comes clear to us in our relatively short involvement in this process is the fact that industrial policy at least as it is stated from a legislative standpoint, is a series of various pieces of legislation aimed at various areas. In addition, from the business side, the industry or the companies involved in a particular area intend to come in on a single point basis to argue their particular problems or their particular case.

Mr. Florio. If the gentleman would yield. But that is nonpolicy. When you are talking about components and pieces and so on, the difficulty quite frequently is that the pieces don't mesh or they are going in opposite directions and the concept policy connotes to me an idea of coherency, rationality.

Mr. Asher. That is, I think, the point that I was trying to get to, that what would probably be useful would be if the U.S. Government and representatives from industry that cross the varying lines of interest were to sit down and work together on all of the various areas that would collectively represent a policy, an industrial policy, because we are concerned about the areas of antitrust, we are involved in corporate legislation, export control problems. There are various areas that each industry has an involvement and an interest in and often is coming at it from a slightly different angle, but not collectively getting together and between the Government and the broad-based industry, identifying those areas that in fact are of common interest and common ground for everybody moving forward.

Mr. Ritter. But those common grounds are not the mainstreams of each industry's own unique industrial experience. Those are the shared edges of the stream, R&D, making permanent the R&D tax credit, something like a H.R. 1571, something like the Heftel bill to recoup research and development expenditures for shares in products, and sales that have been marketed abroad. I think we can agree on these things and we should be doing them yesterday. We should have done them yesterday. Maybe industrial policy is the kind of thing that gets together so as to provide political focus for some of these things.

I serve as the vice chairman of a high-tech task force with 80 Members of Congress, with Ed Zschau from California, he on the basic high-tech and myself on manufacturing in America. But we see there are basic common grounds that do in a way constitute industrial policy, but they are not the mainstreams of say—I represent the basic steel industry—it is not the mainstream of what

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they would like to see. It is not the mainstream of the automobile industry that they would like to see.

It depends on who is talking about industrial policy as to what they mean and how much weight they give to it. I think even if we had one we would still be left with some of these basic differences between us and our leading competitor in this ballgame, which is Japan, and some of these emerging Asian nations. That is, we are devoting vast R&D expenses, vast development demonstration expenses into a military economy. Our savings rates are less to boot, and they are devoting their Government-oriented expenditures, the Science City outside of Taipei, 250 million dollars' worth of focus and concentration basically coming out of the Government on developing targeted electronics activities.

I mean, how do we deal with this?

Mr. ASHER. Congressman Ritter, one thing I couldn't help but think about earlier, in one of your earlier discussions relative to the defense area, right now we know, for instance, that various 16-K and 64-K Japanese memory products are either being designed in or being requested by various of our defense electronic contractors, and we do not have an argument with that. They have got to go to the latest technology available to them. But if you look at the issues that produce as we have talked about here in the targeting study and the ripple effect, the effect that happens in an area particularly of technology that moves rapidly over a period of time, we are sitting right now with some of our contractors in effect being limited to requesting and subsequently purchasing high density memory from the Japanese because there is either none or a late or yet-to-come requsted American source.

We can't argue with them doing that. They certainly should be designing with the latest technology. But the reason they are doing that is because of the targeting that took place because of the disinvestment several years ago by the U.S. semiconductor manufacturers, and the problem that we are concerned with and the problem that we are trying to deal with in the high-tech work group is to bring this to a level of parity in the open-market environment so when we get to the 256-K and the megabit, that we will be in a catch-up mode and closing rather than running this far behind.

Mr. RITTER. Allentown, Pa., has the major Western Electric facility producing the 256-K. What do you think about the American Electronics Corp. and its potential to offset some of the targeting policies? This is a combination of major U.S. electronic firms—is it AC?

Mr. ASHER. There are two joint ventures. That is MCC of which Harris is one of the founding members; yes.

Mr. RITTER. What is the name of that?

Mr. ASHER. MCC, the Micro Electronics Computer Component Consortium. It is MCC. That represents the area of joint R&D that we talked about earlier wherein the companies are joining together for advanced research into areas dealing in either advanced computer-rated design, various areas relating to solid state research, and essentially the research that will hopefully lead to technology that will bridge the gap and bring us toward the components that we need to get into the VLSI area and eventually——

Mr. RITTER. Are they running the risk of antitrust violation?

Mr. ASHER. That is part of the problem that we are trying to address and one of the reasons we support some modifications to the antitrust legislation.

Mr. RITTER. Our group supports this, but the fact is MCC has gone ahead and somehow given credence to some of the critics who say there weren't the risks to begin with, here is MCC going ahead without H.R. 1571 without the antitrust.

Mr. ASHER. There was a good deal of effort spent and advanced by the companies involved trying to insure that they were in compliance with the law. Second, there have been some companies that have not joined MCC because of their concern as to whether or not it would be protected from attack, and I don't know if I should even mention it now, but at least as I left Harris yesterday, there was some indication that there was some action or request for additional information being called for by the Department of Justice relevant to the formation of MCC.

Now I don't know beyond that other than just as I was leaving work yesterday, there was some indication that there was some additional action either being contemplated or additional questions being asked and data to be provided. So you have got that situation of never knowing, are you really on firm ground in this area, and there are definitely some companies that have held back on joining because of that concern.

Mr. RITTER. Thank you. I thank all of you for an excellent panel.

Mr. FLORIO. Gentlemen, I, too, express my appreciation to you for your help.

The committee stands adjourned.

[Whereupon, at 12:30 p.m., the committee was adjourned.]

[The following statements and letter were submitted for the record:]

STATEMENT OF SENATOR JOHN C. DANFORTH
HEARING BEFORE THE SUBCOMMITTEE ON
COMMERCE, TRANSPORTATION AND TOURISM
COMMITTEE ON ENERGY AND COMMERCE

I appreciate this opportunity to share with the Subcommittee on Commerce, Transportation and Tourism my views on two important pieces of trade legislation: H.R. 1571, the Reciprocal Trade and Investment Act and H.R. 2203, the Competitiveness in International Trade Act. As a principal sponsor of S. 144, the Senate version of H.R. 1571, I intend to address most of my remarks to this bill. However, in view of the paramount importance of the competitive status of American products in international trade, I should like to offer a few thoughts on H.R. 2203, as well.

S. 144, the International Trade and Investment Act is the Senate companion of H.R. 1571. This reciprocity trade bill was introduced in the Senate in January by Senator Bentsen and myself and has since gained the cosponsorship of 41 other Senators on both sides of the aisle. S. 144 first passed the Senate in April of this year, and was passed again on June 16 as Title IV of H.R. 2973. With a few key exceptions, H.R. 1571 contains most of the provisions of S. 144, the product of extensive consultations within the Congress and discussions with the Administration, labor and the private sector.

The result is legislation that should serve to further the objectives we all share -- namely, the maintenance and expansion of market opportunities abroad for United States exports of goods and services, and for foreign investment of the United States. The legislation builds on the broad concept of reciprocity of market access that is fundamental to U.S. trade policy. It strengthens enforcement

of the legal rights of the United States under existing trade agreements and it sets the stage for the expansion of those international rights through the negotiation of agreements in the service and investment areas. Finally, the bill addresses itself to the problems encountered by high technology industries as a result of government intervention that distorts international trade in such high growth sectors.

Overall, the bill is designed to liberalize international trade and to curb protectionist pressures in the U.S. by demonstrating that we will enforce our rights under international agreements. The idea is to close the credibility gap created when we consistently refuse to take protectionist action in spite of the widespread perception that we are the only country practicing what everyone else preaches -- namely, free trade.

To my mind, among the key elements of both S. 144 and H.R. 1571 are:

(1) The systematic procedure whereby the Administration would identify and analyze key barriers to U.S. trade in products, services, and investment.

The required annual report to Congress would include major foreign barriers and distortions to U.S. exports of products (including agricultural commodities), services, and investment, including estimates of their impact on the U.S. economy and efforts to achieve their elimination.

It is my expectation, and that of others involved in the evolution of this bill, that these National Trade Estimates will be used by this and subsequent Administrations to identify the most onerous barriers to

U.S. trade and investment and thereby set comprehensive market enhancement priorities for U.S. trade policy.

In this regard, we would expect the Administration to go beyond its current role as recipient of petitions under Section 301 of the Trade Act and to make use of the provisions for self-initiated 301 cases, as well as the bill's negotiating authority to broaden the scope of existing international agreements.

(2) Amendments to Section 301 of the Trade Act of 1974 that broaden its scope and clarify and enhance Presidential authority to retaliate against foreign unfair trade practices.

In this regard, unfair trade practices for which relief is available under U.S. law would be broadened to cover performance requirements and other trade-distorting barriers to investment. Violations of intellectual property rights are also specifically included as actionable offenses in S. 144, in view of the growing problem of counterfeiting and patent infringement in many advanced developing countries.

Foreign barriers not removed through negotiation or enforcement of the GATT (General Agreement on Tariffs and Trade) could be offset by the United States through withdrawal of prior U.S. concessions, imposition of duties and other restrictions available under present law as clarified by this legislation. Of particular interest is the clarification of the President's authority to impose fees and restrictions on foreign services or suppliers of those services. While the role of regulatory agencies is recognized with respect to trade in services, I am firmly convinced that the Congress never intended regulatory agencies to make trade policy.

Where U.S. retaliatory options are not currently available to the President, S. 144 would provide him with new authority to propose legislation which would enjoy accelerated consideration by the Congress. This provision does not, unfortunately, appear in H.R. 1571.

(3) Finally, the legislation provides for major negotiations to achieve international agreements that encourage fair and open trade in services, investment flows, and high technology.

Knowing that others will be presenting testimony regarding negotiations in the services and high technology sectors, I would like to address the investment portion of the legislation. In fact, barriers to foreign direct investment have major implications for international trade in both products and services.

In developed and developing countries alike, restrictions on foreign investment are being put into place which severely distort access opportunities. The impact on international trade has never been measured and should be of immense concern in the development of U.S. trade policy. The United States has always maintained a liberal investment policy to the benefit of our economy as well as to those of foreign investors. The Administration must be prepared to move forward with all due speed to reach bilateral and multilateral agreements with our trading partners--designed to reduce, eliminate, or prevent restrictions on the flow of investment throughout the world.

Taken as a whole, the International Trade and Investment Act is designed to increase American exports and export-related jobs through stronger enforcement and expansion of domestic and international rules dealing with foreign unfair trade practices. It is intended to move us

beyond the largely rhetorical approach that now characterizes our efforts to achieve greater market access abroad -- into a straightforward mechanism for sorting through and dealing with these foreign actions.

I will be the first to admit that the Reciprocal Trade and Investment Act is not a panacea for all of our economic woes. It does, however, fill a gap in our trade policy. If enacted, it will focus our government's attention on those "generic" barriers to U.S. trade and investment that place limits on our full export potential. The bill strengthens the Administration's hand without forcing it and offers an opportunity for us to move forward in the search for innovative solutions to expand markets for U.S. exports. It reaffirms existing rules governing international trade, but also seeks to expand them to account for the growing complexity in today's trading world.

The Administration and a diverse group of business and agricultural organizations have recognized the value of this trade legislation and have been active in its support. For the record, I should like to include some of the companies and associations that have been particularly active in support of S. 144:

Aerospace Industries Association of America

American Council of Life Insurance

American Electronics Association (AEA)

American Express Company

American Farm Bureau (AFB)

American Trucking Associations (ATA)

Asia-Pacific Council of American Chambers of Commerce (APCAC)

Business Round Table

California Almond Growers

California-Arizona Citrus League

Chamber of Commerce

Chemical Manufacturers Association (CMA)

Cling Peach Advisory Board

Coalition of Service Industries

Computer and Business Equipment Manufacturers Association (CBEMA)

Data General Corporation

DuPont Company

Electronic Industries Association (Communications Division)

Emergency Committee for American Trade (ECAT)

FMC Corporation

International Anti-Counterfeiting Coalition

International Business Machines (IBM)

Millers National Federation

Monsanto Company

Motion Picture Association of America

Motorola Inc.

National Agricultural Chemical Association (NACA)

National Association of Manufacturers (NAM)

National Cattlemen's Association (NCA)

National Council of Farmer Cooperatives (NCFC)

National Foreign Trade Council (NFTC)

The National Grange

Poultry and Egg Institute

R. J. Reynolds

Scientific Apparatus Makers Association (SAMA)

Semiconductor Industry Association (SIA)

Sporting Goods Manufacturers Association (SGMA)

Sun-Diamond Growers of California

Tanners' Council of America (TCA)

TRW Inc.

United Technologies Corporation

Warner Communications Inc.

Before closing, I would like to offer a few thoughts on H.R. 2203, The Competitiveness in International Trade Act of 1983. In particular, I applaud the focus of this legislation -- namely, American competitiveness. Many of America's trade problems do begin at home: No amount of import relief can help an industry that will not help itself to remain competitive. Similarly, American business may produce any number of highly competitive products -- but there is nothing government can do if America's companies are unwilling to seek export markets.

Government can ease the way or (in the case of self-imposed export disincentives) get out of the way of would-be American exporters. However, no amount of information and no government institution can substitute for what American business must do on its own to be competitive.

TESTIMONY OF HONORABLE BOBBI FIEDLER
BEFORE THE HOUSE ENERGY AND COMMERCE COMMITTEE
JUNE 22, 1983

Mr Chairman, I appreciate having the opportunity to express my views concerning unfair trade practices. I have introduced legislation, H.R. 966, that I believe can make a significant contribution in our effort to remedy the situation. I commend this Committee for taking on this challenge to restore America's competitive leadership.

We all know that free trade increases the standard of living of all our citizens. Likewise, we know, from experience, that protectionism hurts people. It increases consumer prices, limits consumer choices and international efficiency. America is an exporting nation. We all benefit from a free international flow of goods. Unfortunately, today, changing economic realities have pushed many nations away from the responsibilities of our interdependent global economy.

In recent years, America's export performance has declined. It may well continue to unless we seriously examine those restrictive policies of other nations that restrain U.S. trade and our response to these barriers. We must provide the leadership to expand interntional markets, for the job situation in this country depends heavily on the future of our exports. With one of five manufacturing jobs producing products for export, our action is demanded.

The effectiveness of existing trade remedy laws is, at times, questionable. Only ten percent of American manufacturers export goods;

a mere one percent of those businesses account for eighty percent of all exported merchandise. Thus, we must ensure that business -- especially small business -- is provided with adequate trade remedy laws or we cannot expect them to be involved in exporting and the resultant job creation it entails.

My testimony deals with Section 301 of the Trade Act of 1974, which authorizes the President to take all appropriate action to remove a foreign practice which is in violation of an international trade agreement or is found to restrict U.S. exports. This appears a powerful weapon to defend the global economy, but the fact that only an average of ten applications a year are submitted to the U.S. Trade Representative for investigation, under Section 301, shows that this trade remedy is a cumbersome, expensive and time-consuming process.

We have seen a number of examples of the limitations to the practical applications of Section 301 trade remedies. After 14 years, the citrus issue has still not been resolved. The latest round of bilateral negotiations with the European Economic Community were abandoned after six years and finally submitted to the dispute settlement process available under the General Agreement on Tariffs and Trade. Clearly, something is wrong when an industry, and the people who depend on it for their livelihood, must be burdened with 14 years of unfair trade. Such terribly long, drawn-out processes give an incentive to our foreign competitors to continue the same unfair practices that Section 301 was written to combat. Their use of unfair trade practices will not be deterred by a process that has proved to be slow and uncertain.

Another limit to the effectiveness of actions undertaken pursuant to Section 301 was seen in the recent failure of the G.A.T.T. dispute settlement panel to make substantive findings in the European Economic Community wheat flour case.

While I have the greatest respect for the U.S. Trade Representative, our businesses, especially our small businesses, cannot tolerate such time lags in trade remedies, especially in today's highly competitive world market. We cannot scare away the ogre of protectionism with a blunt sword. We must let our international competitors know that Congress is committed to growth in trade and is standing beside the U.S. Trade Representative, ready to fight unfair trade practices.

I have introduced H.R. 966, a bill that would strengthen trade remedies available under Section 301 in two ways. First, by giving Congress the information it needs to effectively use this new capability through provision of an annual trade practices report and, second, by permitting Congress to become directly involved in the initiation of remedies under Section 301.

H.R. 966 would require the Department of Commerce to provide Congress with an annual balance-of-trade report. This report would specify the extent to which each negative balance of trade is attributable to unfair trade practices and what actions were taken by the Executive Branch during the preceding year, in response to Congress' actions.

The report would give Congress the full picture of the effect of foreign unfair trade practices on the U.S. balance-of-trade. Publishing the actions would show Congress what has been done and what needs to be done. While Commerce does provide limited information now, it does not provide information that focuses on specific unfair trade practices.

Currently, Congress is not directly involved in the Section 301 process; only the President or private business can initiate an application for investigation. H.R. 966 will give Congress a vehicle that provides leverage to directly affect the decisions the President makes on unfair trade practices, rather than being kept from direct involvement in this key area.

Congressional action would be initiated by adopting a concurrent resolution, citing a particular foreign trade action that Congress has determined to be unfair and requesting Presidential action. Within 21 days, the President will publish, in the Federal Register, what action, if any, he is taking in response to such unfair trade practices. It does not mandate any specific sanctions by the Executive branch.

The annual report, combined with Congress' own expertise and resources, will make the Congress a valuable ally to the U.S. Trade Representative in his international negotiations and as a part of our national effort to keep America exporting.

H.R. 966 would complement the existing remedies available under

Section 301 of the Trade Act of 1974 without prejudicing or weakening them. It would not affect or reduce any of the other remedies available, and in practice should present no obstacle to the use of any of them. Much proposed legislation has come before the Congress recently dealing with issues touching the broad spectrum of international trade. I believe H.R. 966 is entirely consistent with the thrust of what we, in the Congress, are trying to achieve -- to encourage free competition and trade, but to discourage the unfair trade practices by foreign countries that have cost us so much in jobs and opportunities in the past.

Indeed, I believe that the enactment of legislation such as H.R. 966 would reduce the need for the use of any of the many remedies for our trade problems that now exist. Such legislation, by its very existence, would help to deter foreign countries from instituting or carrying out unfair trade practices. Deterrence would be helped by the knowledge that the Congress could act quickly to request action and to have the President come to grips with the issue. It would certainly be much more of a deterrent than the long adjudication times in many Section 301 proceedings.

Today, the institution of world trade is faced with a choice. It can either proceed toward protectionism and all the hardship that it entails, or proceed toward the free system of exports that holds the potential for economic growth for America. I believe that by adopting H.R. 966 and thus strengthening Section 301, we would be arming ourselves with a strong, sharp sword. A weapon that would deter as much as it would retaliate against those who have violated the rules on international trade. I urge this committee to give it its full consideration.

Statement of

THE HONORABLE JAMES R. JONES, M. C.

BEFORE THE ENERGY & COMMERCE SUBCOMMITTEE
ON COMMERCE, TRANSPORTATION & TOURISM
June 22, 1983

Mr. Chairman, thank you very much for this opportunity to offer my testimony on H.R. 1571, the Reciprocal Trade & Investment Act of 1983. I am delighted you have taken the time to give this bill a hearing. Clearly, you and your colleagues share my desire to see the playing field of international trade levelled to a greater degree.

Several of my colleagues from the Trade Subcomittee of the Ways & Means Committee joined me in introducing H.R. 1571 on February 22. This bill reflects the work of that subcommittee in the last Congress. While we were unable to conclude marking up the legislation, H.R. 1571 incorporates all amendments agreed to by the subcommittee.

Simply put, this legislation will strengthen the President's hand in responding to the ever-increasing barriers to U.S. trade abroad. The bill also ensures that foreign direct investment is an activity covered by the provisions of the Trade Act of 1974.

H.R. 1571 is designed to expand world trade to the benefit of all. It is not a protectionist bill. Ultimately, the legislation will increase American exports, increase American jobs, and hasten and strengthen the U.S. recovery.

The bill requires that the United States Trade Representative identify and analyze barriers to and distortions

of U.S. trade in services and foreign direct investment. It further provides that USTR report on factors that significantly affect the "competitiveness of U.S. high technology industries" which have high growth potential in world markets. One of the failings of our current trade laws is that they do not adequately address trade in these sectors.

To this end, the bill amends current law by including in official U.S. negotiating objectives the elimination of barriers to trade in services, foreing direct investment, and high technology. It further requires, in the high tech area, that the President obtain compensation from our trading partners, with special emphasis on foreign industrial policies, discriminatory national treatment, and anti-competitive market practices or structures as unfair practices, if he finds it impossible to reduce or eliminate the barriers.

With respect to services specifically, the bill authorizes the Secretary of Commerce to establish a service industries development program, with the goal being a review of U.S. regulatory, tax, and anti-trust policies, a review of the treatment of services in international agreements, and promotion of export opportunities for the service sector.

Section 4 of the bll allows the President to exercise his authority under Section 301 of the Trade Act of 1974 on a non-discriminatory basis or solely against the foreign country involved, and without regard to whether or not such goods or sector were involved in the unfair practice. It also

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requires that the President rescind such action if the offending act or policy is eliminated. Furthermore, the USTR, at its discretion, may self-initiate 301 cases after consulting with the private sector.

I am certain that you agree that American products, particularly in the emerging high tech and service industries, are competitive with products around the world, as long as they are given equal access to foreign markets. The United States does not need to "protect" its industries with barriers of our own. All we need, and all this bill asks for, is a chance to compete fairly and openly on the world market.

Thank you again for holding the hearing and giving me an opportunity to include my testimony in the hearing record.

U.S. Council for an Open World Economy
INCORPORATED
7216 Stafford Road, Alexandria, Virginia 22307
(202) 785-3772

Statement submitted by David J. Steinberg, President, U.S. Council for an Open World Economy, to the Subcommittee on Commerce, Transportation and Tourism of the House Committee on Energy and Commerce in hearings on H.R. 1571 (The Reciprocal Trade and Investment Act of 1983). July 1983

(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 private interest.)

I applaud the emphasis placed by the Administration and many members of Congress, including the sponsors of H.R. 1571, on the need for other countries, especially the most economically advanced, to remove barriers that unfairly obstruct access to those markets for U.S. goods, services and investment. However, neither the Administration's trade-policy agenda nor any of the trade bills that have been introduced in Congress adequately address the nation's needs in this regard. H.R. 1571 (The Reciprocal Trade and Investment Act of 1983) is currently the centerpiece of efforts in the House of Representatives to deal with this question. The bill's major provisions include encouragement for more forceful U.S. action against unfair foreign barriers against American exports, and bringing services and investment within the scope of the President's authority to retaliate against unfair foreign practices deemed harmful to our country's international commercial interests. The bill would authorize negotiations to secure fair, open access abroad for U.S. services and investment, and for U.S. high-technology products per se.

Such legislation may strengthen political will for seeking equity for American goods, services and investment in foreign markets. But it tends more toward retaliation against allegedly unfair impediments -- as a device to get these barriers removed, though possibly counterproductive -- than toward steady, substantial progress toward freer, fairer international commerce on a truly reciprocal basis. Nor are the provisions for securing fair treatment abroad for U.S. services and capital likely to produce substantial benefits for the United States without a comprehensive free-trade initiative (not now on our national agenda) embracing all forms of international business and involving trade-offs across the lines of all these sectors. The highly touted effort to achieve reciprocally lower barriers to trade in high-technology products suffers similar inadequacy.

The support which this bill has received from the Administration and from much of the "liberal trade" community seems based on absence of a more far-reaching strategy and on relief that the protectionist dangers in previous versions of this kind of bill have been lessened. There is the hope that such legislation might defuse attempts at blatantly protectionist measures. If nongovernment supporters of this kind of legislation (including the Business Roundtable, the National Association of Manufacturers, the Chamber of Commerce of the United States, and the Emergency Committee for American Trade) see this bill as projecting an adequate trade strategy for the 1980's, such a stance corroborates the serious inadequacies I detect in the liberal-trade movement. Whether or not they support such legislation, other liberal-trade organizations (e.g., those representing importers, retailers and consumers) are themselves delinquent in their grasp of the foreign-economic and domestic-economic strategies that should top our national agenda in this policy area. If, as the U.S. Trade Representative has said, this is the most difficult time we have faced in international trade policy since World War II, then this is a time for much more than the Administration is seeking, than anyone in Congress is seeking, indeed more than the liberal-trade community (almost without exception) is seeking, to address this critical problem.

The Administration has no strategy for steady, far-reaching progress toward a truly open world economy. It has a loudly proclaimed free-trade stance, but not a free-trade strategy. Its plans fall far short of the dramatic initiative needed to save the world economy from the deeper protectionist pitfalls into which it may slip during this perilous period for all countries. The other contracting parties of the General Agreement on Tariffs and Trade may not be ready for anything more than "work programs" on longer-term issues and reviewing implementation of the fair-practice codes negotiated in the Tokyo Round. But the United States should not lower its sights to the lowest common denominator.

H.R. 1571 does not raise the world's sights, or our own, high enough. It is not even well-calculated to advance the limited goals for which the bill is designed. The United States needs to raise its own sights and those of the world to the need to seek, with deliberate speed, the freest and fairest international economic system -- indeed <u>optimum</u> reciprocity through negotiation of a free-trade charter (embracing goods, services, investment, etc.) with as many industrialized countries as wish to join us in this venture. There would have to be special privileges and commitments for underdeveloped countries in their relations with the free-trade area created by the charter. Once one or more advanced countries negotiated such an agreement with the United States, all

would do so sooner or later.

Progressive, Not Regressive, Reciprocity

While much more can and should be done to advance the cause of true reciprocity in the sense so assiduously nurtured, with such rewarding results, in the last half-century, the least we can and should do is resist a revisionist redefinition of reciprocity -- one that would set in motion bilateral, trade-restrictive reactions (and counter-reactions) to the alleged failure of certain countries to permit U.S. access to their markets substantially equivalent to their access to the U.S. market. This concept of reciprocity, while possibly inducing some liberalization in certain cases, runs the general danger of ratcheting import barriers higher not lower, and the level of world trade lower not higher. The U.S. economy could hardly benefit from bilateral reciprocity maneuvers that (a) sock American consumers, (b) sacrifice import-dependent and export-dependent American jobs in the wake of retaliatory or emulative reaction abroad to U.S. import-restricting tactics, and (c) suppress the beneficial effects of freer imports on U.S. productivity and overall competitiveness. Such results would do little to "foster the economic growth of, and full employment in, the United States" (a prime objective of H.R. 1571).

The champions of "reciprocity" should want reciprocity in its finest sense. If so, totally free trade on the part of the industrialized countries, fused with totally fair trade (including rules for ensuring fair exchange rates), should be the length and breadth of their perspective. If indeed the objective of reciprocity is fairness, attention should be given to the fact that the most far-reaching progress toward totally fair trade will not be achieved unless impelled, in fact compelled, by negotiated removal of all impediments to international commerce in accordance with a realistic timetable (with permission for strictly controlled departures from the timetable to help cope with unforeseen emergencies). No reciprocity bill now in Congress could possibly ensure significant progress toward this concept of optimum reciprocity and consummate fairness in international commercial relations.

Congressman Jones of Oklahoma (a co-sponsor of H.R. 1571) has said that "to maintain the credibility of worldwide free trade, the United States must earnestly pursue the elimination" of foreign barriers to U.S. goods and services. It is our Council's view that, to move effectively toward this objective, the United States should invite the other economically advanced countries to join us in negotiating a charter that, at long last, programs totally free and totally fair international trade. There will not be a contract for completely fair international commerce without a contract for completely free international commerce, and

vice versa.

Supporters of this kind of legislation say it is needed -- spurring retaliation against substantial and unfair barriers to U.S. access to foreign markets -- because U.S. import concessions have not been reciprocated by our major trading partners, putting us in a weak position to bargain for needed concessions abroad inasmuch as there are few U.S. import concessions left with which to bargain. The remedy proposed in this bill, reviving a risky ploy I heard advocated decades ago, would not achieve the reciprocal, equitable market access the supporters of such legislation say is their aim. It would be more likely to ratchet barriers upward and muddy the channels of international discourse on how to achieve truly reciprocal, increasingly freer international commerce.

The sponsors of such legislation say it would strengthen the President's hand in responding to unfair barriers to U.S. exports and other business abroad. However, notwithstanding their contention that executive action under this legislation would be discretionary with the President ("the bill strengthens the President's hand without forcing it"), the revisionist conception of reciprocity (if it can be reconciled with existing U.S. trade agreements and if in fact it is meant to be enforced) would engender political pressures and government actions harmful to the objective of freer and fairer international economic relations.

How is bilateral reciprocity to be measured? By what standards, and whose standards? Is each country free to decide reciprocity, and act on this assessment, in any way it chooses? What assurance can there be, and how enforced, that whatever standards are used will be applied indiscriminately and with equal intensity to all countries? Instead of forcing the issue of equity in trade relations as the bill proposes, might we not shoot ourselves in the foot, or worse? If negotiation of the free-trade charter I am advocating, and the optimum in multilateral reciprocity which this would engender, seems a fanciful, formidable undertaking fraught with unlimited complexities, how much less formidable, more manageable and more helpful would be a train of trade-restrictive actions and reactions under the rubric of bilateral reciprocity projected by bills like H.R. 1571?

Conclusion

There are parts of H.R. 1571 that merit support. These include authorization for negotiations to achieve equitable access to foreign markets for U.S. services, investment and high-technology business per se, although substantial progress toward such access is not likely outside the framework of a

free-trade charter embracing all forms of international commerce. I shall not allow my advocacy of the strategy proposed in this statement to deter my support for measures less ambitious. Half a loaf may be better than none at all. However, I have reached the conclusion that H.R. 1571 is conceptually not acceptable as even half a loaf.

Besides encouraging political pressures and executive and legislative maneuvers that seem likely, on balance, to increase trade restrictions, and besides its shortcomings with respect to the new negotiations it authorizes, such legislation -- setting the tone and the scope of U.S. trade policy for many years to come -- would divert the energies of government from what urgently needs to be sought in this major policy area. The United States needs to get tough in trade policy, but in a way that reveals toughmindedness about the objective at which this nation and the world economy should aim and how to make it politically palatable at home and abroad. Without a dramatic strategy of such proportions, the danger of slippage into deeper protectionism is considerable.

If Congress insists on passing the likes of H.R. 1571, I urge at least the following amendment: that, in estimating the trade-distorting impact on U.S. commerce of foreign policies or practices impeding American business, and in retaliating against such barriers or proposing legislation to counter them, the President should be required to assess the cost to the nation of any such countervailing action and make such estimates public.

Travel Industry Association of America

1899 L Street Northwest
Washington, D.C. 20036

Telephone 202 293-1433

June 23, 1983

The Honorable James J. Florio
Chairman, Subcommittee on Commerce,
Transportation and Tourism
House Committee on Energy and Commerce
House Annex II, Room 151
Washington, D.C. 20515

Dear Mr. Chairman:

The Travel Industry Association of America (TIA) appreciates this opportunity to set forth, for the record, its views on H.R. 2848, the Service Industries Commerce Development Act of 1983.

TIA fills a unique need in the travel industry that stems from the industry's own diverse nature. Our membership is drawn from the airlines, attractions, hotels and motels, travel agents, tour operators, convention and visitors bureaus, state government travel offices, food service establishments, intercity bus and rail lines, and other components of the travel industry.

Tourism in America is served by over one half million different businesses that offer a wide range of services to the traveler. Some of these businesses are organized nationally by industry component and are represented by trade associations that promote and protect their specialized interests; however, to represent the broad base of tourism, the Travel Industry Association of America deals with issues of interest and concern common to all in the travel industry. Few of these concerns are more critical or affect the travel industry more broadly, than service trade policy. We support service industries development legislation which will further strengthen U.S. policy directed to reduce trade barriers, thus improving our service export position.

Chairman
William H. Edwards
President
Hilton Hotels Division
Hilton Hotels Corporation

First Vice Chairman
Robert Glersdorf
President
Exploration Holidays & Cruises, Divisions of Alaska Tour & Marketing Services, Inc.

Second Vice Chairman
George L. Fichtenbaum
President
American Sightseeing International

President
William D. Toohey
President
Travel Industry Association of America

Secretary
William N. Thurmes
Vice President & General Manager
Busch Entertainment Corporation

Treasurer
Gabriel Phillips
Senior Vice President - Traffic Services
Air Transport Association of America

The growth of the service sector since the end of World War II and its tremendous contribution to our nation's economy and international balance of payments has, until recently, been ignored by government officials. In 1981, the service sector accounted for 65 percent of our gross national product and employed 71.9 percent of all non-agricultural employees. The March 1983 Survey of Current Business, published by the Bureau of Economic Analysis, Department of Commerce, reports the exceptional performance of the service sector in 1981 resulted in an $11.1 billion balance of payments surplus on goods and services. In that year, the merchandise trade deficit was $27.9 billion, while services generated a $39.00 billion surplus. In 1982, however, the highly visible $36.3 billion merchandise trade deficit was almost exactly offset by a much less noticed -- and significantly smaller -- $36.1 billion surplus in services. Consequently, the balance on goods and services transactions between the United States and the rest of the world shifted $.2 billion into the red in 1982 as the U.S. merchandise trade deficit worsened and the surplus in services declined.

The prospects for merchandise trade growth are not expected to improve. The Commerce Department predicts that with the economic recovery here expected to boost the merchandise trade deficit sharply this year, the nation's balance in these transactions would likely be more than $20 billion in 1983, well above the $14.8 billion record set in 1978. If, as the Department of Commerce suggests, trade in goods continues to stagnate, the importance of service trade development becomes all too clear.

At a time when the service sector of our economy accounts for the greatest employment growth, travel and tourism is one of the most labor-intensive service industries and employs those who most need jobs and traditionally have the most difficulty finding them. In 1981, the travel and tourism industry was responsible for almost 20 percent of the total increase is U.S. employment. Indeed, the increase in employment since 1973 in eating and drinking places alone is greater than total employment in the automobile and steel industries combined.

Travel and tourism is, in a very real sense, the epitome of a service industry. Though the industry is often mis-

leadingly represented as one of many individual service enterprises, it actually makes up a significant portion of food services, lodging, transportation, advertising and entertainment. The industry also enjoys a close and mutually beneficial relationship with services such as telecommunication, banking, insurance and high technology such as data processing and computer services.

The travel and tourism industry is now the second largest retail industry in the United States. In 1981, the industry generated $191 billion in receipts and $17.9 billion in federal, state and local tax revenues. It directly employs 4.5 million Americans at every level of skill and indirectly provides another 2.2 million supporting jobs. Inbound international tourism represents our nation's third largest source of export income. The 23 million international visitors to the United States in 1981 spent $12.2 billion while staying here, which directly supported more than 300,000 jobs and generated more than $1.1 billion for federal, state and local governments in tax revenues.

Unfortunately, the role and dominance of travel and tourism is consistently and vastly underestimated even among some of the most sophisticated observers of the service industry. This is difficult to understand when, in view of government efforts to minimize and to reduce unemployment, to generate additional federal, state and local revenue, and to improve our balance of payments, travel and tourism is clearly a force to be reckoned with and nurtured.

While the United States may have, until recently, failed to recognize the effect of services industries, the subtlety has not been lost by our major trading partners. In recent years, nearly all our trading partners have been devoting substantial resources to development of trade. Developing countries in particular have noticed that service provision generally requires less initial capitalization than manufacturing, seems less vulnerable to inflation and recession and strengthens currency. The result of this awareness has been an intensification of efforts to capture a larger share of the world services market, with whatever economic device might be available and frequently at our expense. Consequently, the potential for expanded service sector trade is increasingly threatened by barriers to foreign trade. Non-tariff trade barriers and discriminating trade practices are multiplying, adversely affecting our export

position and promising to grow worse if left unchecked. The major objective of trade barrier imposition is to produce a competitive disadvantage for foreign enterprise, thereby protecting fledgling domestic service companies. Since many of these companies are publicly owned, American businesses ultimately subsidize their own competitors while gradually losing market access and viablity.

In late February 1983, the Office of the U.S. Trade Representative (USTR) circulated a draft study paper on international travel and tourism among travel industry officials. The paper, one of a series on barriers to international trade in various service sectors, has been prepared for U.S. government use in international trade discussions. It identifies and examines government-imposed restrictions affecting tourist trade. The following quotation from the study describes the lack of progress in removing barriers to international travel and tourism:

> "The problems confronting international tourism are many and varied; some are peculiar to individual aspects (e.g., customs regulations, documentation formalities, transportation, lodging, travel agencies), some are more general in nature and apply to several aspects of tourism (e.g., market access, operation of subsidiaries). Most of the problems do not lend themselves to quick solutions inasmuch as government actions are required to affect changes."

While all appropriate examples are too numerous to individually cite, among the broad spectrum of trade barriers highlighted by the draft report are: more than 100 countries impose restrictions limiting the amount of currency their citizens may purchase for travel abroad; 81 countries, including Greece, Italy and New Zealand, limit the amount of overseas travel; 20 countries tax overseas travel; 76 countries require residents to purchase travel insurance or deposit a prescribed amount of money in a non-interest-bearing account prior to departure. Restrictions on tourism-related businesses include: rules on the right to establish and advertise a business; prohibition against transferring funds out of the country; and requirements that foreign-owned businesses share profits with local partners. Also, airline radio and TV commercials produced abroad are prohibited in some countries, while other countries require that hotel rates be published a year in advance.

Coming from the Office of the President, the study may signal an end to long-standing apathy by Washington officials on the subject of travel and tourism. It offers encouraging evidence that the U.S. government finally is recognizing the economic importance of international travel. We hope the results of the study will also stimulate greater awareness of Congress of what various components of the industry (e.g., U.S. carriers, hotels, tour operators and travel agents) are up against in dealing with foreign governments seeking to protect local industries against American competition.

We hasten to mention that barriers which affect other service industries have a profound impact on travel and tourism as well. Restrictions governing the construction industry continue to frustrate the attempts of American companies to build new hotels or other travel facilities. Discriminatory telecommunications regulations have a broad and negative impact on the establishment and use of reservations systems. Banking restrictions often make it very difficult to exchange currency. We would caution the committee, however, that while services have some common interests which can and should be pursued, trade barriers affect individual industries in different ways. Multi-lateral negotiations should generally be approached on an industry-by-industry basis, thus avoiding the possibility that one service might become pitted against another.

Having this background, we support in principle, the objectives of H.R. 2848, and we praise Chairman Florio and Mr. Dingell for supporting and introducing legislation which addresses the crucial trade issues confronting the service sector today. H.R. 2848 would establish within the Commerce Department a program to enhance the international competitiveness of the U.S. service sector, through special analysis of U.S. and foreign restrictions and improved data gathering. The bill would also provide new Presidential authority to counter foreign barriers to service trade. In essence, the present proposal provides the focus essential to address the specific needs and concerns of the travel and tourism industry in the international arena with the long-range goal of strengthening our export competitiveness.

Finally, we are especially pleased that this legislation recognizes a growing and increasingly unfulfilled need

for service industry data. This has been a persistent problem for the travel and tourism industry. The bill calls for more comprehensive service industry data collection and analysis, which is essential for the development of appropriate policy designed to promote the expansion and liberalization of international trade in services. There is, however, one aspect of the language addressing this issue in H.R. 2848 which concerns us. We believe the extensive subpoena authority and penalties set out in this legislation, particularly in light of the very wide range of information requests set out in Section 3(a)(1) to which these authorities might be applied, undermines the cooperative spirit upon which any efforts between business and government to improve data collection systems on services must be based.

In conclusion, Mr. Chairman, we believe H.R. 2848 is an important step toward the creation of comprehensive service industries legislation so vitally needed by this country, and we hope that your legislation will provide such incentive.

Sincerely,

William D. Toohey
President

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