

UNITED STATES - JAPAN TRADE RELATIONS

HEARING
BEFORE THE
SUBCOMMITTEE ON TRADE
OF THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES
ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

MARCH 28, 1996

Serial 104-60

Printed for the use of the Committee on Ways and Means



U.S. GOVERNMENT PRINTING OFFICE

36-625 CC

WASHINGTON : 1997

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-054133-6

COMMITTEE ON WAYS AND MEANS

BILL ARCHER, Texas, *Chairman*

PHILIP M. CRANE, Illinois
BILL THOMAS, California
E. CLAY SHAW, JR., Florida
NANCY L. JOHNSON, Connecticut
JIM BUNNING, Kentucky
AMO HOUGHTON, New York
WALLY HERGER, California
JIM MCCRERY, Louisiana
MEL HANCOCK, Missouri
DAVE CAMP, Michigan
JIM RAMSTAD, Minnesota
DICK ZIMMER, New Jersey
JIM NUSSLE, Iowa
SAM JOHNSON, Texas
JENNIFER DUNN, Washington
MAC COLLINS, Georgia
ROB PORTMAN, Ohio
JIMMY HAYES, Louisiana
GREG LAUGHLIN, Texas
PHILIP S. ENGLISH, Pennsylvania
JOHN ENSIGN, Nevada
JON CHRISTENSEN, Nebraska

SAM M. GIBBONS, Florida
CHARLES B. RANGEL, New York
FORTNEY PETE STARK, California
ANDY JACOBS, JR., Indiana
HAROLD E. FORD, Tennessee
ROBERT T. MATSUI, California
BARBARA B. KENNELLY, Connecticut
WILLIAM J. COYNE, Pennsylvania
SANDER M. LEVIN, Michigan
BENJAMIN L. CARDIN, Maryland
JIM McDERMOTT, Washington
GERALD D. KLECZKA, Wisconsin
JOHN LEWIS, Georgia
L.F. PAYNE, Virginia
RICHARD E. NEAL, Massachusetts
MICHAEL R. McNULTY, New York

PHILLIP D. MOSELEY, *Chief of Staff*
JANICE MAYS, *Minority Chief Counsel*

SUBCOMMITTEE ON TRADE

PHILIP M. CRANE, Illinois, *Chairman*

BILL THOMAS, California
E. CLAY SHAW, JR., Florida
AMO HOUGHTON, New York
MEL HANCOCK, Missouri
DAVE CAMP, Michigan
JIM RAMSTAD, Minnesota
DICK ZIMMER, New Jersey
JENNIFER DUNN, Washington

CHARLES B. RANGEL, New York
SAM M. GIBBONS, Florida
ROBERT T. MATSUI, California
WILLIAM J. COYNE, Pennsylvania
L.F. PAYNE, Virginia
RICHARD E. NEAL, Massachusetts

CONTENTS

Advisory of March 6, 1996, announcing the hearing	Page 2
---	-----------

WITNESSES

Office of the U.S. Trade Representative, Hon. Ira Shapiro, Senior Counsel and Negotiator	7
---	---

American Forest & Paper Association, Maureen R. Smith	91
American International Group, Inc., Oakley Johnson	74
Anderson, Stanton D., Electronic Industries Association of Japan	128
Armstrong, Thomas W., Semiconductor Industry Association	33
Deline, Ken, Deline Box and Display on behalf of Eastman Kodak Co	32
Dreier, Hon. David, a Representative in Congress from the State of California	46
Eastman Kodak Co.:	
George M.C. Fisher	23
Ken Deline	32
Electronic Industries Association of Japan, Stanton D. Anderson	128
Fisher, George M.C., Eastman Kodak Co	23
Frost, Ellen L., Institute for International Economics	119
Fuji Photo Film, Inc., John Patrick	61
Graham, Hon. Lindsey O., a Representative in Congress from the State of South Carolina	116
Health Industry Manufacturers Association, Ed Rozynski	84
Hilty, Donald P., Economic Strategy Institute	154
Institute for International Economics, Ellen L. Frost	119
Johnson, Oakley, American International Group, Inc., and International In- surance Council	74
Levin, Hon. Sander, a Representative in Congress from the State of Michigan	53
Murphy, Cyril D., United Air Lines, Inc	134
Patrick, John, Fuji Photo Film, Inc	61
Paxon, Hon. Bill, a Representative in Congress from the State of New York	43
Rozynski, Ed, Health Industry Manufacturers Association	84
Semiconductor Industry Association, Thomas W. Armstrong	33
Smith, Maureen R., American Forest & Paper Association	91
United Air Lines, Inc., Cyril D. Murphy	134

SUBMISSIONS FOR THE RECORD

Andersen Worldwide, Robert F. Kelley, and Charles P. Heeter, Jr., statement	168
Guardian International Corp., Auburn Hills, MI, Ralph J. Gerson, statement ..	175
Keough, Steven J., Minneapolis, MN, statement	180

UNITED STATES-JAPAN TRADE RELATIONS

THURSDAY, MARCH 28, 1996

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:30 p.m., in room B-318, Rayburn House Office Building, Hon. Philip Crane (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON TRADE

FOR IMMEDIATE RELEASE
March 6, 1996
No. TR-19

CONTACT: (202) 225-1721

Crane Announces Hearing on United States-Japan Trade Relations

Congressman Philip M. Crane (R-IL), Chairman of the Subcommittee on Trade of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on United States-Japan trade relations. The hearing will be the second in a series to be held throughout 1996 on the status and future direction of U.S. trade policy. It marks the first hearing of the series to review one of our major bilateral trade relationships as the United States approaches the 21st century.

The hearing will take place on Thursday, March 28, 1996, in Room B-318 of the Rayburn House Office Building, beginning at 2:00 p.m. Additional hearing days will be scheduled at a later date.

Oral testimony will be heard from both invited and public witnesses.

BACKGROUND:

One of America's most important and contentious trading relationships is with Japan. As our second largest trading partner, Japan absorbed more than \$64.3 billion in U.S. exports in 1995. Overall U.S. exports to Japan have increased more than 20 percent over 1994 levels, reducing the trade deficit with Japan more than 10 percent, the first year-to-year decline since 1990. Yet, the overall size of the bilateral trade deficit with Japan -- \$59.3 billion in 1995 -- continues to be a source of deep friction between the two countries. A significant cause of the deficit is macro-economic imbalances between the two countries, primarily the excess of total spending over total savings in the United States, and the high rate of savings in Japan. In addition, Japan needs to sustain and expand efforts to open its economy to internationally competitive U.S. goods and services.

In 1993, the United States concluded the Framework for a New Economic Partnership with Japan. This umbrella agreement identified macro-economic goals and outlined areas for sector-specific and structural negotiations. The Administration has negotiated agreements under the Framework in key sectors such as automobiles and auto parts, financial services, and investment. In other sectors, such as photographic film, further negotiations are necessary. As well, the Administration is seeking renewal of the United States-Japan Semiconductor Agreement which expires on July 31, 1996. Many of these issues will be on President Clinton's agenda when he visits Japan on April 16, 1996.

FOCUS OF THE HEARING:

The focus of the hearing will be to review the overall state of United States-Japan relations, including U.S. trade policy towards Japan and prospects for increased trade in the future. In particular, the hearing will evaluate the effectiveness of various sectoral agreements in increasing U.S. exports to this important trading partner and progress in resolving ongoing bilateral trade issues.

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:

Requests to be heard at the hearing must be made by telephone to Traci Altman or Bradley Schreiber at (202) 225-1721 no later than the close of business, Wednesday, March 20, 1996. The telephone request should be followed by a formal written request to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Subcommittee on Trade will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee staff at (202) 225-6649.

In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. The full written statement of each witness will be included in the printed record.

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 200 copies of their prepared statements for review by Members prior to the hearing. Testimony should arrive at the Subcommittee on Trade office, room 1104 Longworth House Office Building, no later than 1:00 p.m., Tuesday, March 26, 1996. Failure to do so may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement, with their address and date of hearing noted, by the close of business, Thursday, April 11, 1996, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Trade office, room 1104 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any aliases or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the same full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Chairman CRANE. Will everyone please be seated. Good afternoon; this is a meeting of the Ways and Means Trade Subcommittee to continue our series of hearings on U.S. trade policy in the post-Uruguay round environment. We will receive testimony today on the status and future direction of United States-Japan trade relations.

This hearing is being held in anticipation of the President's trip to Tokyo to meet Prime Minister Hashimoto on April 16 where many of the issues we want to review today will be discussed. Accounting for 40 percent of the world's GDP, the relationship between the economies and the United States and Japan is as immense as it is complicated. Overwhelmingly dictated by macroeconomic forces, notably a high budget deficit and low savings rate in the United States, the large bilateral trade deficit with Japan continues to fuel protectionist measures in the United States. The good news is that after years of stubborn resistance to increased import penetration, the Japanese economy is showing measurable signs of true structural reform. For example, Japan increased overall imports last year by 22.8 percent.

Japan has become a much more hospitable market for high value-added manufactured imports than in the past. With this movement, Japan has begun to address its historic status as an outlier country not participating fully in the give and take of international trade. The stubborn bilateral trade deficit, which has defied all of our best efforts, shows marked improvement in 1995. As we evaluate prospects for the United States-Japan relationship in the 21st century, the need for better communication and cooperation is evident.

In light of China's military aggression, more should be done to coordinate bilaterally with Japan on security issues in the region. General deregulation of the Japanese economy also continues to be a high priority for solving market access problems on a large scale. Market-restricting measures identified by the industries represented here today, while the result of larger systemic problems, must also be addressed by Japan directly. While I agree we should use the WTO and APEC wherever possible to consult and negotiate solutions, recent Japanese resistance to discussing issues which are the subject of 301 investigations only encourages those in the United States who want to limit trade with Japan.

As the Washington Post recently reported, Japan may be the vanishing villain of the trade deficit drama. Japan is America's second largest trading partner, buying more than \$64 billion of U.S. products during 1995. Yet, as the world's greatest exporter, improved living standards for U.S. workers depend on getting a fair chance to compete across the fast-growing Asian market. The Japanese market remains the key to a successful Asian strategy, and we must work with Japan to achieve trade liberalization both in Japan and throughout the Pacific rim. The stakes are high, and market access problems remain deep in Japan.

I look forward to today's testimony, which will help us to better evaluate preparations for the President's trip in April. As a result of scheduling conflicts with other Subcommittees, we have begun later than I would have liked today, and we were also interrupted on the floor by some head knocking that produced a recorded vote

that was not predicted. I urge Members and witnesses to abbreviate their comments where possible and try to stick to the 5-minute rule. But all statements that you may have prepared will be inserted in the record, and we will be following a highly compressed schedule, so I would hope that all of our members—when they get over here— [Laughter.]

[The opening statement follows:]

**OPENING STATEMENT
CONGRESSMAN CHARLES B. RANGEL
SUBCOMMITTEE ON TRADE
HEARING ON U.S.-JAPAN TRADE RELATIONS
MARCH 28, 1996**

Mr. Chairman, thank you for holding these hearings today to review U.S. trade policy towards Japan and to evaluate the effectiveness of our numerous bilateral trade agreements with Japan. This hearing is particularly timely in view of President Clinton's upcoming visit to Japan in mid-April. In his meetings with Prime Minister Hashimoto, the President will undoubtedly discuss a number of ongoing trade problems we have with Japan and ways to resolve those problems. I hope these hearings can assist the Administration in preparing for the President's visit. I welcome Ambassador Shapiro, Congressman Levin, Congressman Dreier, and our other witnesses to help take us through the issues today.

Japan is our second largest trading partner behind Canada. Our merchandise exports to Japan reached an all-time high of almost \$65 billion last year, but our merchandise deficit, while coming down, is still unacceptably high at almost \$60 billion. While our bilateral trade deficit with Japan can be attributed in part to macroeconomic forces, it is still true that the Japanese market is less open to U.S. imports than the American market is open to Japanese imports. While progress has been made, Japan over the last two decades has been probably the largest source of trade policy frustration for the United States.

Since 1980, we have negotiated well over 50 bilateral trade or trade-related agreements with Japan. The Clinton Administration has negotiated some 20 of these agreements. Despite our success in negotiating these agreements, the success of the agreements themselves in opening the Japanese market to U.S. exports has been mixed. Some agreements have indeed led to a demonstrable and impressive increase in U.S. exports. Others have not been fully implemented or have been less effective.

It is important to learn from our past negotiating and implementation experiences which trade agreements with Japan have worked well and why. It is also important to ensure that the agreements are being fully complied with and that we are getting the most out of them. In this connection, the private sector, in addition to the government, has an obligation to monitor implementation and to take full advantage of the market access opportunities opened up by the agreements.

Finally, with respect to ongoing negotiations, we must do what we can to assist our negotiators in reaching effective outcomes with Japan. In this regard, I was somewhat discouraged to read in the paper recently statements made by high-ranking Japanese officials that the era of trade bilateralism between the United States and Japan is over. Our ability to reach bilateral trade agreements with Japan has contributed to a modicum of stability in what has been at times a rocky trade relationship. I would hope that Japan would recognize this and continue to reach bilateral trade agreements with us to address specific trade problems.

In closing, Mr. Chairman, I would like to publicly acknowledge that USTR has just issued its 1995 Annual Report on the Trade Agreements Program. In Annex II of this report, USTR has compiled and publicly presented for the first time ever a consolidated list of all the substantive trade agreements entered into by the United States since 1984 to increase foreign market access and reduce barriers and other trade distorting policies and practices. This addition to USTR's annual report is in response to an amendment I sponsored to USTR's authorization bill last year. Although that authorization bill has not been enacted into law, USTR nonetheless saw fit to implement the substance of the amendment and I wish to thank them publicly for their work in this regard.

Thank you again, Mr. Chairman.

Chairman CRANE [continuing]. All of our Members would adhere faithfully to the clock on the table there. And with that, I would like to introduce Ambassador Shapiro for his opening statements.

STATEMENT OF HON. IRA SHAPIRO, SENIOR COUNSEL AND NEGOTIATOR, OFFICE OF THE U.S. TRADE REPRESENTATIVE

Mr. SHAPIRO. Thank you, Mr. Chairman. It is a pleasure to be here. I welcome the opportunity to speak with the Subcommittee to discuss the administration's Japan trade policy, and my comprehensive statement, I am glad, will be in the record, and I will try to abbreviate my remarks.

From the start of this administration, Mr. Chairman, the President has said that we reject what he described as the false choice between unilateral free trade on the one hand and protectionism on the other hand. He has affirmed that open and competitive commerce enriches us as a Nation, and that we will compete, not retreat. But he has also stated that we will welcome foreign products and services into our market, but we will insist that our products and services be able to enter other markets on equal terms.

For more than 3 years, the administration has followed this view: Open trade but with comparable access. We believe American companies benefit from and will support free trade but only if it is fair trade as well. In our experience, Mr. Chairman, nowhere are those principles more applicable and nowhere have we worked harder to apply them than with respect to Japan. We have insisted from the beginning that our companies and workers needed greater access to the Japanese market and have tried to redress and rectify the longstanding imbalance and lack of access to that market.

We have said from the outset that we would work to open Japan's market multilaterally where possible; regionally where appropriate; and bilaterally where necessary, and we have worked steadfastly to do so. Nearly 3 years ago, our two countries signed the United States-Japan Economic Partnership Framework, which was a comprehensive approach to macroeconomic, sectoral and structural issues. We felt that we had to attack these questions together, that if macroeconomic change occurred, if structural change of the sort that you referred to had occurred, it would reinforce our efforts on the sectoral front, but also, our sectoral activities would reinforce the drive for a deregulated, more open, more competitive market. And we also said that making progress required not only concluding trade agreements with Japan but ensuring that they were implemented and enforced.

We have followed a consistent course, and we are beginning to see some important progress after negotiating 20 trade agreements with Japan, including our Uruguay round agreements. As the Chairman indicated, last year, the trade deficit between our countries started coming down and according to Japanese figures, fell to its lowest level in about 12 years. We have seen great progress on the Japanese current accounts surplus, which went down from 3.5 percent to less than 2.6 percent this year. The United States exports to Japan—and I looked at the numbers, and I realized that from 1990 to 1993, they were almost totally flat—at about \$48 billion. But in 1994, we saw an 11-percent increase, and last year, it was a 20-percent increase as the results of a number of things

came into play at the same time, including our agreements and the Uruguay round in its first year. And we are seeing export growth in all major categories, from autos and auto parts, capital goods, agricultural products, and we have seen impressive growth in the sectors that are covered by our trade agreements.

I want to make it clear that we do not attribute what is going on entirely to trade agreements or even to trade efforts on our part. U.S. companies and workers have dramatically increased their competitiveness and expanded resources that they are putting forth to crack the tough Japanese market. Macroeconomic factors also enter into it, but nothing in our standpoint—these things come together—nothing the government does to open the Japanese market will work if our companies and workers are not ready to take advantage of opportunities. But at the same time, their efforts need to be reinforced by continuing government effort in this regard. And I think from our standpoint, the auto agreement that we reached with Japan and developments in the automobile area reinforce the message that government, industry, workers have to combine their efforts and tie into the forces at work in Japan as well. What we have seen since we reached the agreement is significant deregulation, beginning in Japan in the so-called aftermarket; more opportunities for U.S. partsmakers that have been shut out of Japan for 20 years—immediate opportunities, in fact, in certain of the areas; greater commitment of resources and new product offerings from the Big Three, knowing that we are determined to back up their efforts by opening the market.

So we are seeing progress on a number of fronts. There are certain areas where the progress has been less promising, and we remain concerned about certain dealership issues and remain talking to Japan about those. But overall, we are seeing growth of U.S. autos to Japan; growth of sales and auto parts; increasing use of U.S. parts in production that is done here; increasing amounts of automobiles produced here instead of in Japan. And so, overall, we are seeing progress for a number of reasons.

Let me say that when we say we have seen progress, it does not mean that the work is done by any means. We have a lot more to do; we are pledging constant, sustained effort; we have got a full agenda to carry forward from here. We intend to work vigorously on our existing trade agreements and to resolve other outstanding issues. Let me just comment briefly on several of the major issues: The first is we are pleased that earlier this week, the State Department and the Transportation Department negotiators were able to reach an agreement on cargo in their negotiations with Japan, and that is an agreement that expands opportunities for U.S. cargo producers, builds upon what was already there and goes beyond it for a number of our cargo carriers and at the same time extends increased reciprocal opportunities to the Japanese and resolves an important issue between us.

With respect to semiconductors, as you all know, the current United States-Japan semiconductor agreement is due to expire on July 31. We believe that the semiconductor agreement has been an important agreement; that we have achieved a great deal under that agreement; and that it has contributed to harmony between U.S. companies and Japanese companies; relationships have been

stronger than ever before; both countries have benefited from the semiconductor agreement; and an atmosphere of confrontation that existed before has given way to more cooperation. In our view, the record, which I have tried to lay out in our written statement at length, points to the need and the value of a new semiconductor agreement, which, based on industry efforts coupled with a government-to-government agreement, we believe that it ought to be possible to fashion an agreement that reflects the changed conditions in the industry, where we are now, but carries forward the progress that has been made. Japan has indicated thus far a belief that the agreement should not be renewed or extended, but we believe that discussions that go on concerning this issue between now and June and July hopefully will bring about a recognition that both sides value and benefit from a continuation of the government-to-government agreement and the increased industry cooperation that the semiconductor agreement has had.

Mr. Chairman, if I may, I'd like to say a word about the insurance issue. For some months, we have conveyed to the government of Japan our concern that their plans to implement the insurance agreement were not consistent with the agreement as it has been written, and our concerns have only intensified in recent weeks. The basic issue here, Mr. Chairman, as the Subcommittee knows, is the linkage between primary sector deregulation, primary life and nonlife on the one hand, and the so-called third sector, the smaller sector in which foreign providers have been able to carve out some market share. The agreement is quite clear: Primary sector liberalization has to proceed before the third sector is subject to radical change. You open up the primary sector; you have competition; foreign providers have the opportunity to compete. And only after that, and only after a period of time—several years—has passed, do you allow the third sector to be opened to radical change.

The Japanese have, in their interpretation of this agreement, in my mind seriously departed from that understanding. They have focused their efforts on the opening of the third sector and have not moved forward with primary sector deregulation, and we are continuing to talk with them about it; we continue to want to resolve this issue in the near future. But we will not stand by for an interpretation of the agreement that departs dramatically from the agreement as written. This is a fundamental issue, because it is the implementation of an existing framework agreement.

Last, Mr. Chairman, in terms of current issues—and I am conscious of the time—on the film dispute, in response to a petition filed by Eastman Kodak, we have initiated an extensive investigation of Japanese barriers in the film and photographic paper sector, and Kodak's petition alleges many of the types of problems and pervasive anticompetitive business practices that we have sought to deal with in negotiations in the past on autos, glass, paper and other sectors. Those include direct Japanese Government participation in the creation of a distribution system that severely limits foreign access through interlocking financial relationships and other practices.

Kodak is a first-rate American competitor which has a strong presence in markets around the world. But despite decades of ef-

fort, it has not been able to make more than a small dent in the Japanese market. We are spending significant time and resources on this investigation. We have not concluded the investigation, nor have we reached any conclusions at this time. But I think we are working fully to understand the makeup of the market, potential barriers, and the interrelationship of these barriers to anticompetitive practices.

On February 21, the Japanese Government indicated that the JFTC would conduct a survey in this sector. That survey notwithstanding, we have indicated to Japan that this issue is best resolved through negotiations that would involve MITI because of the market access questions involved. Thus far, as the Subcommittee knows, MITI has preferred not to discuss the issue, saying that this is simply a JFTC matter. In our view, Mr. Chairman, this issue is best resolved through discussions, but we are going to continue our investigation and defining the market and move ahead to resolve this issue after our investigation is finished.

Let me say that some in Japan have argued that Kodak's treatment in the market has been mirrored by Fuji's treatment in the U.S. market, and in my view, that myth needs to be debunked. Comparing market shares can be illuminating if the circumstances are the same, but superficial comparisons of different systems do not work very well if you just look at numbers. As a general matter, foreign firms have no problem gaining access to the distribution system in the United States, and Kodak's activities in the United States have been carefully scrutinized over the years by our antitrust authorities. In contrast, the Japanese Government implemented liberalization countermeasures which effectively restricted foreign producers' access to the Japanese market.

Mr. Chairman, there are a host of other issues that I would be happy to respond to questions on. I want to just indicate that we share your view, and we share the view that I know Congressman Dreier has, that we all would benefit, and the situation in trade would be benefited by broad deregulation and structural change in Japan. We have aligned ourselves with the forces that favor that kind of change, and we have made comprehensive presentations to the Japanese Government on that. I have met with the Diet member, Mr. Mizeno, who is supervising that effort. I meet with him whenever I am in Tokyo. But we believe that we will make the most progress by moving forward on that issue, that set of issues, as well as pursuing the sectoral issues that remain between us and Japan.

I would say after 3 years of sustained work, we believe that we have made good progress, but much remains to be done. We have always benefited from the bipartisan consensus in Congress and the country that the level playingfield between us and Japan portrayed was long past due. We will keep working to enforce our trade agreements, resolve outstanding issues, and deal with new issues as they arrive.

Thank you, Mr. Chairman.

[The prepared statement follows:]

**Testimony of Ambassador Ira Shapiro
Office of the United States Trade Representative
House Ways and Means Trade Subcommittee
March 28, 1996**

Mr. Chairman, I appreciate the opportunity to appear before the committee today to discuss the Administration's Japan trade policy.

President Clinton made it clear that our trade policy would not be business as usual within weeks of taking office. On February 26, 1993, at the American University, he rejected the false choice between unilateral free trade and protectionism. He affirmed the view that "open and competitive commerce enriches us as a nation," and that "we would compete, not retreat." But he also stated "we will continue to welcome foreign products and services into our markets but insist that our products and services be able to enter theirs on equal terms." For more than three years, this Administration has followed this view: open trade--but with comparable access. American workers benefit from, and will support, free trade, but only if it is fair trade as well.

Nowhere are those principles more applicable, and nowhere have we worked harder to apply them, than with respect to Japan. When this Administration came to office, we were determined to obtain for U.S. companies and workers the same level of access to Japan's markets as Japanese exporters have enjoyed in U.S. markets. We indicated then that we would work to open Japan's market: multilaterally where possible, regionally where appropriate and bilaterally where necessary, and we have worked steadfastly to do so.

Nearly three years ago, our two countries signed the U.S.-Japan Framework for a New Economic Partnership. This agreement was carefully conceived and is part of the Administration's broader trade policy. The Framework agreement represents a comprehensive approach to macroeconomic, sectoral, and structural issues. Previous Administrations had focused on one or another of these areas with Japan; this Administration realized that the impact of our efforts to resolve trade problems in specific sectors would be enhanced significantly if they were reinforced by macroeconomic and structural changes in the Japanese economy, which would improve the competitive environment.

The Framework agreement also is distinctly results oriented, a focus that distinguishes it from virtually all previous approaches. In each sector we identified major barriers to access, negotiated to resolve them, and agreed to assess the progress through a series of objective criteria. The Administration recognized that making progress would require not only concluding trade agreements with Japan, but ensuring that they were implemented and enforced. In this regard, when we have faced problems with regard to implementation of our trade agreements, we have taken the steps necessary to enforce our rights under these agreements -- in sectors ranging from construction to cellular phones to sound recordings.

We have followed a consistent course, and we are beginning to see some important progress. Overall, in the past three years, we have negotiated 20 trade agreements with Japan. Last year, the U.S. trade deficit with Japan fell 9.7 percent. Moreover, Japan's current account surplus declined to 2.2 percent of GDP last year, down from 3.2 percent in 1994 and 3.5 percent in 1993. Given that the Framework calls for a highly-significant reduction in Japan's current account surplus in the medium term, the declines we have seen over the past two years are gratifying.

U.S. exports to Japan have grown to record levels, rising 20.3 percent last year over 1994 levels, which had been the previous record high. Since the beginning of this Administration, U.S. exports to Japan have increased by 34 percent.

This growth has not been limited to just a few sectors. We are seeing export growth in all major categories: foods, feeds, and beverages (up 15 percent in 1995); autos, auto parts, and engines (up 36 percent); other capital goods (up 22 percent); industrial supplies (up 20 percent);

and consumer goods (up 17 percent). These gains are particularly impressive given the slow growth that the Japanese economy has experienced for the past several years. In those sectors covered by trade agreements reached by this Administration (from telecommunications to autos to rice), exports grew by more than 80 percent through since the President took office -- nearly 2.5 times as fast as overall U.S. exports to Japan.

This growth of U.S. exports benefits our firms and workers, but it also benefits Japanese consumers. The imported housing initiative recently announced by Prime Minister Hashimoto is a good example of how market opening initiatives can be mutually beneficial. This initiative would reduce the cost of housing in Japan, provide greater choice to Japanese consumers, and provide new opportunities to U.S. firms, which are leaders in housing and building materials.

Obviously, we do not attribute this progress entirely to our trade agreements. U.S. companies and workers have dramatically increased the competitiveness of U.S. products and services, and have expended considerable efforts and resources on marketing these products and services in Japan. Macroeconomic factors also have played an important role. Moreover, Japanese consumers seem more willing to buy high quality, reasonably priced foreign products than they were several years ago. A recent Washington Post story reinforces anecdotally what the statistics are showing: new opportunities and sales in Japan for everything from U.S. autos and auto parts to refrigerators to furniture to blue jeans to breakfast cereal.

However, it is important to recognize the contribution that our trade agreements have made to the recent progress we have witnessed. Opening Japan's market requires a partnership between our government and our companies and workers. Nothing the Government does to try to open the Japanese market will ever be successful unless U.S. companies and workers are poised to take advantage of the opportunities. But at the same time, all the best efforts by U.S. companies and workers may fall short without the pressure and sustained efforts by the U.S. Government to help open the market.

The automotive sector illustrates just how our trade agreements, efforts by U.S. companies and workers, and changes in Japan are combining to open the Japanese market and change the imbalance of U.S. trade. For 20 years, world class U.S. auto parts producers have been closed out of the Japanese market. But because of the trade agreement reached last summer, which committed Japan's Ministry of Transport (MOT) to major steps to deregulate the aftermarket for replacement parts, real competitive opportunities for U.S. parts makers, for sales of everything from roof racks to transmissions, began to appear almost immediately in Japan. Because the agreement required MOT to remove shocks and struts from the "critical parts/disassembly repair list," Monroe shocks will be sold shortly at hundred of gas stations and Toyota is offering them throughout its distribution system in Japan. Thanks to the changes required by the auto agreement, real competitors to the certified and designated garage system in Japan have emerged, opening the door for the first time to high quality, lower cost foreign auto parts. U.S. firms are beginning to seize these new opportunities, and significant progress should continue in coming years.

At the same time, Big 3 vehicle sales to Japan increased 46 percent last year. The trade agreement reinforces the Big 3's intensified commitment to the Japanese market, which was reflected in the extremely positive reaction that the Big 3's new right-hand drive models got at the Tokyo motor show in November.

However, there remain some areas where progress under the auto agreement has been somewhat disappointing. In particular, recruitment of new auto dealers in Japan has been slow, with only 30 new dealers signed up since the agreement was signed. We well understand the frustration of the Big 3 at the limited progress, especially given their serious efforts and the release of new models. We also understand that unless significant progress toward the goal of 200 new dealers is made by the end of 1996, exports of Big 3 vehicles to Japan will continue to be constrained. The Administration will use every opportunity to raise this issue with the Japanese Government, and we expect that the dealer recruitment pace will pick up as the attractiveness of the new U.S. models become evident.

In the United States, Japanese transplants are planning increases in their production consistent with their global business plans. Toyota plans to construct a new plant in Indiana, employing 1,300 workers, with half the parts likely to come from U.S. parts suppliers. Nissan is planning to significantly expand its engine manufacturing complex in Tennessee. Many of the autos that were until recently being made in Japan for the U.S. market are now being made in the U.S. Reliance on U.S. auto parts continues to increase.

There is no doubt that the global automotive market will be extraordinarily competitive in the coming years. But I believe that we are witnessing a situation which has been significantly transformed by the trade agreement and the events of the past few years. We are looking forward to release of the semi-annual auto report in mid-April, which will allow us to fully assess progress and closely monitor implementation of this agreement.

The Current Trade Agenda

While we are encouraged by the recent progress, opening the market in Japan requires a constant, sustained effort. Over the next several months, we intend to work vigorously to enforce our existing trade agreements and to resolve other outstanding issues. Let me highlight the three issues that are of immediate concern: semiconductors, insurance, and film, and say a few words on the civil aviation agreement reached earlier this week.

Semiconductors

The current U.S.-Japan Semiconductor Arrangement is due to expire on July 31. It constitutes an important and successful agreement that we believe should be extended.

We have achieved a great deal under the Semiconductor Arrangement -- particularly over the last three years:

- Foreign market share of the Japanese semiconductor market has increased significantly and the U.S., which has the largest and most competitive semiconductor industry in the world, has been the major beneficiary of this development.
- The agreement referenced the U.S. industry expectation that foreign market share should reach 20 percent by the end of 1992 if adequate market opening measures were undertaken. The foreign market share now has exceeded 20 percent for nine consecutive quarters. In 1995, foreign market share averaged 25.4 percent, fully three percentage points above the 1994 average share of 22.4 percent and six percentage points above the 1993 average share of 19.4 percent.
- Relations between the U.S. industry and the Japanese industry have greatly improved -- much to the benefit of both parties. Long-term commercial relationships and alliances between U.S. and Japanese companies have taken hold and are flourishing. By creating an environment in which Japanese user companies and U.S. suppliers were able to take advantage of the market opportunities and the competitive strengths offered by each party, the agreement has resulted in increased sales for foreign suppliers and better products, better service, lower input costs and a broader array of semiconductors for Japanese users. The result has been better end products, and more competitive industries on both sides of the Pacific.
- The harsh confrontation which had characterized discussions between the U.S. and Japan on this issue has been replaced by an atmosphere of cooperation.

The conclusion that the Japanese government has drawn from this situation is that the Arrangement that expires on July 31, 1996 should not be extended. Understandably, we draw a very different conclusion. We think it is important that the gains made under the agreement be preserved and that the progress made in recent years be continued -- and that continuation of some kind of government-to-government arrangement is needed to achieve these objectives.

The current Arrangement (and the earlier 1986 Arrangement) was negotiated to address

persistent problems of foreign access to the Japanese semiconductor market. These problems were largely the result of the tightly-knit relationships (initially developed behind a wall of formal trade barriers) between Japanese users and suppliers of semiconductors. For years, despite the demonstrated world class competitiveness of U.S. and other foreign semiconductor producers, their participation in the Japanese market remained extremely limited -- as reflected by very low foreign market share. The framework of commitments and activities established by the bilateral agreement, both by governments and industries, has provided a means of overcoming these impediments and of achieving the major strides in market access that we have seen in recent years. They have been a critical factor in encouraging U.S. industry to make the sort of major efforts and investments needed to "crack" the notoriously tough Japanese market. Without an arrangement, our companies see the prospects for further progress as uncertain and the risk of backsliding to be a real concern.

Although much progress has been made, we believe there is still plenty of room for further improvement and that a continuation of the sort of efforts called for under the agreement will yield additional gains in terms of industry cooperation and increased market access. In particular, we think improvements can be registered in:

- The automotive, telecommunications, and video game sectors, where foreign share remains rather low and U.S. and foreign suppliers have very competitive products to offer.
- Increased foreign participation in design-ins -- particularly, so-called heart of the system, big ticket design-in contracts. Foreign participation in the Japanese market is still disproportionately focused on commodity products, or products such as microprocessors where Japanese firms are not competitive.
- Sales to small and medium-sized Japanese companies which have not yet integrated foreign products to the point where sales could be expected to be sustained or improved in the absence of an intergovernmental semiconductor agreement.

Moreover, this is a highly cyclical industry. Worldwide growth in demand for semiconductors increased by 40 percent in 1995, the highest level ever. But this is an industry where growth is characterized by peaks and valleys. As recently as 1990, the world semiconductor market grew by only 1.6 percent, and in 1985 there was negative growth. Growth in 1996 is forecast at approximately 22 percent, or only about half the growth we saw in 1995. We are now seeing clear signs of a weakening of demand for semiconductors, particularly for DRAMs.

The point is, although the long-term prospects for growth in the semiconductor industry are very good, we should still expect periodic downturns and, in particular, we should not expect the rosy economic conditions of recent years to continue without interruption. These downturns breed disputes and the established consultative mechanisms of the bilateral agreement will provide a way of constructively dealing with these problems and addressing them effectively.

We believe that a new agreement should reflect the progress made and the improvements in industry cooperation that have occurred under the current arrangement. We frankly anticipate a reduced role for government in a new agreement. Moreover, we have made clear to Japan that we are prepared to address any of their specific concerns seriously and flexibly, including the fact that the agreement should not include a new numerical target.

We believe that the merits of continuing the progress and the improvements we have achieved under the current agreement are overwhelming, and we are optimistic that common sense and pragmatism will eventually lead to a mutually beneficial resolution of this matter.

Insurance

For months, the Administration has conveyed to the Government of Japan our serious

concerns about the Ministry of Finance's apparent plans to implement the insurance agreement reached between our countries in 1994 in a way that would violate the agreement. Our concerns have only intensified in recent weeks, as the Ministry of Finance has moved closer to the point when it would have to issue ordinances to implement its new insurance law.

The core of the dispute with Japan centers on the linkage between deregulation of Japan's primary life and non-life insurance markets and the entry of Japanese insurance firms into the so-called "third sector," a segment of the market consisting of such products as personal accident and cancer insurance. Currently protected by overregulation and anti-competitive corporate practices, the primary life and non-life sectors combined make up 95 percent of Japan's total insurance market, the world's second largest at over \$380 billion in total premiums in FY1994.

The Ministry of Finance's imposition of excessive uniformity among insurers has prevented foreign firms from competing in the primary life and non-life sectors based on their strengths of product innovation, pricing and marketing. As such, foreign firms were forced to concentrate their efforts in building a presence in the remaining 5 percent of Japan's market consisting of third sector products. Foreign firms currently rely on the third sector market for more than half of their total premium income generated in Japan.

In light of the dependence of foreign firms on the third sector market, the U.S. sought during the negotiations of the insurance agreement to prevent MOF from engaging in immediate, discriminatory and selective deregulation of the third sector, while retaining protections for Japanese insurance firms in the primary life and non-life sectors. We believed that MOF should first focus its deregulatory efforts on the 95 percent of the market dominated by large Japanese insurers, rather than the 5 percent of the market critical to foreign and small and medium-size Japanese firms.

That is what the agreement establishes. It contains a clear linkage between deregulation of the primary life and non-life sectors and new or expanded activities by Japanese companies in the third sector. Before Japanese companies -- including the new subsidiaries to be formed later this year -- can undertake significant new or expanded activities in the third sector, there must first be substantial deregulation in the primary sectors.

Precisely put, the key provision of insurance agreement currently under dispute states that, "with respect to new or expanded introduction of products in the third sector, it is appropriate to avoid any radical change in the business environment, recognizing that such change should depend on medium to small and foreign insurance providers first having sufficient opportunities (i.e., a reasonable period) to compete on equal terms in major product categories in the life and non-life sector through the flexibility to differentiate, on the basis of the risk insured, the rates, forms and distribution of products."

As far back as last spring, USTR began to hear growing concerns from U.S. firms about the MOF-led reform process, in particular with regard to the third sector provisions. Contrary to the agreement, MOF's interest in deregulation appeared targeted solely on the third sector, where it is prepared to allow new non-life subsidiaries of life insurance companies to market insurance. We raised this issue repeatedly with MOF and at all levels of the Administration. Yet despite several months of discussions, Japan continues to adhere to a position inconsistent with this basic linkage.

In fact, MOF appears determined to resist timely and meaningful deregulation in the primary sectors. For example, a February 29 Kampo announcement sets forth a threshold of 30 billion yen insured risk for commercial fire insurance above which firms will be allowed to innovate based on price. Unfortunately, this "market opening" on the part of MOF applies to less than 2 percent of this important market segment.

Our officials have put forward proposals for longer-term substantial deregulation of Japan's insurance market. Unfortunately, MOF has rejected our proposal on long-term substantial deregulation. The U.S. position is pro-deregulation and pro-consumer. It would

benefit Japanese consumers and companies and would be consistent with the thrust of deregulation espoused by Prime Minister Hashimoto.

I am not at all optimistic that we will be able to bridge our differences in the absence of a reaffirmation by MOF of the basic, long-term linkage between deregulation in the primary sectors and expansion by Japanese companies in the third sector. Without the assurance of this basic linkage, our industry faces long term decline in its competitive position in Japan, contrary to the very premise of the agreement. The U.S. remains willing to continue our bilateral talks if MOF will positively address this issue. However, we will not stand by if a priority sector Framework agreement is not implemented as intended.

Film

Let me now turn to the film sector. In response to a petition filed by Eastman Kodak, USTR initiated an investigation of Japanese barriers in the film and photographic paper sector. Kodak's petition alleged many of the types of pervasive anticompetitive business practices that the U.S. sought to deal with in negotiations on autos, glass, paper, and other sectors. Among these are direct Japanese government participation in the creation of a distribution system that severely limits foreign access through interlocking financial relationships, exclusionary rebates, and other anticompetitive practices.

Kodak is a first-rate American competitor, which has a strong presence in markets around the world. Despite decades of intensive efforts, however, Kodak has made little more than a dent in the Japanese market.

The structure of the Japanese film market, which features a complex and rigid distribution system, differs significantly from the structure of the market in the U.S. Primary wholesalers or subsidiaries of film manufacturers deliver most of the film that is distributed to the 279,000 outlets that sell film in Japan. Japan's four largest film wholesalers have distributed Fuji film exclusively since 1975. Fuji maintains close ties to these distributors, through a variety of means.

Because foreign manufacturers have been unable to gain access to this channel they have attempted to develop parallel distribution networks, but with only limited success. Foreign manufacturers use secondary wholesalers to distribute a small percentage of their film (approximately 15 percent), but none of these secondary wholesalers have the national coverage or size of the tokuyakuten. In fact, the largest secondary wholesaler of photographic goods is about one-third as large as the smallest tokuyakuten. Foreign manufacturers also have tried to increase their market share through direct sales to discount stores. Agfa's use of this distribution channel has been hailed as evidence that it is possible to enter the Japanese market without going through the tokuyakuten. Unfortunately, Agfa has not been able to obtain more than a token market share using this channel of distribution.

Without full access to the distribution network, retail sales of foreign film will remain constrained. About half of all film sales in Japan are made through photospecialty stores (as compared with about 3 percent in the U.S.). Foreign film is more available in large discount stores, but these stores are located mainly in major metropolitan areas and their number, size, and hours of operation are limited by the Large Scale Retail Store Law.

Even without getting into the allegations of anticompetitive practices for the moment -- and we are still investigating these issues -- these are some of the complex distribution problems that foreign firms face. There is clear evidence that the Japanese Government played a key role in setting up this distribution structure. Nonetheless, the Government of Japan has refused to meet with us to discuss this matter, insisting that it is strictly a company-to-company dispute. In the Japanese Government's view, Kodak is alleging anticompetitive practices by Fuji, and thus, should go to the Japan Fair Trade Commission (JFTC) which has jurisdiction over the Antimonopoly Act and anticompetitive practices.

On February 21, the Japanese Government announced that the JFTC would conduct a survey of the film and photographic paper markets. This survey notwithstanding, we are continuing to seek consultations with the Government of Japan given that the JFTC survey cannot address the full range of issues involved in this case. Among the topics we would like to discuss are laws, administrative guidance, and recommendations regarding distribution and the conduct of competition in the Japanese market issued by the Japanese Government during the past five years, all of which could be used to improve market access in Japan. These include the 1991 Guidelines for Improving Business Practices, 1993 Recommendations on Medium-Small Wholesale Industry Business Practices, 1995 New Business Reform Law, 1995 Vision for Distribution in the 21st Century, the 1995 Economic Plan for Structural Reform, the Large Scale Retail Store Law, and Japanese Government implementation of its commitments under the Structural Impediments Initiative.

We have made it clear to the Japanese Government that we would prefer to address this issue in a cooperative manner. However, if the Japanese Government remains unwilling to consult with us, we will be left with no choice but to consider what other steps are necessary.

Some in Japan have argued that Kodak's treatment in the market is "mirrored" by Fuji's treatment in the U.S. market. This myth needs to be debunked. Market share comparisons can be illuminating if supported by evidence of market barriers, but superficial comparisons of market share are misleading and distort the serious nature of the problems faced by foreign firms in the Japanese market. First of all, as a general matter, foreign firms have no problem gaining access to the distribution system in the U.S. Moreover, beginning in the 1920s, the U.S. Government has taken anti-trust action against Kodak's practices in the U.S. market. In contrast, the Japanese Government implemented liberalization countermeasures which effectively restricted foreign producers' access to the Japanese market.

Civil Aviation

Turning to civil aviation, negotiators from the Departments of State and Transportation reached agreement with Japan on Wednesday, March 27, on the elements of an air cargo agreement which creates significant new commercial aviation opportunities for both sides. It is expected that the parties will meet again in Washington in mid-April to finalize the text of a Memorandum of Understanding on Air Cargo Services. The agreement, which meets the goals the U.S. and Japan set out in Los Angeles last year, is a balanced package which liberalizes and expands our bilateral aviation regime. This successful negotiation illustrates our ability to work bilaterally and to reach agreement on a difficult and complex commercial issue.

Other Agenda Items

While the Administration considers it a priority to make progress on the issues I have outlined, we also intend to vigorously monitor and enforce our other bilateral agreements with Japan in such critical areas as autos and auto parts, telecommunications, supercomputers, computers, wood, paper, and glass. We are fully committed to ensuring that Japan is living up to its obligations under the WTO. Moreover, to complement these sectoral efforts, we also are pursuing structural initiatives.

Let me briefly summarize where we stand on these issues. We have challenged Japan in the WTO for its failure to protect existing sound recordings in a manner consistent with its obligations under the TRIPs agreement, and are gratified by indications that Japan has decided to change its law to provide the 50 years of protection required by TRIPs. We are consulting with Japan about disturbing evidence that recent supercomputer procurements have not been made in accordance with the procedures of the Supercomputer agreement, which had produced significant gains in recent years. While we are pleased about the strong showing made by U.S. personal computers in the Japanese market, we have brought to Japan's attention evidence of deep discounting on computers by Japanese companies which has cost our companies sales in the public sector market.

We are concerned about lack of progress under the NTT agreement. Foreign share

reached 10 percent in 1994, which is disappointing given the global competitiveness of U.S. firms in this sector. In addition, we are extremely concerned about the reluctance of NFI's personal handyphone subsidiary to follow the NTJ procurement procedures. We have hope for progress in the area of wood products, where Prime Minister Hashimoto has put forth the concept of an ambitious imported housing initiative, but remain troubled that Japan has not moved further to reduce tariffs and to adopt performance-based, rather than prescriptive, standards for building materials. We remain seriously concerned about the lack of effective implementation by Japan of our bilateral agreement on paper and paper products, which led to continued 301 watch listing in this sector. We note the 93 percent increase in U.S. exports since the conclusion of the glass agreement, but we are continuing to monitor implementation of this agreement carefully, to insure that the current level of imports represents the beginning of growth that the competitiveness of our companies' warrant.

To complement our sectoral efforts, we have been working closely with the Japanese Government on structural issues, in particular on deregulation, competition policy, and administrative reform. Japan is currently revising its deregulation plan and the new final plan is scheduled to be released tomorrow. In support of these efforts, the U.S. presented a 42-page submission on deregulation and competition policy to the Japanese Government last November. The submission includes specific deregulation proposals in 12 areas, including agriculture, autos and auto parts, construction, energy, insurance, financial services, telecommunications and transportation. We discussed our submission with Japan in December, and met again in late February in an effort to encourage Japan to factor our suggestions into its revised plan.

While we have been disappointed with Japanese Government efforts so far, we hope that our support will help advance Japan's deregulation agenda, providing benefits for both Japan and the U.S. We intend to stay involved vigilantly in the deregulation effort, and are gratified that the European Union is doing the same, to ensure that deregulation is carried out in a way that provides real opportunities and equitable access for foreign companies.

We also hope for strong leadership in this area from Prime Minister Hashimoto. He has stated his view that Japan would benefit from strengthened competition policy from by the Japan Fair Trade Commission. He also spoke sweepingly about the importance of deregulation and economic reform in his recent book, in a speech delivered in Vancouver in May 1995, and in his inaugural speech to the Diet as Prime Minister, delivered on January 22. In that speech, he committed his administration to weeding out regulations that "have been perverted into citadels of protection for vested interests" and to more vigorous enforcement of the Antimonopoly Act by the JFTC.

Conclusion

In sum, after three years of sustained work, the Administration believes that we have made good progress in the long effort to open the market in Japan, but much remains to be done. We have benefitted from the bipartisan consensus in Congress and the country that a level playing field for trade between the U.S. and Japan is long past due. We will continue aligning our efforts with those in Japan who believe that their country should continue moving in the direction of a more competitive, less regulated, more open economy. We will keep working to enforce our trade agreements, resolve outstanding issues, and deal with new issues as they arise - - to expand trade and open the Japanese market for the benefit of both our countries.

Chairman CRANE. Thank you, Mr. Ambassador.

Given his experience as a former trade negotiator, how does Prime Minister Hashimoto approach bilateral trade disputes with the United States?

Mr. SHAPIRO. We have had considerable experience with Prime Minister Hashimoto in both 1994 and 1995. He is obviously a strong advocate of Japan's interests and a strong negotiator. He is also someone who has always valued the United States-Japan relationship in the broadest sense and recognized the need to resolve problems and move forward. So I believe that we will be able to continue making progress. I believe it will never be easy. It has not been easy in the last 3 years; it will not be easy now. I checked with my predecessors, Mr. Chairman, they said it was not easy then. [Laughter.]

So we are going to continue making progress.

Chairman CRANE. Well, given Prime Minister Hashimoto's commitment to strengthen competition policy, are you optimistic that the Japanese Fair Trade Commission will become a more vigorous enforcer of the Japanese antimonopoly act?

Mr. SHAPIRO. Mr. Chairman, I hope so. We share the view that Japan would benefit from a vigorous JFTC, and I know that the Prime Minister does feel that way. So we want to be optimistic about it. At the same time, the track record over the years has not been that of a strong antitrust and enforcement agency nor one that has been a strong policeman of fair competition. I noted in the Financial Times recently an article which quoted the chairman of the JFTC as saying that the tradition of antimonopoly enforcement had never really taken strong root in Japan. So we are hopeful; we are optimistic; but we want to be realistic about the need to change things.

Chairman CRANE. Well, we appreciate all you are doing, and I am also glad that we are not attempting to pursue unduly some of the disruptive threats of trade retaliation under section 301. But we wish you Godspeed in the effort, and with that, I would like to yield to Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman, and thank you, Mr. Shapiro, for your testimony and for the work you are doing. As you know, Mr. Shapiro, I would like to turn our attention to intellectual property rights, which we have discussed before in the context of several high-tech companies in my home State of Minnesota. As you know, one such company, Cyber Optics, is currently experiencing some serious problems with patent application flooding by a large Japanese motor company. I know that Japan is on the priority watch list with respect to the enforcement of intellectual property rights or market access for persons relying on intellectual property. Can you comment on what steps have been taken to push the Japanese Government to address this problem of patent flooding by Japanese companies?

Mr. SHAPIRO. Mr. Ramstad, we have taken up the issue of patents, patent scope and patent flooding with Japan over the years. We have actually made some progress but not enough as yet. The issue of the difference between their patent system and our system remains a serious one, and patent flooding is a problem with which we are familiar. USTR at the moment is in the middle of its annual

special 301 review, and we are considering the submissions that we are getting from parties about inadequate IPR protections. And based on that information, including submissions from companies like Cyber Optics, we are going to announce the results of our review on April 30. But we continue to push forward on these patent issues and try to bridge the differences between our systems.

Mr. RAMSTAD. I have heard a lot of anecdotal evidence about the effects of patent flooding on U.S. market shares and trade balances, and I look forward to seeing the results of the research. I understand there is a study being done as to how this affects the competitiveness of our industrial sector.

Mr. SHAPIRO. Well, you also may have spoken to some of our people about this.

Mr. RAMSTAD. Right; I have.

Mr. SHAPIRO. But I want to make sure you are in touch with the people who are actually negotiating.

Mr. RAMSTAD. I would like to ask you one final question, Mr. Shapiro. As far as I am concerned, this is a new low. As I know you are aware, there is a lawsuit currently pending under Japanese law against Cyber Optics for—can you imagine?—the terrible offense of contacting the U.S. Embassy for assistance in resolving its pending legal matters. Is that practice common in Japan or atypical?

Mr. SHAPIRO. Well, I do not know if I would characterize it as a new low or not. I have not heard of one quite like that so—

Mr. RAMSTAD. That is a first as far as your knowledge?

Mr. SHAPIRO. I mean, I think we would take quite seriously the rights of companies to try to seek recourse, and I would like to look into that problem. I am not aware of that suit.

Mr. RAMSTAD. I would appreciate if you would do that and get back to us.

Thank you very much again, Mr. Shapiro.

Mr. Chairman.

Chairman CRANE. Thank you.

Mr. Zimmer.

Mr. ZIMMER. Thank you, Mr. Chairman.

Mr. Shapiro, I appreciate your candid remarks on the issue of insurance. What I would like to ask is if the Japanese Government fails to comply fully with the terms of the insurance agreement, what specific actions or responses would the USTR propose be taken?

Mr. SHAPIRO. Mr. Zimmer, first, of course, I am first still hoping that we will successfully resolve the issue, and we are continuing to discuss it with our counterparts. I am not in a position now to talk about specific steps that would be taken in response to this problem if it is not addressed. And I should say that, as you know, the steps that we are concerned about, the issuance of ordinances that carry out the new insurance business law contrary to the agreement, those things have not occurred as of yet, so we are looking at something that we have been worried could occur. But we are looking at all realistic and all possible and appropriate options for responding.

But let me say that this is, in our minds, the most serious case that we have, potentially, of nonimplementation of a framework

agreement, and we would have to respond appropriately but strongly.

Mr. ZIMMER. Without committing yourself to a specific course of action, could you describe what specific legal recourse is available under our trade statutes?

Mr. SHAPIRO. Without specifically committing myself to a course of action, I think we have a number of areas that we would need to look at in terms of section 301. You know, obviously, one would look at the whole range of options that are available, including the services area.

Mr. ZIMMER. I understand that no further talks have been scheduled between USTR and your Japanese counterparts between now and the President's visit to Tokyo next month. Assuming this issue is not resolved by then, can we expect these negotiations to drag on, as we have seen in the case of other trade disputes?

Mr. SHAPIRO. I think we have to see what happens. Japan has to decide how quickly it is going to move ahead and implement the new insurance business law. So while this is a pressing matter right now, and our concerns are being registered right now, I think we will just have to see how it goes. But I do not regard this as something that is going to play out over a long period of time.

Mr. ZIMMER. At what point do you say that further negotiations will no longer be productive, and it is time to take other measures? Can you describe the point at which you would conclude that?

Mr. SHAPIRO. I would rather not prejudge that at the moment, because as I indicated, a lot depends on actions that are taken that would put forth ordinances or regulations that were contrary to what we think the agreement is. And thus far, we are still dealing with a problem to be anticipated.

Mr. ZIMMER. So even in principle, you cannot describe that one?

Mr. SHAPIRO. It is a pressing matter now.

Mr. ZIMMER. Well, thank you. I appreciate your sense of urgency. I yield back my time.

Chairman CRANE. Thank you.

Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman. I am going to have a chance to participate later, so let me just be very brief and ask a few quick questions. First of all, I would like to congratulate the Ambassador and Mr. Kantor and the administration for its active efforts. But let me ask a few questions specifically.

Recently, MITI Vice-Minister Sakamoto said that he thought bilateralism was dead, and all trade issues should be pursued in the WTO. I wondered if Mr. Shapiro would like to comment on that comment.

Mr. SHAPIRO. Well, Congressman, first, I would say that we are dealing with a lot of issues with Japan right now on a bilateral basis. With respect to Mr. Sakamoto's speech, which did seem to go beyond MITI's stated position, which is well known, on film and semiconductors to make a broader point, we fundamentally disagree with that view. And I would subscribe to what Chairman Crane said. Frankly, we have a United States-Japan bilateral framework. We are always going to have bilateral issues that need to be addressed bilaterally.

Second, we need no reminders of the importance of the WTO, and we will take appropriate disputes to the WTO. But the WTO does not cover all trade issues; it does not cover all trade disputes. We said throughout the Uruguay round proceedings that we would take disputes to the WTO where appropriate, and we would proceed bilaterally with our consultations and our negotiations. We reserve the right to do that, and all member States do that. And it is particularly noted that the WTO, like the GATT before it, does not address certain kinds of trade barriers, informal barriers, of the sort found in Japan that have burdened many of our industries. So the suggestion that we should seek recourse through the WTO on those matters or wait until some international consensus emerges is not one we accept.

Mr. LEVIN. And I assume those comments would apply to the semiconductor field as well as others.

Mr. SHAPIRO. Well, I think that is certainly right. And on semiconductors, we believe that the semiconductor agreement has benefited the participants in the agreement, the United States and Japan, but we also believe that other foreign providers of semiconductors have benefited from the opening of the Japanese market. It is an MFN agreement, and we do not subscribe to the view that it needs to be handled in the auspices of the WTO.

Mr. LEVIN. One last question; you referred to deregulation and to Mr. Dreier's statements, and he and I are going to be testifying subsequently. Let me just ask you to comment briefly on the proposition in Mr. Dreier's testimony: "Our trade policy should focus on deregulation and competition rather than look for managed market access for select American exports."

Mr. SHAPIRO. Well, I endorsed the part about deregulation and competition. We really do believe that the structural efforts and the sectoral efforts need to go together. We are trying to open the markets in many key sectors for U.S. companies and workers and for other foreign providers to get into Japan, and we think we are having success in doing so. To be honest, our sectoral efforts also come back to deregulation oftentimes, Mr. Chairman. In autos and auto parts, in insurance, and in many of our agreements, you get deregulation of certain sectors because you approach them sectorally rather than waiting for a broad blueprint. So I think the two go together.

Mr. LEVIN. Thank you.

Thank you, Mr. Chairman.

Chairman CRANE. Thank you, and Mr. Shapiro, we want to express again appreciation and support for all your efforts, and with that, I want to suggest that we bypass our colleagues, Congressman Levin and Congressman Dreier next on the panel, because there are plane connections, I know, that some of the panelists would like to make. We would like to bring up next George Fisher, chief executive officer with Eastman Kodak Co., who is accompanied by Ken Deline, founder of Deline Box and Display and Thomas Armstrong, the president of the Semiconductor Industry Association.

And in the interim, the Subcommittee will stand in recess to make this vote. We are down to about 10 minutes, guys, and if you

could rush over and rush right back, I would appreciate it. Thank you.

[Recess.]

Chairman CRANE. We will commence with you, Mr. Fisher, and again, I would like to ask you all to keep your formal remarks to under 5 minutes, but any further remarks you have will be made a matter of permanent record.

Mr. Fisher.

STATEMENT OF GEORGE M.C. FISHER, CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, EASTMAN KODAK CO.

Mr. FISHER. Thank you, Mr. Chairman. I appreciate this opportunity to testify on the topic of United States-Japan trade relations. Given the importance of your time, I will, as usual, simply submit my formal remarks for the record and highlight some of the key points and then address your questions.

In the United States, you can literally walk down any street or through any mall and find a store that sells Japanese film today. Unfortunately, the converse cannot be said. In most stores in Japan, Kodak film, the most popular film in the world, is completely absent. While Kodak produces products geared specifically to Japanese tastes and has spent over \$750 million in the last 10 years promoting them and building a business, while Kodak's commercial efforts in Japan have led to many product design awards, including one last year from MITI, and while Kodak has competed successfully in other markets in Japan with motion picture film, x-ray film and microfilm, for some set of reasons, we seemingly can achieve little more than a 10-percent share of the consumer photo market, thanks to what we believe is anticompetitive behavior that is currently condoned and facilitated by the Japanese Government.

In what is the most complete survey to date of the Japanese consumer photo film market, we surveyed more than 2,000 retail outlets in 45 of Japan's 47 prefectures this past December and January. For greater accuracy, that study is weighted according to the sales volume of specific retail outlets. We are releasing that study today. In summary, it shows that Kodak film is wholly absent from two-thirds of the Japanese retail market, and in the 34 percent where Kodak film is available, we are able to compete on price in only 10 percent of the Japanese market. Why? Quite simply, the Japanese Government has helped create a market structure that shields its domestic photo industry, particularly Fuji, from meaningful competition. These barriers are in effect today and include but are not limited to a complex web of distributors, financial institutions, wholesalers and retailers that limit our access to retail shelf space; photo wholesalers who are induced by discriminatory rebates and promotional payments that Fuji uses to exclude competitors and discourage price competition; a premiums law that allows private trade associations to create fair competition codes, which limit the use of advertising and market strategies to lower prices, and a large scale retail store law which restricts Kodak's sales by impeding the establishment and expansion of large discount and photo specialty retail stores.

These governmental actions not only hurt our ability to compete on a level playingfield; they are inconsistent with Japan's obliga-

tions under international agreements and in some cases even at odds with Japan's own antimonopoly law. The Japanese Government's position not only excludes foreign suppliers; it has created a profit sanctuary for Fuji and a worldwide competitive threat to Kodak and the American jobs we provide. Over the last 10 years, we figure this has cost us about \$5.6 billion in sales or, to use a Commerce Department equivalent in jobs, tens of thousands of U.S. jobs.

What is it that we seek? Kodak's goal is truly resolution, not retaliation or dictated market shares. We know we have high-quality products that will sell and do sell all over the world if only consumers have access to them. We simply seek a more open marketplace and the ability to put Kodak film on more Japanese store shelves. In fact, where we are allowed to compete in that small fraction of the Japanese market, we do reasonably well, with market shares in excess of 20 percent.

Let me summarize our objectives under three headings: Getting on the shelf, getting off the shelf and getting more shelves. Getting on the shelf means essentially ending the restrictive distribution system that I described under which Fuji exercises control over Japan's distributors of photographic supplies and prevents even open-minded, well-intentioned distributors from even dealing with Kodak products. Getting off the shelf means ending a related practice under which retailers who are dependent on Fuji financially are induced to mark up the price of Kodak products so that retail consumers never see our discounts. Getting more shelves means lifting government restrictions on distribution at large-scale photo specialty stores and discount retailers, where our consumer photo products in Japan have actually fared reasonably well when allowed to compete.

These seem to me to be modest and somewhat reasonable goals, and they are consistent with Japan's international obligations as well as the expressed commitment of Japanese officials to deregulation. But we do not expect to get resolution of this issue without U.S. Government resolve. After all, in the last 36 years, there have been only 15 private antitrust cases in Japan. Now, compare that with the over 26,000 private antitrust cases in the United States in only the last 24 years.

But we need to remind ourselves that the barriers I speak of are not old news, something that happened yesterday, they are in place today, as we speak, and they are sanctioned, condoned and tolerated by the Japanese Government. That is why last May, after having carefully researched the situation, we did file a section 301 petition with the U.S. Government. In July, the USTR agreed to investigate and proceed with government-to-government negotiations to correct the situation. As incredible as it may seem, to date, almost 9 months later, the Japanese Government still is refusing to discuss the matter. In fact, on March 15, just 13 days ago as has been mentioned twice in this hearing so far, MITI Vice-Minister Sakamoto made a speech in which he said the era of bilateralism is over.

In short, this means that the Japanese Government has very publicly refused to address our market access issue without providing U.S. negotiators an opportunity even to present their views.

This is unprecedented behavior and reflects, in my mind, an unacceptable denial of legitimate American interests. It also has broad ramifications that will go well beyond this particular film case. Failure to come to positive resolution on a case documented as thoroughly as this one sends a negative signal to every American company trying to compete in Japan today, not to mention that Japan would then be successful in unilaterally redefining our bilateral trading relationship.

The simple fact is this case is not about film; this case is about fairness and true market access. If a company like Kodak, whose brand name is recognized throughout the world and associated with quality and value, cannot compete in Japan on an equal footing, what American company can when faced with the same inhibitors in the marketplace? The administration and Congress clearly made it known during the Uruguay round that the WTO agreements, with minor exceptions, do not address foreign measures that encourage or tolerate private anticompetitive practices. Rather, in such cases, 301 was to and is to remain a fully available tool. Indeed, the continuing need for bilateral approaches in such cases was broadly recognized by all countries in those GATT negotiations.

While certain discrete actions of Japan's Government could be presented to the WTO panel for adjudication, its toleration of systematic anticompetitive activities that block market access is not covered by WTO rules. Any retreat from the commitments made in the Uruguay round to bilateral approaches would be disastrous and not in keeping with the commitments made during those negotiations. This Subcommittee should not consider retreat as a viable option. I continue to hope that Prime Minister Hashimoto will determine that Japan's interests are truly best served through deregulation and enhancement of competition. During a recent press briefing with President Clinton, he acknowledged exactly that.

That would be in the long-term best interests of both of our countries. After all, when you consider that both of these countries have about 40 percent of the world's GNP, failure to deal with the legitimate trade concerns that we are facing will only frustrate both economies and both nations in general and subsequently increase tensions and leave consumers with fewer choices and higher prices and Americans with fewer jobs.

Thank you.

[The prepared statement follows:]

Testimony Before the Committee on Ways and Means
 Subcommittee on Trade
 Hearing on U.S.-Japan Trade Relations

George M.C. Fisher
 Chairman, President and CEO
 Eastman Kodak Company

March 28, 1996

Thank you for the opportunity to testify today on U.S.-Japan trade relations. This is an important and timely topic. Active participation by the Congress, and especially this Subcommittee, on U.S.-Japan trade relations has never been more essential.

As most of you are aware, despite Kodak's reputation as a world-class company that has long produced quality products which are competitive in virtually all other world markets, we have been unable to gain true access to the Japanese market. Before going into that specific dispute, I would like to describe to you the importance of the industry involved.

Importance of Imaging to Jobs and the Information Economy

Human communication has traversed many media over the ages, from pictures drawn on cave walls, to smoke signals, to spoken and then written language, to the typewriter and printing, to telegraph, telephone, radio and television. Yet, today there is only one readily available means for sharing pictures over distances in real-time: television, which is predominantly a one-way medium for most of us.

That reality is about to change.

The power of computers (in millions of instructions per second) is doubling virtually every 18 months, and the cost for that computing power is decreasing by 20-30% a year. These technological advances are eliminating physical barriers to real-time transmission and communication -- not just of sounds, but of documents, still images, and even moving images. And when it comes to images and pictures, Kodak sits at center stage.

So the imaging business is not only about photographs of one's grandchildren, but much more. It is a constantly evolving technology-driven industry. And it is important, not just to human communications, but to U.S. jobs.

Kodak's manufacturing operations mean good U.S. jobs. Kodak employs nearly 50 thousand workers in several U.S. states. Our operations also support those of numerous suppliers and distributors with thousands more employees.

Our contribution to the export picture is equally important. In New York State, we are not just the leading manufacturer but the leading exporter as well.

At the same time, one of the key facts I have to consider as Chairman of Kodak is that half the people in the world have yet to take their first picture. There is dramatic growth potential in developing markets such as Russia, India, Indonesia and China. In China alone, if we could get people on the mainland to take as many photos as the people in Taiwan, the number of film exposures worldwide would grow by 50%.

So we have launched special initiatives to improve access to those markets, to get to know their governments and their people better -- and to begin selling more of our products.

The potential is tremendous.

But with these opportunities come significant challenges. Some of our most promising markets remain closed because of unfair trade practices. That is clearly the case with Japan.

Closure of the Japanese Market

It is somewhat ironic that I am here today with bad news, because Kodak has participated in Japan's market for over 100 years and has been cited by both U.S. and Japanese officials as a model of a U.S. company that has "done it right" in Japan. We produce products geared specifically to Japanese tastes, and we have spent over three quarters of a billion dollars in the last ten years promoting them. Our commercial efforts in Japan have led to product design certificates and marketing awards.

We have competed successfully in Japan with a number of our products, such as motion picture film and microfilm. This should not surprise anyone, because Kodak is a world class producer with tremendous product development and marketing acumen. If we can't compete in Japan, no one can.

Yet, here we find ourselves engaged in a major struggle over access to Japan's market for basic consumer photographic supplies.

If I achieve nothing else today, I hope I can at least make you all aware of the context, so that you can appreciate the importance of that effort.

It is important not simply because Japan itself is a huge market -- the world's second largest, worth over \$13 billion annually -- where Kodak should be selling much more than it does today. The problem is that Fuji Film, operating in a profit sanctuary created for it by the Government of Japan, has amassed a "war chest" of more than \$8 billion using current exchange rates which it can use, and is using, to attack Kodak's position world-wide.

Revenues derived here and abroad from consumer photographic film and paper are critical to Kodak's ability to remain on the imaging industry's cutting edge technologically.

In short, our long-term growth, and many thousands of U.S. jobs in this important sector of the economy, depend on the success of our effort to break into the closed Japanese market.

We have been unable to gain significant access for consumer photo film and paper. Our share of Japan's consumer photo products market is only 10 percent. Kodak commissioned a survey of Japan's retail outlets which was conducted in December 1995 and January 1996. The survey sampled 2028 retail outlets in 45 of Japan's 47 prefectures. The survey found that:

- ◆ Kodak film was wholly absent from two-thirds of the Japanese retail market (by volume).
- ◆ And in the one-third of the market where our product is available, Kodak film is available and able to compete on price in only 10 percent of the Japanese market.

These results are far worse than those we have achieved in other world markets -- even those where we face domestic competitors.

Why? The Japanese Government has helped create a market structure shielding its domestic photo industry, particularly Fuji, from meaningful competition for more than 20 years. Kodak and other foreign suppliers face an exclusionary distribution network that denies us full market access. These protective measures have focused not just on foreign competition generally but on Kodak in particular. Japan's government-industry strategy to exclude Kodak from the market continues today.

After carefully researching the barriers confronting Kodak in Japan, we filed a petition with the U.S. Government in May of 1995 under Section 301. We did not take this action lightly. Looking at all of our efforts, both past and present, we concluded that no matter what we did to market our products in Japan, it would never be enough to succeed unless something was done about the Japanese Government's active role in keeping us out.

We were gratified to have our case accepted for investigation by the USTR. We are also gratified that the leadership in both major parties and in both houses of Congress, as well as the President, all seem to recognize the seriousness and strength of our case.

The evidence we have presented is overwhelming -- and it comes almost entirely from Japanese sources. This is regularly cited as the best documented market access case in history. No one, with the predictable exception of Fuji and the Japanese Government, has challenged its validity.

What are the barriers and how do they work? Both the government and the private sector play a role. As far as government action is concerned, the most serious current barriers are the Premiums Law, the Large Scale Retail Store Law, and toleration of illegal anticompetitive practices.

- ◆ Under the Premiums Law, the Japan Fair Trade Commission ("JFTC") delegates power to trade associations to create and self-enforce "fair competition codes" which limit the use of advertising and marketing strategies to lower prices. Arm-in-arm with the JFTC, Japan's domestic suppliers in the photo film industry maintain high, stable prices while disciplining independent-minded retailers who may be tempted to offer promotional or discount incentives to consumers. As a result, Kodak is effectively prevented from competing on price.
- ◆ The Large Scale Retail Store Law also restricts Kodak's sales by impeding the establishment, expansion and operation of large discount and photo specialty stores. These are the very stores where we have best been able to market our products.
- ◆ The Japanese Government also knowingly tolerates and encourages anticompetitive practices designed to keep out imports and maintain artificially high prices.

The private sector's role involves restrictive business practices designed to keep our products out of the distribution system entirely or -- in those instances where our products do reach the retail shelf -- to prevent them from being priced competitively.

These practices are real today, and they have been in existence for a long time. It sounds astonishing, but we have documented that beginning in the 1970s and with the government's active support all the way along, Japan's photographic film and paper industry has been purposefully reorganized to blunt Kodak's entry.

The Japanese Government has essentially "privatized protection," helping private parties to form a complex web of distributors, financial institutions, wholesalers and retailers. Within this unusual market structure and through anticompetitive practices tolerated by the government, Fuji and others (acting as agents of the Japanese Government) are able to suppress import penetration. Examples include:

- ◆ Fuji's control of photo wholesalers through rebates and massive security deposits;
- ◆ Fuji's threatened supply cutoffs to wholesalers that use or promote Kodak's products; and
- ◆ trade associations enforcing high prices to the consumer.

The Japanese Government's actions in this sector are inconsistent with its obligations under international agreements. And the private actions undertaken by Fuji and other players violate Japan's own Anti-Monopoly Law. Yet the government sits idly by. The intended result -- and the actual result -- is that Kodak has limited access to the retail shelf and, where we are able to sell, we are not allowed to price competitively.

That's the short version. The long version is available in thousands of pages, in the reading room at USTR.

But we must not get so wrapped up in the details of these practices that we ignore their effect. The Japanese Government's active involvement in the market place to exclude foreign suppliers has created a profit sanctuary for one Japanese company and a real, long-term, world-wide competitive threat to Kodak and the U.S. jobs we provide.

If the Japanese market had been open, Kodak estimates that it would have made additional sales of \$5.6 billion over the last 10 years. Using the Commerce Department's figures linking export revenues to jobs, that's the equivalent of tens of thousands of U.S. jobs.

What Kodak is Seeking

Kodak's goal in this effort is resolution, not retaliation or artificial quotas. We know we have high quality products that will sell, if only consumers have access to them. We simply seek a more open marketplace and the ability to put Kodak film on more store shelves in Japan. In fact, in those portions of Japan where competition exists, we do very well, capturing over 20% of the market.

Our objectives in the trade case can be summarized under three basic headings: "getting on the shelf," "getting off the shelf," and "getting more shelves."

- ◆ Getting on the shelf means gaining access to retail outlets for Kodak film, which in turn requires access to the major wholesalers that supply those outlets.
- ◆ Getting off the shelf means ending anticompetitive practices under which retailers are induced to mark up the price of Kodak's products so that, no matter how competitively we price at the wholesale level, retail consumers seldom see our discounts.
- ◆ Getting more shelves means lifting onerous government restrictions on distribution such as the regulations that limit large-scale photo specialty stores and discount retailers -- one type of sales environment in which our consumer photo products in Japan have fared well.

These are modest and reasonable goals, and they are consistent with Japan's international obligations as well as the expressed commitment of Japanese officials to deregulation. Japan's political leadership for years has stressed the need for deregulation and stronger competition policy. Yet this rhetoric has not been matched by action.

While our goals are modest and reasonable, the stakes for us as a company are high. And the case is time-sensitive. We have been effectively shut out of Japan for many years already, and we are already feeling the world-wide competitive impact of the profit sanctuary that exists in Japan. Resolution of this case cannot simply be delayed for a few years until the Japanese Government finds it more convenient to address the problem.

The Japanese Government recently announced that the JFTC will compile a study of competition in the photo supplies market world-wide. This announcement appears to be intended to deflect the U.S.

Government's Section 301 initiative, but it must not be allowed to succeed in doing so.

The JFTC has tolerated anticompetitive practices while permitting industry groups to squelch rather than promote price competition. To resolve these issues, direct involvement by Japan's Ministry of International Trade and Industry and the JFTC will be necessary, and enforceable international commitments to implement real reforms -- not just to carry out studies -- must be included in any agreement settling the case.

Japan's Refusal to Negotiate and Effort to End "Bilateralism"

Notwithstanding the overwhelming evidence, Japan has refused to discuss this matter. Without providing U.S. negotiators an opportunity to present their views, the Japanese Government has publicly refused to address our serious market access problem.

This is unprecedented behavior, and it has broad ramifications that go well beyond this case. Japanese officials are plainly testing the resolve of the U.S. Government to deal effectively with market access issues, attempting to redefine the bilateral relationship as one that focuses solely on non-commercial interests.

This attempt cannot be taken lightly. Failure to come to positive resolution on a case documented as thoroughly as this one would send a negative signal to every U.S. company attempting to obtain access to Japan. If this case cannot be resolved satisfactorily, then no industry can be successful.

Other countries also have reason to be concerned by a Japan that has closed its home market and then refuses even to discuss the barriers with an affected exporting country.

The Administration and Congress expressly recognized, in the Uruguay Round Statement of Administrative Action, that the WTO agreements, with minor exceptions, do not address foreign government measures that "encourage or tolerate" private anticompetitive practices; rather, in such cases, section 301 is to remain "fully available." Indeed, the continuing need for bilateral approaches to cases of this type was broadly recognized by all countries during the Uruguay Round.

Certain discrete actions of the Japanese Government in the photo sector raise very serious questions under WTO rules and could perhaps be presented to a WTO panel for adjudication. However, the Japanese Government's toleration -- over a period of more than 25 years, and continuing to this day -- of systematic anticompetitive activities that block market access for U.S. and other imported products simply is not covered by WTO rules.

The Administration pledged to Congress that it would continue to use Section 301 aggressively in this context and that, notwithstanding the new WTO dispute settlement rules, the continued viability of Section 301 as a bilateral trade tool for addressing problems falling outside WTO jurisdiction was assured.

These commitments were fundamental to Congress' decision to ratify the results of the Uruguay Round, as was the accompanying amendment crafted by Congress to clarify the Section 301 provisions on toleration of anticompetitive activities.

Japan has called into question the resolve of the U.S. Government to address the many unreasonable trade barriers not eliminated through the Uruguay Round negotiations. If Japan is successful with this tactic, it will affect U.S. efforts to open virtually any market for U.S. exports.

Any retreat from the commitments made in the Uruguay Round implementing process would be disastrous. This Subcommittee should not countenance such a retreat.

Conclusion

In the end, the focus of this case must be on Japan and not on Washington. Resolution ultimately depends on the same Japanese Government that created the market barriers in the first place.

And the dynamics within Japan have changed significantly in the past months with the elevation to power of Prime Minister Hashimoto. During a press briefing after his recent meeting with President Clinton, Mr. Hashimoto noted that deregulation is his answer to market access problems.

I continue to hope that the Prime Minister will determine that Japan's interests are best served by finding a way to deal with this case productively through deregulation and enhancement of competition. Given the strength of Kodak's case, the case should lead to negotiations that in the long run will improve the often acrimonious economic relationship between our two countries.

As Mr. Hashimoto is well aware, our economic destinies are inextricably linked. Between our two countries, we account for 40 percent of the world's GNP. And failure to deal with legitimate trade concerns only frustrates the economies of both nations, increases tensions, and leaves consumers with fewer choices and higher prices.

Chairman CRANE. Thank you.
Mr. Deline.

STATEMENT OF KEN DELINE, FOUNDER, DELINE BOX AND DISPLAY; ON BEHALF OF EASTMAN KODAK CO.

Mr. DELINE. Mr. Chairman, thank you for the opportunity to testify today on United States-Japan trade relations. My name is Ken Deline; I am the founder of Deline Box and Display in Windsor, Colorado. I would like to speak briefly in support of Eastman Kodak Co.'s effort to gain access to the Japanese market. The success of this case, and the continuing ability of the United States to address market access barriers abroad, is important not just to the large domestic manufacturers like Kodak but to their suppliers as well.

Deline Box and Display produces packaging for Kodak products, many of them destined for Japan. These products fall into three broad categories: Medical x-ray film products, graphic art film products and photographic paper products.

There are two primary points I would like to make today. The first is that it is not only Kodak that has a stake in better access to Japan's photographic film and paper market. We and other suppliers are affected as well.

Our facility in Colorado was originally dedicated 100 percent to Eastman Kodak. Anything impacting Kodak's sales volume positively or negatively translated directly into an impact on Deline's volume as well. Although we have diversified, Kodak still accounts for about 50 percent of our business.

So, our fortunes rise and fall with Kodak's. Sales by Kodak into foreign markets translate into sales and jobs for us. So, you can understand the impact on us when, as market surveys conducted during this case have documented, Kodak film is available and able to compete on price in only 10 percent of the Japanese market. The second point is that Kodak has been extremely proactive and energetic in its efforts to crack into Japan—more so, in fact, than any other customer Deline deals with.

This applies particularly to packaging design. It may surprise you, but I have seen many instances in which Kodak's product and packaging design have been based not on European or even U.S. market factors but on factors specific to Japan. There have been instances when we have changed the packaging used domestically in the United States just to achieve economies of scale, to cater to the Japanese needs.

It is incredible to me that there have been allegations that Kodak has been unwilling to do what is necessary to succeed in Japan. From my perspective, I assure you those charges are not true.

Mr. Chairman, we at Deline Box and Display appreciate your efforts and those of this Subcommittee to facilitate a successful outcome in this case. It is important that we continue to be able to address issues like this bilaterally with Japan in a businesslike manner. I hope the forceful but constructive message being sent today will find its target and contribute to a solution that is in both countries' best interests.

Thank you, Mr. Chairman.

Chairman CRANE. Thank you, Mr. Deline.
Mr. Armstrong.

**STATEMENT OF THOMAS W. ARMSTRONG, PRESIDENT,
SEMICONDUCTOR INDUSTRY ASSOCIATION**

Mr. ARMSTRONG. Thank you, Mr. Chairman, for this opportunity to speak on behalf of the Semiconductor Industry Association. As president of the SIA, I can assure you of our industry's deep belief in and support for open markets. We strongly supported GATT and NAFTA. To continue the process of opening markets, we strongly support renewal of the 1991 United States-Japan Semiconductor Agreement. We would like to do this through cooperation, not through confrontation.

As you know, semiconductors are a pervasive part of our lives and are becoming more so. Our industry employs 240,000 people nationwide, and our products are the enabling technology behind the nearly \$400 billion U.S. electronics industry, which provides employment for 2.5 million Americans. Yet, our industry is a very young industry. Next year will mark the 50th anniversary of the transistor, and this year marks the 25th anniversary of the microprocessor, the heart of a personal computer.

We have been very successful in having our products accepted not only in the United States but throughout the world. The reason for that success is that we have continuously introduced succeeding generations of state-of-the-art technology at consistently lower prices, and that, of course, is a formula for success. It has been, except in one place. In Japan, despite our technological edge and our highly competitive prices, we could not sell much product, and this was because the market was closed to us for many years. Fortunately, primarily through the efforts of the U.S. Government, we entered into an agreement with the Japanese which gave us access to the Japanese market.

When we first signed the agreement in 1986, foreign producers had only 8 percent of the Japanese semiconductor market. In 1995, foreign market share was 25 percent, with an 18-percent share for U.S. producers. On its face, it would appear that this agreement has worked well and that we have made remarkable progress in the last 10 years, and for the most part, I think the agreement has worked well, certainly a lot better than the alternative, which would be no agreement. But there is much left to be done. For example, while the United States has an 18-percent market share in Japan, we have a market share of about 50 percent in the world outside Japan, and in combined markets which include neither Japan nor the United States, we have a 40-percent market share.

These numbers indicate quite clearly that Japan's markets, while more open now than in the past, still have a long way to go before they become truly open. It is for that reason that I am here today to support the government's efforts to renew the agreement. The agreement does four very important things: First, it calls for a commitment for continued progress increasing market access for non-Japanese—not just United States—semiconductors. Second, it provides a mechanism for measuring market share in such a way that the numbers are monitored and verified by both nations' governments and are not subject to dispute. Third, it establishes a net-

work of relationships where outside suppliers and Japanese purchasers can communicate regularly to provide opportunities for design in and sale of projects. And fourth, it establishes a procedure under which the Japanese chip producers calculate and maintain their chip production costs so that they can be quickly produced in the event of dumping allegations.

These four elements have been highly beneficial to both the United States and to Japan. They have made possible extraordinary cooperation between the United States and Japanese industry. The agreement has increased foreign market access, and it has dramatically reduced trade frictions. The agreement has made these positive things happen, and without this agreement, they may not continue. Without it, in fact, we would not even have an agreement on what the market share numbers are today.

The United States and Japan need this agreement to build on the progress of the past 10 years, because there is still more progress to be made. We are flexible on the specific terms of a new agreement. We are not seeking a numeric target. We just want continued and steady progress; we are not seeking a guaranteed market share. But we do believe strongly that the job of obtaining full access to the Japanese market is not yet done.

Mr. Chairman, thank you for this opportunity to present our views.

[The prepared statement follows:]

STATEMENT OF THOMAS W. ARMSTRONG
PRESIDENT, SEMICONDUCTOR INDUSTRY ASSOCIATION

HEARING ON U.S.-JAPAN TRADE RELATIONS
BEFORE THE SUBCOMMITTEE ON TRADE
COMMITTEE ON WAYS AND MEANS

MARCH 28, 1996

I appreciate this opportunity to appear before the Subcommittee on Trade of the Committee on Ways and Means to present the views of the Semiconductor Industry Association ("SIA") on U.S.-Japan trade relations.

The central issue for the SIA in terms of trade with Japan is renewal of the 1991 U.S.-Japan Semiconductor Trade Agreement, which is scheduled to expire this July 31. As I will explain in greater detail below, SIA believes that the Agreement has been extraordinarily successful in promoting cooperation between the U.S. and Japanese industries, has increased foreign market access in Japan, and has reduced trade frictions in this sector. Therefore, SIA strongly believes it is in the best interests of both the United States and Japan, as well as both U.S. and Japanese industry, to ensure that continued progress is made through a new government-to-government agreement with Japan.

Before going into greater detail on the Agreement, I would like to take a minute to give the Subcommittee a sense of the dynamic and growing U.S. semiconductor industry.

The U.S. Semiconductor Industry

Semiconductors are an increasingly pervasive aspect of everyday life, enabling the creation of the information superhighway and the functioning of everything from automobiles to advanced medical equipment. Semiconductors are also the linchpin underlying this nation's advanced military weapons systems. A growing proportion of the value of these systems is dependent upon electronics products -- up to 40 percent in some cases. The current design of the F-16 Fighter, for example, includes 17,000 electronics components. They are also intrinsically important in radars, weapons guidance and control systems.

U.S. semiconductor makers employ 240,000 people nationwide. Their products are the enabling technology behind the nearly \$400 billion U.S. electronics industry, which provides employment for 2.5 million Americans.

The U.S. semiconductor industry is currently the world market share leader, with 1995 world sales reaching \$59 billion, representing almost 41 percent of the \$144 billion world market. Moreover, the world semiconductor market is expected to double by the year 2000, with projected sales of over \$300 billion.

U.S. semiconductor producers are highly committed to maintaining their lead in both semiconductor manufacturing and technology. The U.S. semiconductor industry devotes on average 20 percent of its revenues to capital spending and another 11 percent to research and development -- among the highest of any U.S. industry.

This commitment to product quality and innovation has paid off. U.S. semiconductor manufacturers remain on the cutting edge of technological development, and are often the first to bring to market advanced new products.

While investing heavily in the industry's future competitiveness and technological capabilities, SIA members also have always actively sought to secure foreign market access for U.S. products. Because the semiconductor industry is so global in nature -- roughly half of the U.S. industry's revenues are derived from overseas sales -- SIA has been dedicated since its inception to promoting free trade and opening world markets.

For example, the U.S. industry has been in the forefront of efforts to eliminate tariffs on semiconductors and related products worldwide. At SIA's urging, both the United States and Japan eliminated their semiconductor tariffs in the mid-1980s. During the Uruguay Round, the

U.S. industry succeeded in convincing Korea to eliminate its tariffs on these products. Today, SIA continues to push more broadly for semiconductor tariff elimination as part of the proposed Information Technology Agreement.

However, the elimination of tariffs and other traditional trade barriers has proven to be insufficient to ensure full market access in key markets, particularly Japan, the second largest semiconductor market in the world.

History of U.S.-Japan Trade in Semiconductors

U.S. efforts to obtain access to the Japanese semiconductor market date back more than twenty years. Until the first U.S.-Japan Semiconductor Agreement was signed in 1986, U.S. and other foreign semiconductor suppliers had little success entering the Japanese market. By bringing together both the U.S. and Japanese industries and both the U.S. and Japanese governments, the Agreement made substantial progress in opening Japan's market possible.

Before the 1970s, the Japanese semiconductor market was protected by a wide range of formal and informal barriers, including import restrictions, investment restrictions and local content requirements for computer equipment. During that period, Japanese semiconductor producers became internationally competitive, and began challenging the U.S. industry in world markets.

In 1971, under pressure from the Nixon Administration, Japan agreed to begin liberalizing its restrictions on semiconductor imports and foreign investment. However, due to the use of liberalization countermeasures put in place by the Government of Japan (including the issuance of administrative guidance to discourage purchases of foreign products), the foreign share of the Japanese market remained virtually static, ranging around 10-11 percent of the Japanese market.

In a number of specific cutting-edge product sectors, U.S. semiconductor companies encountered a recurring phenomenon during the 1970s and early- to mid-1980s: They could achieve sales in Japan only until Japanese companies developed a competing product, at which time domestic sourcing replaced foreign supply. By 1982, the U.S. share of the Japanese market was below what it had been in 1974, the last year the Japanese market was protected by quotas.

In 1982, the U.S. and Japanese governments tried to remedy the problem of inadequate foreign market access through the formation of the U.S.-Japan Work Group on High Technology Industries, which issued a set of recommendations aimed at increasing foreign market access in Japan. After an initial modest increase in share coinciding with a boom in demand for semiconductor products, U.S. sales in Japan dropped sharply. By mid-1985, U.S. share of the Japanese market was lower than it had been when the High Tech Work Group's recommendations were adopted in 1983.

The U.S.-Japan Semiconductor Agreement

In 1986, President Reagan sought and concluded a five year agreement with the Government of Japan to open the Japanese market to foreign semiconductors. Because of the frustration brought about by the failure of previous agreements to produce market opening results, the 1986 Agreement included a side letter which stated that the Government of Japan recognized and welcomed the fact that the U.S. industry expected foreign share of the their market to grow to and exceed 20 percent by 1991. It also provided for joint efforts to increase the number of foreign semiconductors that are "designed in" new Japanese electronics products.

Unfortunately, the 1986 Agreement did not immediately lead to any progress in opening Japan's market. In 1987, the U.S. Government imposed sanctions on Japanese electronics products in response to breaches of the Agreement. Following the imposition of sanctions, U.S. share of the Japanese semiconductor market began to improve.

One year before the Agreement was set to expire in 1991, after three years of fairly steady, gradual progress, foreign share of the Japanese market again began to decline. It was apparent to all parties that the threshold objective of 20 percent foreign share would not be met by July 1991, and that, despite an increase in design-in activity, further market share progress was not self-sustaining.

In July 1991, President Bush sought and concluded a second agreement with the Government of Japan to continue the market opening process. The 20 percent figure was to be reached by December 31, 1992, and with an unprecedented 4 percentage point increase in the third and fourth quarters of 1992, this objective was achieved.

The Agreement has led to tremendous progress in opening the Japanese market. Foreign share increased from 8.5 percent in 1985 to 25.4 percent in 1995.

SIA's Commitment to Japan

Many in America, who had been pessimistic that investments in Japan would not result in the increased sales that similar efforts in other markets yielded, gained confidence that due to the Agreement their efforts in the Japanese market could yield increased purchases by Japanese firms. Under the 1986 and 1991 U.S.-Japan Semiconductor Agreements, U.S. semiconductor makers have invested heavily in Japan. In order to meet the needs of their Japanese clients, SIA members not only maintain sales offices in Japan, but also have factories as well as extensive test and research and design facilities, as well as a number of joint venture operations in that country.

As an example of the increased commitment to the Japanese market, the eight largest SIA member firms report that since 1988 they have doubled the number of technical employees, including design engineers, they have in Japan. These firms also continue to steadily increase their sales expenditures in Japan. These extensive efforts -- undertaken in conjunction with the activities put in place by the Agreement -- have yielded progress in recent years.

SIA's Board of Directors has met annually in Japan every year since the two governments signed the 1986 Agreement. These meetings not only symbolize the commitment of the U.S. industry to serving the Japanese market, but also provide an opportunity for the leaders of the U.S. industry to meet with their Japanese counterparts, as well as the Japanese government and media. SIA is the only U.S. industry association to hold regular high-level meetings of this type in Japan to demonstrate a sustained commitment to that market.

Joint Efforts with Japanese Industry

SIA members participate regularly in the Joint Working Group established under the Agreement, which brings together representatives from the two industries and the two governments three times a year to discuss progress under the Agreement. The Joint Working Group has been an effective forum through which both U.S. and Japanese firms can raise their concerns and address them in an open manner.

Since the first Agreement went into effect, there have been more trade promotion events related to semiconductors than any other industry. The events have spanned a broad range, including seminars on specific sectors of the industry to broad trade missions sponsored by the Electronic Industries Association of Japan (EIAJ) and the Department of Commerce. Literally hundreds of small one-on-one meetings have been held, as well as numerous large conferences sponsored by the International Semiconductor Cooperation Center (INSEC) and the Japanese Ministry of International Trade and Industry.

SIA and EIAJ have cooperated directly on numerous projects, such as an effort last year to increase personal computer use in Japan. The two industry associations also have worked on "Chip In" campaigns, originally proposed by EIAJ, aimed at focusing attention on the role and responsibilities of both suppliers and users in successfully designing foreign semiconductor devices into Japanese systems. SIA and EIAJ also have joint committees which focus on specific sectors of the Japanese market, including the consumer, telecommunications, and automotive sectors.

While both SIA and EIAJ members benefit from the results of such joint activities and increased design-ins, they are not the only winners. The major beneficiaries from these cooperative ventures are worldwide consumers of Japanese electronics products.

These mutually beneficial activities -- made possible by the U.S.-Japan Semiconductor Agreement -- are at the root of increased market access in Japan, and are worth continuing.

The Case for Renewal of the Agreement

The purpose of the 1991 U.S.-Japan Semiconductor Agreement, like the 1986 Agreement which preceded it, is to allow foreign manufacturers equitable access to the Japanese semiconductor market. The goal of the Agreement is to open the Japanese market to the point where sales generally occur without respect to the nationality of the supplier.

It is a well-known fact and a regular subject of discussion both inside and outside Japan that there remain structural impediments in the Japanese market and a need for "deregulation." The U.S.-Japan Semiconductor Agreement was negotiated to overcome market access impediments. There exist ingrown interrelationships both within keiretsu groups and among other Japanese firms and a mentality that favors dealing first with those within the same family of companies or corporate group, and second, with other Japanese companies, before any foreign products will be considered. Overcoming these structural impediments requires Japanese government action, as provided for under the Agreement.

The Agreement has resulted in a significant amount of progress being made. Japanese purchasing agents have told U.S. semiconductor sales representatives on numerous occasions that they are very pleased with the existence of the current Agreement because it provides them with a degree of flexibility within their companies without which it would be impossible to consider buying foreign products. That is what the Agreement is all about.

The issue of renewal of the Agreement turns on whether the Japanese market is now fully open and, therefore, no further action is needed. No foreign company which sells in the Japanese market believes that the market is fully open. At the same time, Japanese politicians and government officials continue to speak out in favor of deregulation. In the semiconductor sector, the path of deregulation has been established and the method for achieving it exists in the terms of the U.S.-Japan Semiconductor Agreement. The Agreement must be renewed if the effort at deregulating the Japanese semiconductor market is to continue.

The Agreement has opened the lines of communication between U.S. semiconductor suppliers and Japanese end-equipment producers, and between the U.S. and the Japanese governments. It provides a structure within which both industry-to-industry and government-to-government cooperation are fostered. An extensive network of inter-industry institutional arrangements and joint projects have been created under the umbrella of the inter-governmental U.S.-Japan Semiconductor Agreement.

The members of SIA are committed to continuing progress, but the job is not done. A large gap remains between the sales of all non-Japanese semiconductor producers outside Japan and their sales in the Japanese market. U.S. semiconductor makers account for 50 percent of the world semiconductor market outside Japan -- almost three times the market share they have been able to achieve in Japan. Much work remains to be done in opening the Japanese market.

The Gap

U.S. semiconductor manufacturers are extremely competitive in all open markets across a wide range of applications and a wide range of products. There remains a sharp disparity, though, between the share U.S. manufacturers account for in the world market outside Japan and the share they account for inside Japan. In the world, excluding Japan, American manufacturers accounted for 50 percent of all semiconductor sales in 1995. In Japan, U.S. semiconductor makers accounted for only 18 percent of sales in the Japanese market that same year.

This huge disparity between U.S. sales outside Japan and sales inside Japan is evidence that sales in that country are, unfortunately, still not always made solely on the basis of market forces such as technology, price, quality, service and delivery. Moreover, the gap is both consistent and persistent not only across the full range of applications, but across the full range of semiconductor products made by U.S. manufacturers.

Furthermore, the wide disparity between U.S. sales outside Japan and inside Japan is not explained by the argument that the U.S. industry does better in the United States and the Japanese industry does better in Japan. A comparison of the 40 percent share U.S. firms earn in world markets outside both the United States and Japan with the 18 percent share U.S. firms have in

Japan demonstrates that a significant gap remains. By contrast, there is only a small difference between the 23 percent share Japanese firms have in the U.S. market and the 28 percent share they have in world markets outside both the United States and Japan.

EIAJ has argued that the importance of the domestic Japanese market is decreasing, reducing the need for a bilateral agreement. They claim this is due to the shift offshore of much Japanese consumer electronics manufacturing, along with the exponential growth in electronics manufacturing in Pacific Rim countries outside of Japan, such as Malaysia, Thailand, Taiwan and Singapore. However, this argument does not take into account the fact that although the domestic Japanese market is decreasing in terms of its relative size with respect to overseas markets, it remains the center of high value-added, custom design-ins. Most Japanese electronics producers design products in Japan for manufacture at their facilities throughout Southeast Asia. In order to make sales to these Japanese affiliates, it is necessary to win design-ins that are awarded in Japan.

In addition, the majority of products being produced in other Asian nations by large Japanese multinationals are mass volume, relatively less sophisticated products. Japan, despite its decline in size relative to the rapidly expanding markets of Asia, is still the second largest semiconductor market in the world and the center of highly advanced, high value-added production.

Moreover, the movement of low foreign content consumer electronics production from Japan offshore in part explains the why total foreign share in the Japanese market has increased in recent years, even though no additional solid opportunities have been created from this movement. For example, according to EIAJ data, foreign share in Japan increased from 22.2% in 1993 to 23% in 1994, but this was largely due to the fact that consumer semiconductors represented only 32% of the Japan market in 1994, compared to 37.6% in 1993. In fact, according to EIAJ data, foreign share in all products outside of consumer goods actually declined during this period.

Similarly, an analysis of one particular market segment -- Gate Arrays/Standard Cells/Full Custom circuits -- demonstrates the need for continued progress in improving foreign market access in Japan. Both the U.S. and Japan have strong, competitive companies producing these chips, and the close relationship between suppliers and users required to design in these semiconductors make them a good indicator of whether U.S. suppliers have become firmly entrenched in the Japanese market. Yet in this category, foreign suppliers' share increased from 8.4% in 1990 to 17.5% in 1993, and actually declined to 17.0% in 1994 -- according to a Nomura Research Institute study sponsored by EIAJ. This is far below the share that U.S. suppliers are capable of, based on their demonstrated competitiveness in world markets.

Continuation of an arrangement between the United States and Japanese governments is needed to maintain a framework for cooperation which will allow further market opening to take place. The existing framework has allowed both the two governments and the two industries to prevent a return to the litigiousness and friction that once characterized this sector, while facilitating market opening progress.

The way to continue building on the results that SIA and EIAJ have worked so hard to achieve over the last few years is to renew the Semiconductor Agreement prior to its expiration in July 1996, thereby avoiding a return of bilateral friction in the semiconductor sector and allow work to continue toward narrowing the gap between competitive outcomes in the world outside Japan and those which take place within the Japanese market. In short, the Japanese market must become fully contestable to all competitive producers regardless of nationality.

The Threat of Renewed Dumping

During the mid-1980s, Japanese dumping of semiconductor products in foreign markets drove nine of eleven American makers of commodity memory chips (DRAMs) out of the DRAM business (and one company -- Mostek -- out of business altogether). This dumping also had a severe impact on the financial health of U.S. makers of other memory chips (EPROMs). Trade in semiconductor products became a source of tremendous friction between the United States and Japan. To deter renewed dumping of semiconductors, Japanese firms are required under the current Agreement to collect and maintain certain cost and price data that would be necessary to

determine whether their products were being dumped. This data remains in the possession of each company and is not provided to any government official -- U.S. or Japanese -- unless a formal antidumping investigation is initiated.

Although there has been no allegation of Japanese dumping under the 1991 Agreement, this is most likely due to tight world market conditions which have existed through late 1995. The antidumping provisions of the Agreement will not be tested unless and until there is a very sharp decline in prices for a particular semiconductor product. The semiconductor market is very cyclical in nature, as recent sharp downturns in the prices of DRAMs clearly shows. Moreover, it is an industry where products have very short life cycles and one in which change can be very rapid. All of this makes renewed dumping a possibility.

The world semiconductor industry is currently experiencing a period of explosive growth. The global chip industry is expected to more than double in size to approximately \$300 billion by the turn of the century. Meeting the demand generated in the next five years will require the construction of over 100 new production facilities or "fabs," each of which will cost anywhere from \$1 billion to \$2 billion -- and 70 percent of which will be obsolete within three years of their construction due to the short product life cycles of this dynamic industry. Capital expenditures deemed necessary to boost competitiveness may lead in fact to overcapacity and dumping. Several factors contribute to these capacity swings. Most notably, forecasting demand beyond a few months is highly uncertain, and periods of demand start and end abruptly. As a result, periods of overcapacity closely follow periods of undercapacity in the semiconductor industry.

The emergence of Korea and Taiwan as major producers of semiconductors is adding significantly more capacity, which in turn further increases the risks of dumping should a downturn take place in any product segment of the world semiconductor market. However, while Korean and Taiwanese production could help tip the market into overcapacity, the market leaders in DRAMs remain Japanese producers, who have 39 percent of the world market for semiconductors overall and 49 percent of the world DRAM market.

Given the history of the industry -- and the devastating impact dumping has had in the last decade and could have again in the future -- it is in the best interests of both the U.S. and Japanese industries that the minimal level of protection against dumping afforded by the Agreement be continued.

The Need for Businesslike Solutions, Not Trade Litigation

Some critics have argued that with the establishment of the World Trade Organization (WTO), the bilateral cooperative arrangements of the Agreement are no longer necessary. While SIA believes that the WTO provides an important forum for enforcing many rules governing international trade, we disagree strongly with the suggestion that the WTO can replace the Agreement. This is neither practical nor reasonable; rather, it is a litigious, bureaucratic approach that should be rejected.

Filing complaints at the WTO about market access is not a realistic solution in disputes in the semiconductor sector. The WTO provides for panels of judges to consider broad issues through a process that can take well over a year. The only remedy available through the WTO is trade sanctions.

The U.S.-Japan Semiconductor Agreement, on the other hand, provides for pragmatic solutions to specific problems through joint industry-to-industry and government-to-government meetings. At these meetings, the U.S. and Japanese industries and governments discuss such detailed issues as the need to make available devices for surface mounting, or the need to open additional design centers. These are not matters for judges in Geneva to resolve.

Avoid Disputes Before they Occur

The U.S.-Japan Semiconductor Agreement has served as a mechanism to diffuse concerns before they develop into major trade disputes. The U.S. and Japan semiconductor industries have moved from rancor to cooperation in less than a decade. Continuation of a government-to-

government agreement is the best means to maintain and build on the harmonious relations that have developed and are continuing to grow.

Under the Agreement, SIA and EIAJ, and the U.S. and Japanese governments, meet jointly three times a year. These meetings have allowed SIA to establish very valuable relationships with our EIAJ counterparts through an extensive series of joint activities. Under the Agreement, the two governments work together to calculate foreign share of the Japanese market, and jointly issue quarterly reports. Calculation of foreign market penetration in Japan by the United States absent any government-to-government consultations on the issue is likely to lead to disagreements between Washington and Tokyo.

The members of SIA believe it is in the interests of both the U.S. and Japanese industries and the Governments of Japan and the United States, not only to provide a context in which these relationships are maintained, but also to keep this vital industry free from the strife that would likely arise in the absence of an Agreement. Renewal of the Agreement will help ensure not only that progress continues in opening Japan's markets -- where work remains to be done -- but that friction does not develop between the U.S. and Japanese governments over trade in semiconductors.

Conclusion

The American semiconductor industry's consistent commitment to product quality and innovation have allowed U.S. producers to regain their technological leadership. Retaining that leadership is critical to America's defense capabilities as well as for its commercial interests. In an era in which multibillion dollar investments are required simply to keep up with growing demand, maintaining technological competitiveness will require not only the industry's continued commitment to technological advances, but also attaining full access to markets worldwide -- particularly the world's second largest market, Japan.

Although the U.S.-Japan Semiconductor Agreement has been tremendously successful in making progress toward opening the Japanese market and building cooperation between the two industries and the two governments, much work remains to be done.

- The gap between U.S. share in Japan and in the rest of the world remains substantial: 18 percent in Japan versus 50 percent in the world outside Japan. For a product that is shipped around the world in a half-day's time, and given the extensive efforts of the U.S. industry in Japan, this gap can only be due to continuing structural barriers in the Japanese market.
- U.S. companies still find it difficult to win high-value design-in contracts in Japan.
- Market access problems in Japan -- the world's second largest market -- remain real. Substantial gaps exist between U.S. and other foreign industry's performance outside and inside Japan.
- Without the structure of cooperative activities between the Japanese and foreign semiconductor industries, supported directly by the government-to-government efforts under the Agreement, the future of U.S.-Japan cooperation is in doubt.
- Worldwide investment patterns show a tremendous growth in capacity which could result in renewed dumping should there be an unexpected market downturn as has happened in the past. The minimal, non-intrusive antidumping provisions of the Agreement should therefore be maintained.
- The World Trade Organization has been established, but its sanctions-based judicial approach will not promote cooperative, businesslike solutions in technical, product-specific market access issues as has the U.S.-Japan Semiconductor Agreement over the last ten years.

SIA believes that the only way to continue building on the progress that has been achieved over the last few years is to renew the Agreement prior to its expiration in July 1996. Absent renewal of the Agreement, it is clear that the level of government-to-government and industry-to-

industry cooperation that exists today will not be continued. Without regular government-to-government consultations and joint calculation of foreign market share data, independent publication by the United States of market share information would undoubtedly lead to immediate disagreement with both the Japanese government and the Japanese industry. In addition, continuing sales to small and medium sized Japanese companies, which tend to be more insulated from foreign suppliers, would be difficult absent a continuation of the Agreement. The potential for bilateral trade friction evolving around trade in semiconductors is thus very real.

The existing Agreement structure has been instrumental in helping build the progress which has been achieved to date and the members of SIA are committed to continuing this progress. Maintenance of the current arrangement, by which the U.S. and Japanese governments and their respective industries work together in a cooperative effort to promote greater sales opportunities for foreign producers in Japan, will continue to benefit both the U.S. and Japanese industries.

Mr. Chairman, I would like to thank the Subcommittee for this opportunity to present the views of the SIA on this important issue in U.S.-Japan trade relations. I would be happy to answer any questions from the Subcommittee.

Chairman CRANE. Thank you, Mr. Armstrong.

I would like at this point—because again, we may be interrupted by a vote shortly—to yield to Mr. Paxon to welcome his corporate constituent to the Subcommittee today.

**STATEMENT OF HON. BILL PAXON, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF NEW YORK**

Mr. PAXON. Mr. Chairman, thank you, and I apologize for being delayed at a leadership meeting. But I wanted to be here and to welcome George Fisher. On behalf of our community, we are very proud of the leadership of George Fisher and Kodak Co. for 100 years in the Rochester region.

Let me just make a couple of quick points: First of all, George Fisher is a recognized leader in opening global markets to American products, whether at Motorola or today at Kodak. He uses every tool at his disposal to bring barriers down overseas so that American products like Kodak film can be marketed in those corners of the world. He believes in free trade.

But today, unfortunately, the playingfield is unfair and unlevel, and his goal and Kodak's goal is to not only bring about a level playingfield but to, as a result, create jobs and economic growth in this country, and I think that that is to be lauded. I would note that in addition to his tremendous track record at both Motorola and today at the Eastman Kodak Co., Mr. Fisher is a recognized leader in this city in the area of trade policy, serving as an advisor to two administrations on competitiveness and trade as chair of the U.S. Council on Competitiveness and currently a member of the Advisory Council for Trade Policy and Negotiations.

And I would note very clearly that Kodak is and always has been interested as a corporate entity in helping to promote American products overseas and create jobs here—54,000 jobs in this country alone, and Kodak has traditionally been one of the top 10 exporters nationwide. However, the actions by the Government of Japan are undermining Mr. Fisher's ability as well as Kodak's ability to continue to produce jobs and economic growth here as well as overseas. You employ nearly 100,000 people around the world. And I think it is important to note that the policies that are being pursued in Japan clearly are harming Kodak's ability and other companies' abilities to market these products.

Kodak has made a good faith effort, Mr. Chairman, to establish a presence in the Japanese market, investing \$750 million there over the past 10 years. Kodak did not just walk in here and say we want help; they fought and fought and fought to open markets in that nation. Kodak's goal is simple and fair: Allow U.S. companies to compete in Japan as they do all over the world. While Fuji has access to 100 percent of the American market, Kodak is blocked from two-thirds of the Japanese market. And most disturbingly, Japan, one of our closest allies, has absolutely refused, categorically, completely, continually, to respond to American inquiries on this matter. The refusal to respond to requests from U.S. officials is more than disappointing; I think it should be a cause for deep concern in this country, especially considering their stated desire to open markets in their nation.

The President, as it is well known, will be meeting with the Japanese Prime Minister in Tokyo on April 15. The Kodak case must be discussed at that meeting, and I am very pleased that Congressman Houghton and Congressman Levin have circulated a letter to the President asking him to raise this issue. I have just signed the letter, Congressman Houghton and I. I am pleased to be part of the effort to bring about that discussion, and we will do everything we can to continue to help facilitate it. But I want to particularly tip my hat to a gentleman who has not only turned Kodak's fortunes around but is helping to turn America's fortunes around in the global marketplace.

I yield back.

Chairman CRANE. Thank you.

Mr. Fisher, I understand the way you explained it that there are distributors and retail stores over there selling Kodak who are creating artificially high prices for Kodak products. How can Fuji exert that kind of control on a distributor? How do they control the ones that will not even let you in?

Mr. FISHER. The ones that primarily will not let us in in two-thirds of the market are basically controlled through this keiretsu form of distribution system which Fuji owns part of or Mitsui Bank and Sumitomo Bank own part of. Those banks are the two largest shareholders of Fuji. So it is a combination of ownership, rebate systems, security deposits and various horizontal and price-fixing mechanisms that go on within that distribution system. And they just simply keep us out, because those people—the distributors and retailers—even if they wanted to, do not dare step out of line, because their financial future is at stake.

Chairman CRANE. I am sure you have heard the charge that you folks have offered rebates to U.S. drugstores and hotel concessionaires and airport concessionaires. Could you respond to that?

Mr. FISHER. Yes; I clearly stand on the ethics, integrity and record of Eastman Kodak. Also, I must say that whether I like it or not, the U.S. Justice Department has examined us up one side and down the other, and I think the persistence of the U.S. Justice Department to pursue investigations of poor market behavior, that record stands on its own. And as I pointed out, if only the Japan Fair Trade Commission were doing nearly one-tenth as good a job, we would all be better off.

Chairman CRANE. I would like to direct one quick question to Mr. Armstrong, and then, we are going to have to recess. But what evidence do you have that if the arrangement expires that your market access opportunities will diminish in Japan?

Mr. ARMSTRONG. Well, our greatest concern is actually the social and business structure which Mr. Fisher just referred to in the sense that Japan has probably been most successful as an insular nation for years by being very self-reliant. It tends to look toward itself. The businesses look toward themselves, first in a business family and then other Japanese businesses for supply of products. The agreement which we put in place has given us an opportunity to go into Japan and talk to potential purchasers and show them our wares, and it has given also an announcement or an edict by the Japanese Government that it is all right to talk to us.

If we can go in, and we have the opportunity to show our wares, to offer our products, we feel that we can compete very well head to head. But absent that approval and absent that network, we feel that we will start regressing and going back to the bad old ways.

Chairman CRANE. We have time. Mr. Houghton, do you have any questions of these witnesses?

Mr. HOUGHTON. Well, I do not know whether we will have any time; great to see you; thank you very much for coming down.

I guess I just have one question: George, you talk about the focus of this case must be in Japan and not in Washington, and I do not know whether I agree with that, because in the final analysis, it is our problem, and somehow, we must do something about it. I can remember going over to Japan on this television issue many times, and they kept saying why are you coming here? Why do you not solve it yourself?

Suppose they do not do what you want. Suppose Mr. Hashimoto does not come to the table the way that you want. What do we do as a country?

Mr. FISHER. Well, I think Mickey Kantor and the administration and Congress have certain tools they can use. From all my experience in United States-Japan relationships, I think it would be a failure on all our parts if this comes to the United States having to retaliate in some way. But that is a tool that is left at the end of the day, and it is probably a tool of failure on all of our parts. Every experience I have had in the past with the Japanese Government says that once the Japanese Government gets engaged—whether it was the semiconductor issue, cellular telephones, pagers, two-way police radios, all of which I have been involved in, once the government gets engaged and understands that the U.S. Government is really serious—that is important—once they understand that, they are very creative, and solutions do exist to these problems, and we will find them.

Mr. HOUGHTON. So you are optimistic?

Mr. FISHER. If the U.S. Government shows the resolve and does not let somebody like Vice-Minister Sakamoto unilaterally declare that Japan is going to talk to us on only those issues it wants to talk to us. That is ridiculous.

Mr. HOUGHTON. Thank you.

Chairman CRANE. Well, let me congratulate George Fisher for the excellent job he did in getting the cellular telephones into the Japanese market when he was at Motorola. As many of you as can stay, please do, and we will recess to answer this vote and be back promptly.

[Recess.]

Chairman CRANE. Because of the chaotic conditions on the floor, I would like to get underway. We know that our colleague, David Dreier, has a commitment to make that he is already running late to, so I will recognize David first and then our colleague on the Subcommittee, Sandy Levin. So, you may proceed. But let me suggest if you can to try to keep your remarks within 5 minutes, and then, we will put any other submission into the record.

**STATEMENT OF HON. DAVID DREIER, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF CALIFORNIA**

Mr. DREIER. Great; thank you very much, Mr. Chairman, and I hope to have it even less than 5 minutes. I have a full statement which I see Mr. Levin has already perused, that I hope to have inserted in the record.

Let me just say that it is a privilege for me to once again testify before this very important Subcommittee in this hearing on trade, commercial and economic relations between the United States and Japan and for allowing me to make this brief presentation. It was nearly 3 years ago that I had the privilege of appearing with you, and I believe that the two most important policy recommendations regarding our relationship with Japan remain the exact same as they were 3 years ago. And frankly, they have been reinforced over this 3-year period since I was here.

First, we should not try to make the American economy more like Japan. That has been one of the things that we have constantly seen in the past: People trying to get us to do that, to emulate Japan, and I think that is a real mistake. Our openness, Mr. Chairman, is our primary strength. Japan does not benefit from closed or protected markets; it suffers from the closed and ineffective nature of its own economy. If they are to thrive in the 21st century information age, the Japanese economy must become more open like the United States.

And the second point is that we should not ignore the United States-Japan security relationship. A very strong United States-Japan alliance is critical to maintaining long-term stability along Asia's Pacific rim. Stability is a prerequisite to continued strong economic development in the region. Given the unquestionable benefit to the United States of strong economic growth along the Pacific rim, we should remain committed to supporting regional security and stability, and let me expand on those two points briefly.

There is no better evidence of the structural weakness of Japan's closed and inefficient economy than to look at their economic performance in this decade of the nineties. Japan is now in its sixth year of essentially stagnant economic growth. The Japanese economy is clearly plagued by significant structural problems, which include the government-managed industrial and trade policies so often advocated by those who wanted to see the United States become more like Japan.

One manifestation of the structural problems confronting Japan has been the difficulty many U.S. firms have exporting to Japan. However, the fundamental problem in Japan is not a trade problem; instead, Japan's problems go to the heart of their domestic economy. Japan must undertake significant internal reforms to restore long-term economic growth and remain a leading force in the international economy. There will be significant long-term benefits to the United States from a Japan that has corrected its internal problems. A healthy Japanese economy is good for the United States of America. A Japan with an open and competitive domestic market that is navigable by foreign firms will be the type of export market that U.S. companies have dreamed about for two decades.

However, we must recognize that the primary beneficiaries will be the Japanese people, not U.S. taxpayers. The best trade strategy

to deal with Japan is to encourage deregulation and other reforms that move Japan toward more internal openness. This entails encouraging Japan to adopt economic policies that bring about the kind of healthy competition that is a hallmark of the U.S. economy. This also means we should not negotiate trade agreements that make the United States function more like Japan. Do not try to protect selected U.S. industries. Do not pick winners and losers. Do not accept the worst aspects of Japan's governmental interference in the economy and attempt to manage market access for select U.S. exporters. This type of government interference runs directly contrary to our fundamental interests in Japan.

The prolonged Japanese recession is doing what trade negotiators could never do: Forcing slow but steady changes in many areas of the Japanese economy, including the distribution system, keiretsu supplier system, and their tradition of lifetime employment. This is good news for U.S. exporters, as Japan's distribution system and keiretsu practices have been major factors inhibiting U.S. exports. During the past year, American exporters have begun to make significant gains selling products to Japanese consumers, products as varied as furniture, refrigerators and computers. However, this is not the time to be complacent, as the U.S. Government can play a positive role in encouraging reform in Japan.

The second major aspect of our Japan policy that is being underemphasized by the current administration is our security relationship with Japan. It was almost inevitable, following the repeated criticism of Japan policy leveled by candidate Clinton that security policy would take a back seat to trade disputes. The critical error in this policy formulation was the lack of recognition that a stable regional security environment is absolutely critical to continued economic development in Asia. This economic development is needed so that Asian countries can develop into the kind of export markets that can play an important part in our Nation's economic growth. Only the United States and Japan, acting in concert but with America in the lead, can establish a regional security balance in which market economies can continue to thrive. This reason more than any other, Mr. Chairman, is why the United States and Japan have the most important bilateral relationship in the world. The biggest failure of this administration in our trade policy with Japan as well as with the administration's overall trade policy is the failure to maintain strong public support for open trade.

By failing to stand up for free trade, by hedging and adopting the "fair trade" rhetoric that protectionists so often use, the President now faces the most antitrade American public since 1930. The administration helped create this problem by basing its support for trade on the 18th century mercantilist myth that trade is good only so far as it leads to exports. The administration has the trade story backward: Imports improve domestic living standards—we know that—and they improve efficiency and productivity. It is time for our Japan trade policy to move away from public brinkmanship over disputes that are both large and small. This tactic strengthens the misimpression that the United States alone, favors open markets, and that Japan simply exploits American naivete.

On the issue of selling the American people on the importance of maintaining a close relationship with Japan, I am saddened to say that while we have worked closely with the administration during the first couple years of working on their trade policy issues, they have failed in this area, and I hope very much that it will change.

Thank you very much, Mr. Chairman.

[The prepared statement follows:]

Statement of the Honorable David Dreier

before the
Subcommittee on Trade
Committee on Ways and Means
March 28, 1996

Mr. Chairman, Members of the Committee, thank you for holding this important hearing on trade, commercial, and economic relations between the United States and Japan, and for allowing me to make a brief presentation.

Mr. Chairman, nearly three years ago I had the privilege of appearing before this subcommittee to discuss this same issue. The first half of 1993 was noteworthy in our two countries' bilateral relations. President Clinton had run for office championing an aggressive trade policy toward Japan, insisting that his predecessors had sacrificed American economic interests on the altar of foreign policy. Our two governments completed negotiation of the "Framework Agreements," which I hoped would become the point of embarkation for negotiations to create a U.S.-Japan free trade agreement, rather than the basis for government-managed trade relations. More important than events here at home, 1993 marked Japan's third year in a recessionary economic downturn, and internal political reforms resulted in Japan's first non-LDP Government in 38 years.

Three years later, I believe that the two most important policy recommendations regarding our relationship with Japan remain the same. First, do not try to make the American economy more like the Japanese economy. Our openness is our primary strength. Japan does not benefit from closed or protected markets, it suffers from the closed and inefficient nature of its economy. If they are to thrive in the 21st Century information age, the Japanese economy must become more open like the U.S. economy.

Second, do not ignore the U.S.-Japan security relationship. A strong U.S.-Japan alliance is critical to maintaining long-term stability along Asia's Pacific Rim. Stability is a prerequisite to continued strong economic development in the region. Given the unquestionable benefit to the United States of strong economic growth along the Pacific Rim, we should remain committed to supporting regional security and stability.

Mr. Chairman, Japan enjoyed a remarkable period of consistent growth during the 1970's and 80's. Those who advocate more government interference in the economy used Japan as a model, advocating Japanese-style industrial and trade policies for the United States. Looking back, it is clear that Japan enjoyed considerable advantages in their post-war economic recovery, particularly their highly skilled work force, low crime rate and base of industrial knowledge. Each will again help Japan grow in the next century.

However, there is no better evidence of the structural weakness of Japan's closed and inefficient economy than to look at their economic performance in the 1990's. Japan is now in its sixth year of essentially stagnant economic growth. It is clear that they are suffering from more than just a bursting real estate or financial bubble. Instead, the Japanese economy is plagued by significant structural problems, which include the government-managed industrial and trade policies so often advocated by those who wanted to see the United States become more like Japan.

Mr. Chairman, one manifestation of the structural problems confronting Japan has been the difficulty many U.S. firms have exporting to Japan. However, the fundamental problem in Japan is not a trade problem. Instead, the problems go to the heart of the Japanese domestic economy. Japan must undertake significant internal reforms to restore long-term economic growth and remain a leading force in the international economy.

There will be significant long-term benefits to the United States from a Japan that has corrected its internal problems. A healthy Japanese economy is good for America. A healthy Japan that has undertaken the necessary reforms to create an open and competitive domestic market that is navigable by foreign firms will be the type of export market that U.S. companies have dreamed about for two decades. However, we must recognize that fundamental reform of the Japanese economy must be driven primarily by forces within Japan. The primary beneficiaries will be the Japanese people, not U.S. exporters. While a long-term proposition, this is clearly a situation where we enjoy shared interests with the Japanese people.

The best trade strategy to deal with Japan is to encourage deregulation and other reforms that move Japan toward more internal openness. This essentially entails encouraging Japan to adopt economic policies that bring about the kind of healthy competition that is a hallmark of the U.S. economy. This also means we should not negotiate trade agreements that make the United States function more like Japan. Do not try to protect selected U.S. industries. Do not pick winners and losers. Do not accept the worst aspects of Japan's governmental interference in the economy and attempt to manage market access for select U.S. exporters. This type of government interference runs directly contrary to our fundamental interest in Japan, which is to promote deregulation and reduce government interference in the economy. These industrial policies will also weaken our domestic economy.

During the past year, American exporters have begun to make significant gains selling products to Japanese consumers; products as varied as furniture, refrigerators and computers. Many U.S. exporters are going after Japanese consumers that finally appear willing to abandon high-priced Japanese suppliers for American exporters that are combining low-price, high quality and strong customer service. A recent report of the Mitsubishi Bank research division indicates that foreign firms have doing strikingly well in a Japanese business environment afflicted with prolonged slow growth and uncertainty. In contrast to Japanese firms struggling to cope with stagnant economic demand, foreign firms have "rapidly expanded sales and increased market shares in the face of heightened competition."

The prolonged Japanese recession is doing what trade negotiators could never do, forcing slow but steady change in many areas of the Japanese economy, including the distribution system, *keiretsu* supplier system, and the tradition of lifetime employment. This is good news for U.S. exporters, as the distribution system in Japan and the *keiretsu* system of long-term exclusive suppliers have been major factors inhibiting U.S. exports. However, this is not the time to be complacent, as the U.S. Government can play a positive role encouraging reform in Japan.

From a policy perspective, the Administration must not lose sight of long-term objectives in the rush for short-term gains. Deregulation is more important than any single market access dispute. While individual industrial sectors might highlight particular Japanese practices that have inhibited imports, our trade policy should focus on deregulation and competition, rather than look for managed market access for select American exports.

For example, the United States should be advocating deregulation of the Japanese telecommunications market, including breaking up the corporate monopoly of Nippon Telephone and Telegraph. We should also be pushing Japanese political leaders to reduce the regulatory control of the Ministry of Telecommunications. **The Telecommunications Act of 1996**, which I believe will be remembered as one the most important reforms of the 104th Congress, sets up the United States to be the world leader in the 21st Century Information Age economy. It will result in hundreds of thousands of good American jobs, and will contribute to maintaining U.S. leadership in numerous related industries. Breaking the grip of both the corporate and government telecommunications monopolies in Japan will similarly help reinvigorate the Japanese economy.

Similarly, during the Administration's hard-fought negotiation over market access for U.S. autos and auto parts last year, the focus should have been on deregulation and the promotion of fair competition within Japan, rather than negotiating market access to compensate U.S. firms for past Japanese Government practices. The Administration came far too close to starting a trade war that would have sacrificed the California economy, where growth depends on a strong relationship with Japan and the rest of the Pacific Rim, in order to bring short-term benefits to Midwest auto manufacturers. A Japan policy that focusses on broad deregulation and promoting competition benefits all U.S. exporters and all regions equally.

The second major aspect of our Japan policy that is being underemphasized by the current Administration is the critical importance of our security relationship with Japan. It was almost inevitable, following the repeated criticism of Japan policy leveled by candidate Clinton, that security policy would take a back seat to trade disputes. The critical mistake in this policy formulation was the lack of recognition that a stable security environment is absolutely critical to continued economic development in Asia. This economic development is essential if Asian countries are ever going to develop into the kind of export markets the President claims are critical to our own economic growth.

The President and many of his trade advisors had claimed that the Cold War caused the United States to make security a higher priority in our dealings with Japan than economic relations. In reality, the post-cold war environment in Asia involves a greater likelihood of security confrontations. The current Administration has seen its Japan policy faced with the North Korean nuclear program as well as the recent tensions in the Taiwan Strait. All the countries of the region are getting wealthier and dedicating greater resources to modern military equipment. In addition, the rise of China as a major economic and military power has pushed regional security issues to the fore.

Within this environment, the United States offers the only good leadership prospect toward establishing a stable 21st Century security arrangement for Asia's Pacific Rim. The countries of Asia clearly see China becoming a major regional power with significant implications for regional stability. Japan, likewise, carries a regional trust deficit on security matters which disqualifies it from playing the role of security broker. However, the United States and Japan can together play the vital role of establishing a regional security balance in which market economies can continue to thrive. This reason, more than any other, is why the United States and Japan have the most important bilateral relationship in the world.

Tensions in the U.S.-Japan alliance, revealed for all to see last fall with the incidents on Okinawa, have been developing for years and could worsen. A top priority of the Administration must be ensure against deterioration of the security relationship. They can best do this by working with the Government of Japan to reestablish what our vital shared national interests are, and how we can best secure them in the changing regional environment. In fact, many of the preeminent issues are of a security nature, which if mishandled, will make our economic concerns moot.

Mr. Chairman, the biggest failure of the Clinton Administration in our trade policy with Japan, as well as with the Administration's overall trade policy, is the failure to maintain strong public support for maintaining an open international economy. Unfortunately, the rhetoric of the President and his leading trade advisors have served to reaffirm the mislaid fears of many Americans regarding trade. By failing to stand up for free trade, by hedging and adopting the "fair trade" rhetoric of protectionists, this President now faces the most anti-trade American public since 1930.

The Administration created this problem by basing support for trade on the 18th century mercantilist myth that trade is good only so far as it leads to exports. By stressing exports and ignoring imports, the Administration gets the trade story backwards: imports improve domestic living standards and force domestic companies to become more efficient and productive. In addition, many import products are used as inputs in the manufacture of high value-added products, helping make American producers competitive and cost-efficient.

Since the 1930's, the Congress and the Administration have had a relationship in which the President upheld free trade while Congress, regrettably, gave voice to local protectionist constituencies. The Clinton Administration has failed to uphold their role in the relationship. The result has been a public that is increasingly inclined to protectionism. At this point, the greatest threat to an open international economy at the end of the 20th Century is not Japan or the European Union, it is public opinion here in the United States.

It is time for the our Japan trade policy to move away from public brinkmanship over disputes large and small. This tactic strengthens the misimpression that the United States alone favors open markets and that Japan simply exploits American naivete. It is no wonder that more Americans believe the protectionist rhetoric of politicians whose policies would, if practiced, devastate American prosperity in the 21st Century. On the issue of selling the American people on the importance of maintaining a close relationship with Japan, this Administration has clearly failed.

Chairman CRANE. Thank you. Let me ask a question first to Sandy.

Sandy, are you on a tight time constraint too?

Mr. LEVIN. No.

Chairman CRANE. Then let me yield to Charlie to direct any questions to David first.

Mr. RANGEL. Is he leaving before Mr. Levin testifies?

Do you have to leave?

Mr. DREIER. Yes, I have a 4:30 meeting, Charlie.

Mr. RANGEL. Well, since you have to leave, you can put your answer in writing. I see where you are very critical of the internal policy of the Japanese Government as well as President Clinton, and you, like everyone else, want free and open trade and less rhetoric. It is my understanding that the negotiators are bogged down; everyone is trying to resolve our differences without sanctions and without a breakdown completely in negotiations. So, in reading your testimony, I think everyone wants to reach the same objectives. But what would you have the President to do specifically that he has not already done?

Mr. DREIER. Well, the one point that I was making already in my testimony is that we have unfortunately had the entire emphasis on the issue of exports, not realizing that we have the potential to benefit from the flow of Japanese products which are sold in this country, improving the standard of living of the American people. And by pursuing that goal, it plays into that hand of not trying to recognize the overall benefits of open markets and free trade for all. And I think that quite frankly, while we worked long and hard on the NAFTA and the Uruguay round of the GATT, and I have traveled with both of you, other Members, and I was privileged to travel with this Subcommittee to Latin America last year, we have not seen what I believe is the kind of emphasis that the administration should place on the overall benefits of free trade. Because when they start talking about fair trade, it does, again, play into the hands of those who would be less than geared toward the goals that we share.

Mr. RANGEL. Well, I would agree with you that we should not have broad and general rhetoric, but I cannot buy American-made anything electronic anywhere in the city of New York because of the great value of free trade.

Mr. DREIER. But you can buy everything in New York because of the great values of free trade.

Mr. RANGEL. Yes; I am not knocking it. The Japanese have done a fantastic job. If you want anything, you have got to buy Japanese. But I have people who manufacture in New York, and they want to sell a couple of rolls of film, you would agree that they should be able to get on the Japanese markets as well.

Mr. DREIER. Absolutely.

Mr. RANGEL. Then we are saying the same thing; it is just that you complain when you are losing jobs from manufacturers against those that are shipping here but for those who are the creators—

Mr. DREIER. I do not complain about it.

Mr. RANGEL. I do not mean you specifically, but in New York, we welcome the trade, because if it was not for the imports, we would be out of business in a lot of areas.

Mr. DREIER. I am glad you recognize it. I am glad that you recognize it, Charlie.

Mr. RANGEL. So I look forward to working with you, whether in the minority or the majority. [Laughter.]

Mr. DREIER. Well, let us just keep things as they are. [Laughter.]

Mr. RANGEL. Thank you.

Chairman CRANE. Mr. Houghton.

Mr. HOUGHTON. Nothing, thank you.

Chairman CRANE. Mr. Graham, do you have any questions?

Mr. GRAHAM. No.

Chairman CRANE. And do you have any questions?

Mr. CAMP. Camp.

Chairman CRANE. Camp, I know; do you have any questions?

Mr. CAMP. It is easy; it is a four-letter word.

No, I have no questions, but I want to thank Mr. Dreier for his very excellent testimony and his leadership on trade issues in general in the Congress, and I appreciate the testimony.

Chairman CRANE. Well, thank you for coming, David.

Mr. DREIER. Thank you very much. I am sorry I have to leave.

Chairman CRANE. We will excuse you early, and Sandy can get in the last word.

Mr. DREIER. No, I will let you do that, Mr. Chairman. [Laughter.]

STATEMENT OF HON. SANDER LEVIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. LEVIN. I do not think David wants me to have the last word, but let me try.

Mr. Chairman and Mr. Rangel and my colleagues from various States, including my colleague from Michigan, I will tell you that this discussion today only underlines my strong feeling as I say in my testimony that I know you will put in the record that few areas have been as besieged by rigid theories or by the pitfalls of an either-or framework as trade policy. The issue has been cast as a choice between fair trade and protectionism or unilateralism and multilateralism, and I think we have just heard kind of another dichotomy of exports and imports.

As our trade imbalance with Japan grew in the seventies and eighties, the dominant voice was that of complacency. Suggestions to act vigorously were usually dismissed as protectionism. There were some efforts—MOSS and SII—that a number of us here participated in, but they were handicapped either by rigid opposition or by ambivalent execution. And then, in 1988, a number of us joined together to enact super 301 and also to strengthen regular 301 with the language making it an unfair trade practice for foreign governments or when foreign governments tolerated anti-competitive practices.

And in the last few years, under the leadership of the Clinton administration, there has been an effort to actively work the ground that lies between the extremes of unreciprocal free trade and rigid protectionism, and it should be clear that what this effort does is to look at bottom-line results. It tries to open foreign markets, not build walls around our own. It starts with the proposition that free trade is not truly free if one side is rigged. And from there comes the notion of fair trade as well as free trade, and this results-

oriented approach has been applied to a number of sectors, especially as to Japan, our largest creditor. And particular importance was placed on the largest single component of that bilateral deficit: Autos and auto parts. Two-thirds of our deficit, as you know, Mr. Chairman, has been in autos and auto parts.

This results-oriented approach has brought substantial progress on the overall bilateral trade deficit with Japan. In 1995, it declined by more than 10 percent, and that trend continues in 1996. An important part of that results-oriented approach was the agreement last year on autos and auto parts. I thought at the time it was an important step—not a complete one but an important one in the right direction—and the data so far show that that is true: Foreign vehicle sales in Japan are up 30 percent in 1995, and foreign auto parts have also risen, and there will be a report in a few weeks that will summarize the first year.

But much remains to be done. U.S. automakers have made grudging progress in securing dealerships in Japan, with only 30 new dealerships to date out of an expected 200. So I think that the reports of the keiretsu system demise are greatly exaggerated, but there has been progress to date opening the door to the possibility of market reform and substantial exports. More work has to be done, clearly, in the auto parts sector, where the Japanese promised deregulation. But so far, only one critical part has been deregulated.

So, it is clear that we have to continue this results-oriented approach. In this increasingly global economy, we must take steps to ensure that our businesses and workers are prepared to compete, and we have to stand up for them to ensure that they have a fair chance to compete.

Mr. Chairman and my colleagues, I list in my testimony some of the voices that I think would take us off course, for example, that of European Union Commissioner Sir Leon Brittan, who said just a few days ago that there is no longer a place for unilateral action. What the Europeans have done is to let the United States knock down doors, and then, they have come in to take advantage of it, sometimes, though, cutting a deal with the Japanese themselves in a much more rigid way than we ever did, for example, in autos.

Also, I point out to the briefing memo that talks about a bilateral trade deficit with Japan—this is the briefing memo prepared by the majority staff saying that a bilateral trade deficit with Japan does not affect lost production or lost jobs or lost wages. Whatever may be the case in macroterms, in terms of specific industries, I think that is clearly not correct.

Let me just say a word if I might about deregulation, and then, I will finish. I think this is an example of the unnecessary polarization and the unwise dichotomies. Mr. Dreier and I have been talking trade for a long time. I am sorry he had to leave. He said we should not negotiate trade agreements that protect selected U.S. industries; do not pick winners and losers; our trade policy should focus on deregulation and competition rather than look for managed market access for select American exports. We are not picking winners or losers; we are not looking for managed access for selected American exports. We are not elevating exports to the derogation of imports. Look: Everybody who came here before me was

from a specific industry. Everyone said the American Government needs to stand up for us. And we on that side sat there congratulating the witnesses here for their activism in trying to open up the Japanese market, and they had applauded the efforts of the U.S. Government to help them: Insurance, high technology, film, semiconductors, we were not picking winners or losers when the U.S. Government does that. It is industry that has picked the winners and losers and says let the winners compete abroad like their winners compete in the United States.

So I do not understand that. And where it says here: "By failing"—on page 3—"to stand up for free trade, by hedging and adopting the fair trade rhetoric of protectionists, this President now faces the most antitrade American public since 1930," every one of the businesspeople who came here in the last few hours talked about fair trade. And they are all not protectionists; they want the opposite. But as they said, they do not want foreign protectionists to keep us out. So I close where I started, and that is: This area has been beset by this unnecessary polarization, by these dichotomies.

What this government increasingly has tried to do in the last years is to say that we want other countries to open their markets like we have opened our markets to them. And I think it is about time that we not use the rhetoric invoking the ghosts of the past to try to make some progress in the present and in the future. I have felt that for so long this trade issue has been beset and besieged by this polarization, and it is up to us who are opposed to it to speak out. It is when we do not that we give ammunition to those on the fringes who, indeed, would build or try to build walls around America.

Thank you very much.

[The prepared statement follows:]

Testimony of the Hon. Sander Levin

On United States-Japan Trade Relations

Before the House Ways and Means Trade Subcommittee

March 28, 1996

Thank you, Mr. Chairman, for giving me this opportunity to express my views on United States-Japan trade relations at this critical moment.

Few areas have been as besieged by rigid theories or by the pitfalls of an either/or framework as trade policy.

The issue has been cast as a choice between free trade and protectionism, or between unilateralism and multilateralism, while our persistent trade imbalance is described by economists as either irrelevant or fateful.

As our trade imbalance with Japan grew in the 1970s and 1980s, the dominant voice was that of complacency. Suggestions to act vigorously were usually dismissed as protectionism. There were some efforts -- MOSS and then SII - but they were handicapped either by rigid opposition or ambivalent execution.

Nevertheless, in 1988, several of us sought to legislate a more vigorous trade policy by enacting Super 301 and by adding language to regular 301 that attacked a growing and pernicious form of trade barrier -- foreign government toleration of anticompetitive practices.

And in the last few years, under the leadership of the Clinton Administration, there has been an effort to work the ground that lies between the extremes of unreciprocal free trade and rigid protectionism.

This effort looks at bottom-line results. It aims to open foreign markets, not build walls around our markets. It starts with the proposition that "free" trade isn't truly free if one side is rigged. And it recognizes that trade imbalances can undermine particular sectors important to the American economy.

This results-oriented approach has been applied to a number of sectors involving a number of nations. Special attention has been given to the country with which we have had the largest deficit: Japan. And particular importance was placed on the largest single component of that bilateral deficit: autos and auto parts, which consistently have accounted for a whopping two-thirds of our bilateral trade deficit with Japan. In 1995, \$35.3 billion of the \$59.2 billion bilateral deficit was in this sector. Auto parts alone made up 20 percent of the deficit. Other targeted sectors include glass, semiconductors, film, air cargo, telecommunications, medical equipment and insurance.

The results-oriented approach has brought substantial progress on the overall bilateral trade deficit with Japan. In 1995, the bilateral trade deficit declined by more than 10%, the first year-to-year decline since 1990. The trend continues in 1996, with February marking the ninth consecutive monthly decline in the merchandise trade deficit. And Japan remains our second largest trading partner, absorbing \$64.3 billion U.S. goods and services in 1995.

An important part of the results-oriented approach was the agreement reached last year with Japan on autos and auto parts. I believed at the time that the agreement was an important step in the right direction, and the data thus far supports that view. A vital part of the effort continues today through the most comprehensive monitoring and enforcement mechanism ever undertaken by government and industry. In the past in other Administrations there was a failure to follow through on agreements.

As a result, there has been a refreshing change in the automotive sector. Foreign vehicle sales in Japan were up 30% overall in 1995, including a 30% increase for U.S.-built Big 3 vehicles and an overall 46% increase for Big 3 vehicles produced worldwide. Foreign auto parts sales in Japan were up 13.5% January-November 1995 over the previous year, while Japanese transplant facilities in the U.S. reportedly are using more domestic parts. And important progress has been made in deregulating the aftermarket for auto parts, progress which will continue under the review process set up under the agreement.

As a result of this results-oriented approach, eager Japanese consumers for the first time are beginning to have real opportunities to buy American cars and other American goods and services. And many U.S. companies for the first time are reaching levels of production that justify investments targeting the Japanese market.

But, of course, more remains to be done. For example, U.S. automakers have made grudging progress in securing dealerships in Japan, with only 30 new dealerships to date out of an expected 200 by the end of 1996. Also, almost 60 percent of vehicles going to Japan from the U.S. are built by Japanese transplants, which in turn use fewer "actual" U.S. parts than the Big 3. Thus, Japan is still trading to a large degree with itself. Reports of the keiretsu system's demise are greatly exaggerated, although the progress to date cracks open the door to the possibility of real market reform and substantial exports of Big 3 vehicles and other U.S. goods.

More work also remains in the auto parts sector. For example, of the 32 auto parts on Japan's restrictive "critical" parts list, only 1, power steering, has been deregulated to date, while only 7 of the 42 auto parts on the "modified" parts list have been deregulated. Pursuant to the terms of the agreement, Japan is conducting a one-year review of these parts lists, so that deregulation may continue to move speedily in the right direction.

And let us not forget that, overall, Japan continues to represent our largest current account deficit: \$59.3 billion in 1995 (down from \$65.7 billion in 1994 and \$59.31 billion in 1993).

That's why I strongly urge that we continue this results-oriented approach for all nations that do not allow a level playing field for U.S. businesses and workers. In this increasingly global economy, we must take steps to ensure that our businesses and workers are prepared to compete, and we must stand up for them to ensure they have a fair chance to compete.

We must reject the voices that attempt to steer us off course:

-- European Union Commissioner Leon Brittan, who was in Washington last week to proclaim that "the days of the old U.S. approach surely are numbered." "In our view," he said, "there is no longer a place for unilateral

action, or the threat of it." Instead, he puts his faith exclusively in cooperative dialogue with Japan based on mutual respect for the multilateral system.

I've always taken particular exception to these complaints by the Europeans. They are hiding right behind us when we push to open a market while criticizing our methods in order to curry favor with protectionist nations. They then will cut a deal with such countries for a rigid limit on access to the European markets, as they did on autos as to Japan.

- The briefing memo prepared by the majority staff, which blithely claims that "[O]ur bilateral trade balance with Japan is largely the result of macro-economic imbalances. ... [A] bilateral trade deficit with Japan does not reflect 'lost' production or 'lost' jobs or 'lost' wages."

But in the 1980s jobs were lost -- indeed, key parts of industries were lost. Sure, macroeconomics plays an important role. But I remember when the pundits said if we could only cut the budget deficit and bring the value of the dollar down to 200 Yen, the trade deficit would disappear. Now the budget deficit has been halved, and the Yen is around 100, yet the trade deficit persists. Meanwhile, other nations run trade surpluses while maintaining even larger budget deficits than the United States. Case in point: Japan, whose budget deficit is larger as a share of GDP than the United States'.

- Others are calling for "deregulation" in Japan and other nations to mirror calls for deregulation in this country. Deregulation is important, but in Japan it won't happen without continued outside pressure and is no magic bullet.

Those who are unwilling to take an aggressive path between the extremes of unreciprocal trade and no trade only give aid and comfort to extreme voices.

It took us a long time to escape the rhetoric and ghosts of earlier days and to develop this hard-headed, commonsense approach. We must remain vigilant. This is no time to return to the failed policies of the past.

Chairman CRANE. Thank you, Sandy.

Has that agreement of last year improved the ability of American auto companies to get dealerships in Japan?

Mr. LEVIN. The answer is yes, not enough, but yes. There are 25 more. It is only part way toward the target. And I do not see—and some of this is, in a sense, Japanese deregulation—it will not happen unless there is more pressure from us. So it is a partial breakthrough.

Chairman CRANE. Immediately after that agreement, Ambassador Kantor indicated that the United States estimated that private-sector plans would lead to a \$9 billion increase in American-made parts in 3 years. In your estimation, are the U.S. auto parts manufacturers beginning to realize that target that Mickey referred to?

Mr. LEVIN. Yes; Mr. Houghton and I and others have been in regular contact, I think, with the industry, and the parts industry feels that the agreement has helped to open the doors. There is much more to be done. The deregulation is too small. As I mentioned, only one critical part has been deregulated; and you know what that means: These critical parts are so listed and so controlled that foreign suppliers—I used to carry around my universal joint that I picked up at Joe's Auto Parts on Main Street for \$11.46, and it costs 10 times that in Japan. So the answer is I think there has been some progress, but there is going to be a report, Mr. Chairman, to you and to other Members of this Subcommittee and to the American people, I believe, within the first 2 weeks of April, a specific report on specific progress under this agreement. And we will see. I think your conclusion and mine will be that it opened the door that was very much shut for auto parts producers, at least most of them, but there is a long way to go for the door to be as open there as it is here.

Chairman CRANE. Thank you.

Mr. Rangel.

Mr. RANGEL. Well, let me thank you, Sandy, and I look forward to working with you now and in the next session on sensitive issues.

Mr. LEVIN. Thank you.

Chairman CRANE. Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Chairman.

Sandy, it is good to see you, and of course you know you and I have worked lockstep on many of these different issues. I think the question that I keep asking myself is why are we not going faster? When you take a look at the global deficit with Japan, it hovers between \$40 and \$60 billion every single year, and it may get a little bigger on auto parts, a little worse on flat glass. Something else comes in here. We just do not seem to be able to make any headway. So on a scale of 1 to 10, 1 being jawboning, 10 being cut off everything, what do you think we ought to do? Where in the middle should we be in order to signal that we really are serious here? Because it is not just Japan, but it is Korea, and it is China, and it is others who have to understand that we have a set of rules that if they want to play in our market—which is our most precious asset—they have to abide by, as we would in theirs. What do we do?

Mr. LEVIN. Well, it seems to me we need to have an activism, an aggressiveness that goes way beyond 1, which is jawboning, and is not a building the walls around this country; that simply will not work in this kind of an international economy. And I think what we really need to do is to actively press Japan in this case to live up to its agreements. We have section 301 in our artillery. We have got to make it clear that we will use it as we have in the past.

Mr. HOUGHTON. Can I just interrupt 1 minute?

Mr. LEVIN. Sure.

Mr. HOUGHTON. But, you know, every time, Sandy, we seem to come up to an agreement, we never have any numerical standards, no index and no goals, no anything. It is just we want to do this; we want to do that. It is probably true on both sides. Is it not possible to, at a minimum, say that if we are going to have a multilateral or a unilateral trade agreement, or if we are going to abide by the conditions of GATT, then we have got to have some numbers.

Mr. LEVIN. Yes, and, of course, in the semiconductor agreement, there was a number. But also, there have been numbers in the auto agreements with Japan. There was a number in the agreement or the understanding that was reached by President Bush, and there are some numbers in the agreement of last year. And while it is not a goal like the semiconductor agreement, it is an expectation on our part, for example, 200 dealerships. We also have an expectation of the deregulation of the auto parts industry by the Japanese, and there are some numerical values attached to it. And I think what we have to be sure of is that the Japanese understand that if they do not take these steps, the United States will take further action. It is in their mutual interest, in their interest; it is in our mutual interest; it is in their specific interest to open up this market. But as you know, Amo, for the first time, there is a monitoring device that will implement this agreement, and the first report will emanate from that monitoring arrangement.

So we mean business, and what the businesspeople here today were saying in a nutshell was for us to do business, the private sector, the government has to mean business in terms of helping the markets be open. And I think that is the exact right balance.

Chairman CRANE. Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman.

And to my colleague from Michigan, I thank you for your testimony, and I think that the comment that you made that more work needs to be done is an understatement. When the auto parts breakthrough occurred, I think there were many who questioned what it really might mean. And additionally, maybe not as much as we had hoped, this report will be very helpful. Clearly, we are still having trouble in the dealership sections, but I agree with you; we have a lot more to do, and your testimony today, I think, helps clarify that, and we are all going to be looking very closely at that April report and try to understand more what that means. So I just want to thank you for your testimony. Thank you.

Mr. LEVIN. And let me just comment briefly. There has been a bipartisan effort in the past, and I hope that will not break down this year. We will see. I think the auto and auto parts areas are so serious that we have to continue to work on a bipartisan basis. Nancy Johnson, Marcy Kaptur and I went on a bipartisan basis to

talk about auto parts. It is 10 years now. And you and others have joined in on this. And unless the Japanese and other countries understand that this country is serious about their opening their markets, they will not do it. Korea is another case in point. In a sense, it is like free enterprise in this country. To win, you have to stand up for yourself. People do not give you much in a free enterprise system. You have to stand on your own two feet and fight for yourself. And that is exactly what we ought to be doing within a framework where disputes can be resolved in an amicable way, hopefully.

Mr. CAMP. Thank you.

Chairman CRANE. Well, Sandy, thank you so much for your testimony.

Mr. LEVIN. Thank you.

Chairman CRANE. And I would like to now invite John Patrick, general counsel for Fuji Inc.; Oakley Johnson, vice president, corporate and international affairs, of the American International Group, Inc.; Ed Rozynski, senior vice president of the Health Industry Manufacturers Association; and Maureen Smith, vice president of international affairs, American Forest & Paper Association to come forward. And before we commence with your testimony, I would like to yield to Mr. Graham to welcome Mr. Patrick.

Mr. GRAHAM. Thank you, Mr. Chairman. I appreciate that. John, I am glad to have you here. John Patrick is general counsel of Fuji from, of all places, Greenwood, South Carolina. That is right in the middle of my district. And John is going to talk a little bit about Fuji North America, and I appreciate the Subcommittee listening to the other side of the story, and I will have a statement a bit later. But John, welcome, and I appreciate your being here and sharing your testimony with the Subcommittee.

Thank you, Mr. Chairman.

Chairman CRANE. And we will start with you, Mr. Patrick.

STATEMENT OF JOHN PATRICK, GENERAL COUNSEL, FUJI PHOTO FILM, INC.

Mr. PATRICK. Thank you, Mr. Chairman and Members of the Subcommittee. I am here to discuss a dispute involving a company that has 70 percent of its home market and pays premiums to retailers to exclude competitors from store shelves. I am not talking about Fuji Film in Japan; I am talking about the Eastman Kodak Co. in the United States. This case is not about an American industry trying to level the playingfield; it is about one company, Kodak, trying to use the U.S. Government to gain an advantage over Fuji Film in a global commercial battle.

In the last 10 years, Fuji Film has invested nearly \$1.5 billion in the United States, and we have 5,000 employees in the United States. In our U.S. manufacturing plants, we have American workers making American products and exporting them around the world. To the best of our knowledge, Kodak has no manufacturing facilities in Japan. Yet despite our enormous commitment to the U.S. market, our share of the consumer film market in the United States continues to hover around 10 percent. We were, therefore, amazed, when Kodak, complaining of its 10-percent share of the Japanese market, filed a 301 complaint. Kodak's claims are groundless.

Let me review the key facts. Fact one: Kodak film is widely available in Japan. Kodak has made a lot of allegations about how Fuji controls distributors to create a distribution bottleneck. The facts, data we would be happy to have this Subcommittee or USTR verify, show that almost 80 percent of the retailers served by Fuji's distributors actually buy or have access to Kodak film. Figure 1 attached to my statement shows these findings. There is no distribution bottleneck that keeps Kodak film off the store shelves.

Fact two: Price competition is alive and well in Japan. We have shown that if you compare the same type of film at the same type of retail outlet, prices throughout Japan are comparable to the United States. The map of Japan attached to my statement demonstrates how widely available discounted film is in Japan. Fuji Film cannot and does not control retail film prices. The market is open to competitively priced film.

Fact three: The Japanese Government does not restrict access to the film market, nor has it tolerated anticompetitive activities. Government restrictions were eliminated decades ago. While Kodak is protected by a 3.7-percent U.S. tariff, there are no Japanese tariffs on consumer photographic products. Furthermore, the Japanese Fair Trade Commission has monitored our industry carefully, and Fuji has taken recommended actions to assure full compliance with Japan's antimonopoly law.

Fact four: Kodak's problems in Japan are the result of its own mistakes. Kodak claims that it has "done it right" in Japan. The facts are that Kodak has refused to compete on price for over 10 years. Kodak was 2 years behind Fuji Film in the introduction of high resolution 400 speed film and 2 years behind Fuji Film in the introduction of one-time use cameras. Today, these two products account for almost two-thirds of the Japanese consumer film market. And Kodak has not advertised aggressively. For the period reported by Kodak, Fuji Film outspent Kodak by a factor of 10 to 1. Kodak cannot expect to increase its market share against an incumbent entrenched with a home team advantage if it refuses to compete on price, is behind in product innovation and does not invest heavily in advertising. Clearly, Kodak is not a company that has done it right.

Fact five: Kodak engages in exclusionary activities in the United States aimed directly at keeping Fuji film off retailers' shelves. This is relevant because it is fair to look at reciprocal opportunities in the United States and because the practices provide a benchmark against which to compare its allegations. The facts are: Until December 1995, Kodak had a rebate program that ensured retailers a 4-percent rebate even if they did not reach a target quantity of sales as long as they agreed not to carry Fuji film. Kodak has paid premiums to companies like Eckerd Drug, Publix Supermarkets, Bradley's and major airport and hotel concessionaires in return for them agreeing not to carry any brand but Kodak. If you walk through National Airport, you will not find any Fuji film. By comparison, you will find Kodak film at Tokyo's Narita and Haneda Airports. Kodak engages in practices far more exclusionary than even what they allege against Fuji Film.

In conclusion, Mr. Chairman, we believe the facts demonstrate that Kodak's case is just plain wrong. It proves only that most Jap-

anese consumers do not buy Kodak film, not that they cannot buy Kodak film. We are confident that the facts will prove that the Japanese film market is open and that Fuji Film is a fair competitor. Antitrust cases are fact-intensive and very complex. Yet, there is enormous pressure here to decide in Kodak's favor with little fact finding. We have suggested neutral fact finding mechanisms to USTR. These include the use of a special panel of experts; appointing a U.S. administrative law judge as well as multilateral mechanisms.

Kodak objects to this and argues USTR should accept Kodak's facts at face value and insist that Japan negotiate. But it has yet to be established that there is any problem to negotiate. Today, we again call on Kodak to let the facts decide.

This completes my statement, Mr. Chairman. Thank you for allowing me to testify.

[The prepared statement and attachments follow:]

**STATEMENT OF JOHN PATRICK
GENERAL COUNSEL
FUJI PHOTO FILM, INC.**

Mr. Chairman and Members of the Subcommittee

My name is John Patrick and I am General Counsel and Secretary to Fuji Photo Film, Inc., the Greenwood, South Carolina manufacturing subsidiary of the Japanese photographic materials company Fuji Photo Co., Ltd. I am joined today by Paul Hudak from our sales and marketing headquarters in Elmsford, New York, and by one of our attorneys, Jim Durling, from the law firm of Willkie Farr & Gallagher.

On behalf of all of us, I want to thank you for the opportunity to appear before this subcommittee to discuss U.S.-Japan trade relations as they affect the photographic materials industry.

Let me begin by saying that one reason we are here today is to discuss a dispute between two companies. One of those companies has 70% of its home market, controls and excludes competitors from its distribution network, and pays premiums to retailers not to do business with its competitors. I am not talking about Fujifilm in Japan. I am talking about the Eastman Kodak Company in the U.S.

This case is not about an American company trying to level the playing field with a Japanese company. It's about one company -- Kodak -- trying to use the U.S. Government to gain a competitive edge over another company -- Fujifilm.

Fujifilm got its start in the U.S. in 1958 with a liaison office of only one person. Fujifilm's sponsorship of the 1984 Los Angeles Olympics provided a significant boost to our U.S. presence. By the early 1990s, our U.S. sales exceeded \$1 billion annually and personnel increased to nearly 2000 employees.

Since then our operations have grown rapidly with the establishment of Fuji Tricolor, Inc., our U.S. photofinishing operation, and the investment of hundreds of millions of dollars in our presensitized printing plate, videotape, film packaging, photographic paper, and Quicksnap single use camera plants in Greenwood, South Carolina.

Indeed, in the last 10 years Fujifilm's total U.S. investments were more than \$1.5 billion. Meanwhile, we have increased our U.S. personnel to 5,000 employees; our U.S. sales have grown to now exceed \$1.5 billion per year, and our exports out of the United States this year will exceed \$100 million. By 1997, our facilities in Greenwood alone will employ more than 1,200 workers and total investments there will exceed \$700 million. Already, our Greenwood facilities manufacture videotapes for export to Japan and Quicksnap cameras to Europe. Overall, we export to more than 40 countries from our Greenwood facilities. We are an American company with American workers making American products.

Despite this enormous commitment in the United States, our share of the U.S. consumer photographic film market continues to hover around 10 percent. Meanwhile, excluding the U.S. and Japanese markets, we have about one third of the world market. Indeed, right here in North America, Fujifilm's share of the Canadian market is 35 percent.

We were therefore amazed when Kodak -- complaining of its 10 percent share of the Japanese market -- filed a Section 301 petition with USTR claiming that Fujifilm, with the assistance of the Japanese Government, has engaged in anticompetitive activities that restrict Kodak's access to Japanese markets.

Kodak's claims are groundless. We have spent the last eight months disproving Kodak's case with thousands of pages of rebuttal and we are absolutely confident that the facts are on our side.

With this case, we think Kodak has truly crossed the line. Kodak now seeks to use government intervention as a substitute for hard-fought competition to increase its sales in

Japan. Kodak is pursuing this case in the face of its own questionable practices here in the U.S. -- which arguably can be blamed for Fujifilm's 10 percent share of the U.S. market.

It is not enough that Kodak continues to be protected by a 3.7 percent tariff in the United States, while Japan has no import duties at all on consumer photographic products. Kodak wants more.

Let me review the key facts in this case.

Fact Number One -- Kodak film is widely available in Japan. Kodak claims that Fujifilm controls its four primary distributors and thereby prevents Kodak from reaching the Japanese retail shelf -- the so-called "distribution bottleneck."

We've shown that there is no such control, and more importantly that there is no bottleneck. The facts -- data that we would be happy to have USTR or this subcommittee verify -- show that almost 80% of the dealers served by Fuji's distributors actually buy or have access to Kodak film. Sales to those customers account for almost 90% of the distributors' sales volume. Figure 1 attached to my statement shows these findings.

Again, this data is verifiable. Kodak has never offered any evidence showing that it cannot get on to retail shelves in Japan. Kodak's market share numbers only show that people won't buy Kodak, not that they can't buy Kodak.

Kodak decided to own its Japanese distributor, just as it does in most of its markets. Kodak has made a lot of allegations about how Fuji controls its distributors. The facts are that Fujifilm's distributors can and, in fact, do carry Kodak products. But why should they want to sell Kodak film, when Kodak owns a distributor that performs this function? Perhaps Fujifilm should buy its four primary distributors, and then Kodak's invented "bottleneck" would be eliminated. The bottom line right now is that Fuji does not have access to Kodak's distribution network in the U.S., Japan, or anywhere else.

Fact Number Two -- Fuji cannot and does not control retail film prices in Japan. Kodak claims that Fujifilm controls prices, thus keeping all prices artificially high. We've shown that if you compare the same film sold at the same type of retail outlet, prices throughout Japan are actually comparable to prices in the U.S.

Kodak's supposed evidence of resale price maintenance is also distorted and manipulated. The map of Japan attached to my statement demonstrates how widely discounted film is available in Japan. Again, the numbers are verifiable. No resale price maintenance exists in Japan.

Fact Number Three -- The Japanese Government has not had any role in the wholesale film market for a quarter century. Kodak claims that the Government of Japan has assisted Fujifilm in restricting the market. Again, this claim is groundless.

The Government of Japan removed any restriction on foreign capital, ownership, prices or other actions decades ago. In addition, the Japan Fair Trade Commission has monitored our industry very closely for years and has recommended that Fujifilm take certain actions to assure full compliance with Japan's antimonopoly law -- actions Fujifilm has taken.

Fact Number Four -- Kodak caused its own problems in Japan. Kodak claims Fujifilm is the problem, but we have provided USTR with evidence showing that Kodak's problems in Japan result not from Fuji's actions but from Kodak's own mistakes.

Former Kodak officials -- including former Kodak president Kay Whitmore and former Kodak Japan president Albert Sieg -- have stated that there were no barriers to competition in Japan's consumer photographic industry. Indeed, Al Sieg said in a recent interview that "I clearly believe that one of the biggest problems that Kodak has in Japan is

that for clearly 10 years of good opportunity, we neglected Japan So you know, we did it to ourselves."

Kodak has refused for over 10 years to compete on price in Japan. Kodak claims it has no incentive to cut prices, but the facts show that in the 1980s, when Kodak film was substantially cheaper than Fujifilm, Kodak's market share went up to about 18 percent. Then, as soon as Kodak prices went up, their market share went down. Kodak has never lowered prices again despite a falling dollar that would have justified cutting prices.

The real truth is what an unnamed Kodak official told a Nikkei Business reporter in 1993 -- "If we would sell film at even cheaper prices than the current price, this cheaper film would be reverse exported back to the U.S. or other markets and end up destroying the global price structure of Kodak prices." In other words, Kodak worries that its own very profitable sales in the U.S. might be threatened by reimports of gray market film from Japan.

Kodak has not been innovative and market sensitive. Kodak claims it has "done it right" in Japan, but the facts show that Kodak has been unresponsive to the preferences of the Japanese consumer. For instance, we have provided USTR with evidence showing that Kodak lagged two years behind Fujifilm in the most important product innovations to hit the Japanese market in the past decade -- high resolution ISO 400 speed film and one-time use cameras.

We've also shown that Kodak has failed to demonstrate a full-fledged long-term commitment to the Japanese market. Unlike Fujifilm in the U.S., Kodak has never set up any manufacturing facilities for consumer products in Japan. And on a purely cultural level, Kodak made perhaps its biggest mistake in 1993 when it canceled job offers to incoming college graduates -- a gaffe that one observer called "maybe the worst marketing decision ever made by a foreign company" in Japan.

Kodak has just not "done it right" in Japan. Kodak talks about its advertising budget in Japan of 5.3 billion yen between 1986 and 1989. Yet, this is only 10% the amount Fujifilm spent in Japan during the same period. How can a company expect to increase market share without investing in advertising?

Fact Number Five -- Kodak has tried to exclude Fuji film from the U.S. market. Kodak and USTR claim Kodak's U.S. practices are irrelevant, but we have provided USTR with information that responds to the requirement in Section 301 that USTR consider the extent to which reciprocal opportunities exist for foreign firms competing in the same industry in the United States.

As I stated earlier, Kodak's share of its home market mirrors Fujifilm's. Kodak has 70 percent of the U.S. market and Fujifilm has 10. Kodak claims that the U.S. market is completely open and that Kodak's share is simply the result of Kodak's well recognized brand and long standing reputation.

In fact, there is an abundance of evidence demonstrating that Kodak engages in exclusionary activities in the United States, aimed directly at keeping Fuji brand film off retailers' shelves. We do not bring this up to justify or explain some problem in the Japanese market. We bring it up because Section 301 requires USTR to investigate the U.S. market to ensure that the principle of reciprocity -- the basic principle that underlies Section 301 -- is upheld. And, it provides a useful comparison.

Despite Kodak's insistence that the U.S. market is open, Kodak has actually stepped up its efforts to exclude Fuji brand film, particularly since last year's termination of Kodak's decades-old consent decrees. Kodak has paid premiums to companies like Eckerd Drug, Publix Supermarkets, Bradlees, and major airport and hotel concessionaires in return for their agreeing not to carry any brand but Kodak. Walk through Washington National Airport. You cannot find any Fuji brand film. By comparison, you will find Kodak film at Tokyo's Narita and Haneda airports.

Until December 1995, Kodak had a VIP rebate program that ensured retailers a four percent rebate even if they didn't reach a target quantity of sales--as long as they agreed not to carry Fujifilm.

Finally, since termination of the consent decrees, which prohibited Kodak from vertical integration into photofinishing, Kodak has bought numerous photofinishing labs, thus capturing for itself a significant portion of that market. Ironically, when Kodak has made these acquisitions, all of which have resulted in significant job losses, Fujifilm has been the one to pick up the pieces and provide jobs to those people Kodak has fired.

As you can see, this case is fact-intensive, and very complex. Although we believe the facts demonstrate Kodak's case is just wrong, Kodak continues to dispute these facts. This is in essence an antitrust case, which would take years to resolve in the U.S. courts. Yet there is enormous pressure here to decide in Kodak's favor with little or no fact-finding.

These factual disputes need to be sorted out - carefully and objectively. To that end, we have suggested alternative neutral fact-finding mechanisms to USTR. These include use of a special panel of experts, appointing a U.S. administrative law judge, as well as multilateral mechanisms. USTR is currently considering a mechanism under the auspices of the WTO. Unsurprisingly, however, Kodak objects to this approach. It appears that Kodak is the only party to the dispute that maintains such a position. In Kodak's perfect world, USTR would simply take Kodak's facts at face value and insist that Japan negotiate. But, as our submissions prove, it is not yet established that there is any problem to negotiate.

What is the bottom line in this case? If you cut through all the rhetoric and the groundless claims and the threats, it's very simple. Fujifilm's biggest competitor in Japan and the U.S. is trying to use the U.S. Government to increase its market share in both countries.

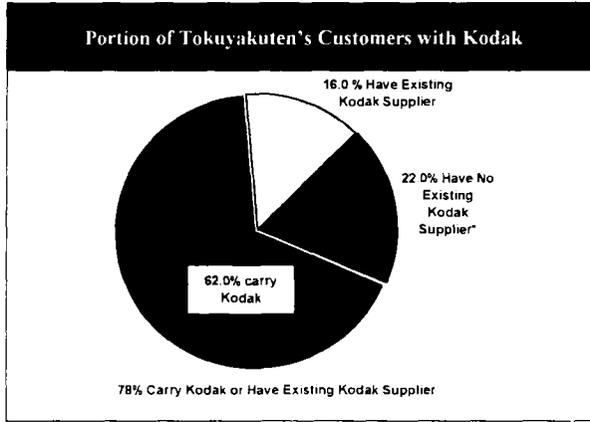
If Fuji's conduct in Japan were the real issue here, then Kodak would have filed a case with the Japan Fair Trade Commission, if for no other reason than to prove its complaint that the JFTC would not do anything. Kodak did not file a claim because Kodak knows that the JFTC watches this sector closely, and that the facts are not on its side.

I want to close by emphasizing that all we want in this case is an outcome based on the facts. If the facts control, they will prove that the Japanese film market is open, and that Fujifilm is a fair competitor.

This is not a fight we sought and we don't enjoy it. Fujifilm makes the finest photographic products in the world. We are ready to get back to the business of competing with Kodak, company-to-company. It is time to stop the fiery rhetoric, get the facts, settle the issues, and return to the marketplace that has made Fujifilm and Kodak great companies and competitors. We are looking forward to that day.

This completes my statement. I am happy to answer any questions you may have.

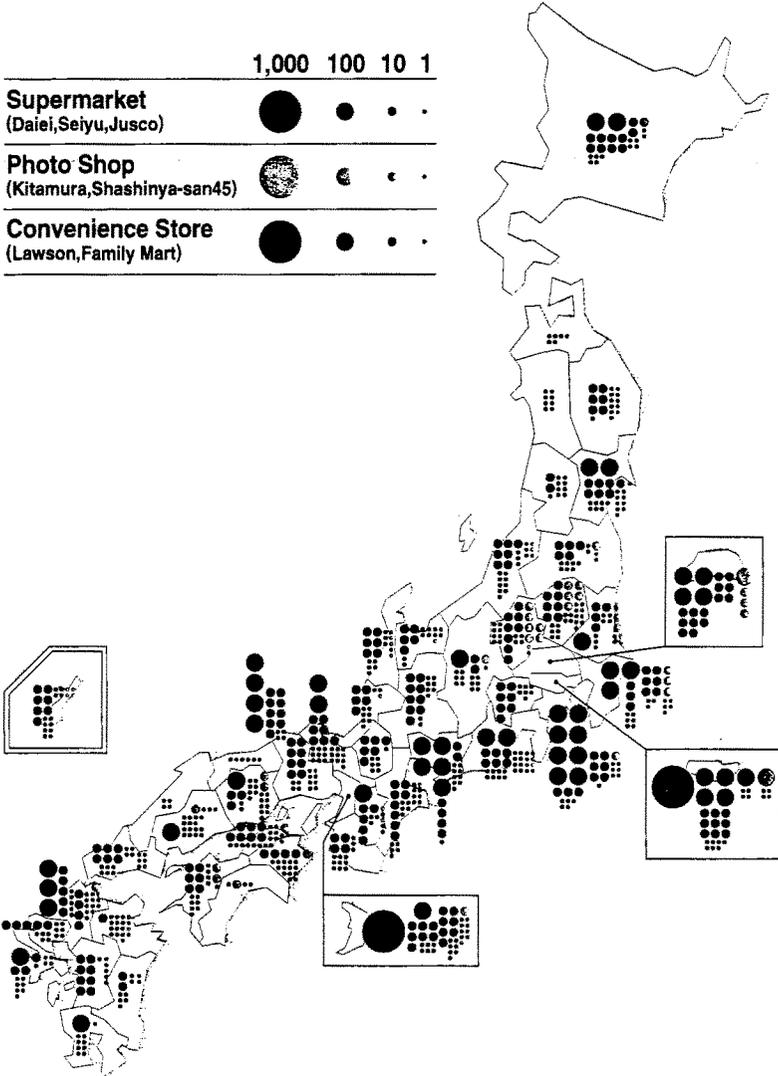
FIGURE 1
Most of the Tokuyakuten's Customers Already Carry Kodak



Source: Survey of Tokuyakuten Customers

* Where the answer was unknown, we classified the customer as not having a Kodak supplier. These numbers are therefore conservative.

Outlets Offering Private / Dual Brand Film by Prefecture



"DISTRIBUTION BOTTLENECK"

KODAK CLAIM	FUJIFILM RESPONSE:
<p>Kodak claims that Fujifilm, with the help of its distributors, engages in practices that result in a "distribution bottleneck" through which Kodak is unable to reach retail shelves.</p>	<ul style="list-style-type: none"> • The vast majority of customers of the Fujifilm tokuyakuten already carry Kodak or have an existing relationship with a Kodak supplier. According to a survey of the tokuyakuten's customers, 78% of them -- accounting for 87% of the tokuyakuten's total surveyed sales volume -- either carry Kodak or have ready access to it. This degree of penetration applies equally throughout Japan, not just in Tokyo and Osaka. There can be no "bottleneck" blocking Kodak's access if the tokuyakuten's customers already carry Kodak. • The tokuyakuten are not an "essential facility." Indeed, although there are many outlets in Japan, 17% of the outlets represent 73% of the sales volume. The survey results demonstrate that Kodak has substantially penetrated these high volume outlets. • Kodak is carried by a wide range of secondary dealers and those dealers thoroughly cover the entire country of Japan. Indeed, if one considers the effective sales areas of only 17 of the 91 dealers listed in "Rewriting History," these alone provide coverage for all of Japan. • In the survey of tokuyakuten customers, Fujifilm separately identified those customers that provided a significant reselling function -- secondary dealers, photo-finishing labs, and those who resell to small outlets such as resort shops. Approximately 80% of the sales volume to those resellers goes to resellers either carrying Kodak or having an existing relationship with a Kodak supplier. • In a third party survey of Kodak availability in retail outlets, the results show Kodak widely available throughout Japan. Kodak is present in outlets accounting for between 56 and 77% of total film sales volume, depending on the geographic region. This finding fundamentally undermines Kodak's case. • Kodak's best coverage is in photo shops, the outlets where Kodak alleges the greatest degree of Fujifilm control. Depending on geographic region, Kodak is available in photo shops representing between 74 and 92% of total sales volume for this outlet type. • Consumer preference survey results corroborate what the coverage survey results show: that in any one region of Japan no more than 17% of consumers cite lack of availability as a reason not to purchase Kodak film. The vast majority of Japanese consumers do not perceive any problem with Kodak's availability at the retail level.

PRICE

KODAK CLAIM	FUJIFILM RESPONSE
<p>Kodak claims that film prices in Japan are twice as high as in the U.S., and that this disparity in prices is evidence that the Japanese market for film is closed to competition, particularly outside Tokyo and Osaka.</p>	<ul style="list-style-type: none"> • Prices in the two markets are actually quite similar. The problem with Kodak's prices is that, while they are not necessarily inaccurate, they are woefully unrepresentative of the two markets. Kodak compares high price photo-shop data in Japan to low price discount store data in the United States. Even if these are the largest store types in each market, comparisons across store types inevitably distort the result. This is because both markets are divided into distinct market segments: outlets that cater to service-conscious consumers, and those that attract price-conscious bargain hunters. Of course Kodak's analysis shows higher prices in Japan -- Kodak has rigged its comparisons precisely for that purpose. • Kodak has been disingenuous about other elements of its price comparisons. It compares Japanese data that specifically exclude promotional prices to U.S. data that include such discounted prices. It compares the leading brand in Japan to a discount brand in the United States. Finally, Kodak compares after-tax prices in Japan to tax-free prices in the United States. • Kodak analyzes only single rolls of ISO 100 speed film, but in doing so conveniently ignores market conditions that make such a choice invalid. As Kodak knows, Fujifilm has been promoting its ISO 400 speed film more aggressively than ISO 100 for many years; ISO 400 sales now top ISO 100 sales in Japan. Meanwhile, discounted multipack sales are rapidly overtaking single packs; by 1994, multipacks accounted for roughly 40% of total film sales in Japan. Kodak therefore limits its comparisons to a product/packaging combination that is quickly losing ground to more aggressively priced film. • Kodak claims that the Nippon Research data used by Fujifilm in its October 24, 1995 submission are geographically unrepresentative of the Japanese market because they cover only the competitive "shark tanks" of Tokyo and Osaka. However, while the specific storefronts Nippon Research surveys are located primarily in the Tokyo and Osaka areas, several are members of large retail chains with outlets covering practically the entire country. Given that these chains sell at basically the same prices throughout Japan, it is simply not true that the Nippon Research data are only representative of Japan's "shark tanks". Other survey results confirm the existence of competitive prices throughout Japan. Indeed, the data Kodak uses confirm this reality.
	<ul style="list-style-type: none"> • The similarity in film prices all over Japan can only mean one thing: the competition that Kodak concedes exists in Tokyo and Osaka is alive and well all over Japan. This is small wonder. Evidence shows that stores selling low priced film are located throughout Japan and that low priced multipack film and private or dual brand film are available in stores all over the country as well.
	<ul style="list-style-type: none"> • Finally, Kodak's claim that film prices in Japan are "extraordinarily stable" suffers from the same kinds of failings that exist in its price comparisons. Kodak focuses on the least aggressively priced product/packaging combination sold in the highest priced outlets and finds stable prices. But, an analysis of price trends in this case is valid only if it incorporates a full picture of market conditions, including the rising popularity of aggressively priced ISO 400 film; the surging market share for multipack film; the increasing popularity of discount stores; and the explosive growth of private and dual brand film.

CONTROL

KODAK CLAIM	FUJIFILM RESPONSE
<p>Kodak claims that Fujifilm controls the tokuyakuten through the use of illegal rebates, guarantee deposits, and its Mitsui keiretsu relationships.</p>	<ul style="list-style-type: none"> <li data-bbox="368 184 499 951">● Rebates: The "remarkably progressive rebates" about which Kodak complains simply don't exist. The JFIC reviewed Fujifilm's rebates years ago, and Fujifilm made the changes necessary to ensure strict compliance. Any remaining rebates used by Fujifilm do not have the effect of either excluding competitors or inducing resale price maintenance. Kodak's rebates in the U.S., on the other hand, are explicitly exclusionary, since they are provided even if volume targets are not met -- as long as the retailer agrees not to carry Fuji brand film. <li data-bbox="499 184 630 951">● Guarantee Deposits: These are merely one form of security held against the accounts payable of the tokuyakuten -- they are commonly used as a tool for security in Japanese business. Indeed, Fujifilm uses them widely with other customers besides the tokuyakuten. These financing tools have no effect on a distributor's behavior, and particularly no effect on whether a distributor deals exclusively with Fujifilm. The tokuyakuten can withdraw their guarantee deposits at any time on the condition that they substitute some other form of security to cover their accounts payable. In fact, Fujifilm holds no guarantee deposits for one of the four main tokuyakuten. <li data-bbox="630 184 842 951">● Mitsui Keiretsu: Fujifilm is not a member of the Mitsui keiretsu. While some sources may so list Fujifilm, these sources have simply sought to place every publicly-traded Japanese firm in one of the major industrial groups. Other sources say otherwise. Indeed, common sense would suggest that Fujifilm is a member of the Sanwa Group, given that its largest shareholder, Nippon Life Insurance, is a member of that keiretsu. More than anything else, this inconsistency shows just the various and broad definitions observers give to the term "keiretsu." Indeed, application of Kodak's definition places Kodak, through its affiliation with Nagase, in the same keiretsu as Ohmya, one of the four main tokuyakuten used by Fujifilm. But even if it were true that Fujifilm is part of the Mitsui Group, the real question is: So what? Kodak itself recognizes that the tokuyakuten are not members of the Mitsui keiretsu. Furthermore, tokuyakuten borrowings from Mitsui Bank prove nothing but that there are a limited number of main banks in Japan -- why would they not borrow from Mitsui Bank?

SO, WHY IS KODAK'S MARKET PERFORMANCE WEAK IN JAPAN?

Home team advantage: Although Kodak and Fujifilm share nearly 70% of the world market -- 36% for Kodak, 33% for Fujifilm -- in the markets where each company has the advantage of incumbency, the companies' shares are a high 70%. In each others' countries, their shares are about 10%. Consumer surveys in both countries confirm that this phenomenon of home team advantage exists; consumers simply prefer their national brands.

Kodak's own missteps: In addition to home team advantage, Kodak simply took none of the necessary steps to position itself to compete with Fujifilm on Fujifilm's home turf.

- Kodak has not tried to challenge Fujifilm's position in Japan by a consistent, aggressive policy of discounting prices. In the early 1980's Kodak's distributor Nagase pursued a discount strategy, and Kodak's film market share reached 18%. When Kodak and Nagase later increased their prices, Kodak's market share declined. Kodak also failed to take advantage of the significant yen appreciation in 1985 to cut prices and gain market share. Instead, Kodak sought to maximize short-term profits and protect its U.S. profit sanctuary from potential gray market imports from Japan.
- Kodak has not beat Fujifilm to the market with consumer-preferred new products since introduction of the 110 system in 1973 (which gained Kodak 4-5 points in share of sales). Kodak rested on its laurels and eventually lost its innovative advantage. In the two most important product innovations in recent years -- high resolution ISO 400 film and the single-use camera -- Kodak has lagged two years behind Fujifilm in introducing comparable products. Together these two products account for nearly two-thirds of color film sales in Japan.
- Kodak rebuffed Asanuma's 1973 initiative to re-establish a relationship with Kodak and consequently lost this distribution support in 1975. Kodak chose instead to rely solely on Nagase, an independent distributor. Despite the obvious problems with ceding control of its distribution to a single independent company, Kodak waited until 1986 to create a joint venture with Nagase -- a full 15 years after such a venture was permitted, eleven years after the supposedly crucial loss of Asanuma, and ten years after full capital liberalization. By that point, Fujifilm had grown to one-third Kodak's size and was its technological equal, if not its superior. While Kodak tarried, Fujifilm had grown into a formidable competitor worldwide and the entrenched incumbent in Japan.
- Kodak's missteps in Japan are well-documented, even by the very sources Kodak itself cites. While former Kodak Japan President Al Siegel did good things for the company in the mid-80s, he was more than a decade too late -- and the company continued to make mistakes even during and after Siegel's tenure. Indeed, Kodak's image in Japan may never recover from the cultural faux pas it committed in rescinding job offers to Japanese college graduates in 1993.

Chairman CRANE. Thank you very much.
Mr. Johnson.

STATEMENT OF OAKLEY JOHNSON, VICE PRESIDENT, CORPORATE AFFAIRS, AMERICAN INTERNATIONAL GROUP, INC.; AND INTERNATIONAL INSURANCE COUNCIL

Mr. JOHNSON. Mr. Chairman, thank you for the opportunity to testify today. In addition to representing American International Group, it is my privilege also to appear with the support of the International Insurance Council, whose insurance and reinsurance member companies represent the overwhelming majority of U.S. firms operating worldwide.

AIG has been in Japan since the end of World War II. Through much hard work, perseverance and innovation, we have become the largest foreign insurer in Japan. Due to a wide variety of formal and informal barriers, however, we and other U.S. insurers have never been able to successfully penetrate major areas of the Japanese market.

Historically, the insurance business in Japan has been tightly regulated by the Ministry of Finance. The market is dominated by a few giant domestic companies which maintain a powerful presence from keiretsu and/or cross-shareholding relationships, often to the exclusion of newcomers. Japanese companies today control 97 percent of the market. All foreign firms combined have 3 percent.

Pursuant to the United States-Japan Framework for a New Economic Partnership mentioned by Ambassador Shapiro, the respective governments began negotiating in 1993 to open Japan's insurance market on a priority basis. Negotiations lasted over 15 months. Throughout that period and up to the present, the U.S. insurance industry consulted closely and regularly with the USTR. Let me state here for the record, Mr. Chairman, that our industry has been entirely satisfied with the vigorous and persistent efforts of the administration, and we fully support the comments made earlier today by Ambassador Shapiro.

The agreement itself is unprecedented. It is the first bilateral insurance agreement in which such detailed obligations are undertaken by two countries. By signing, the Ministry of Finance agreed to enact laws and regulations in conformity with that agreement.

The most important and certainly the most controversial provision in the agreement deals with the linkage between the so-called primary sectors—all major types of life and nonlife insurance—and the so-called third sector: Niche products, such as personal accident, cancer, travel accident and hospitalization insurance.

The primary sectors, dominated by the large Japanese companies represent over 95 percent of the market. The third sector, represented by the remaining less than 5 percent, is critical, however, because it is the only area in which foreign firms have been able to establish a meaningful presence.

Several years ago, the Japanese Ministry of Finance authorized a handful of foreign companies to begin developing what today represents the third sector. After much hard work, top-quality service, and considerable investment, this market has grown from nothing. It was only recently that the large Japanese companies took notice and sought to target the sector for entry.

Now, under the guise of "deregulation," the Ministry of Finance is taking aim at the tiny fraction of the market where Americans have been able to establish a position. This is being done despite the prohibitions in the agreement. As Ambassador Shapiro said earlier, the very essence of the agreement is intended to make possible an increase in the foreign insurance presence in Japan. This is to be done by first liberalizing the primary areas of life and nonlife to allow foreign insurers to compete on equal terms and to apply their established strengths for the benefit of the Japanese consumer. Only after the primary areas have been substantially liberalized for a reasonable period of at least 3 years may the third area then be deregulated.

The Ministry's current deregulation plans threaten to do just the opposite. It seems that the Ministry is not seriously considering true deregulation. It does not seem interested in permitting new, innovative products; competitive pricing; and new distribution channels, all of which would redound to the benefit of Japanese businesses and consumers. Instead, the Ministry seems more intent on maintaining the status quo in the primary sectors while considering radical change in the third sector.

There are other concerns regarding the Ministry's intentions as well.

The new law is scheduled to begin taking effect next week. If the Ministry does not alter its plans, the United States-Japan agreement will be grossly violated.

There is ample evidence that the administration and the Congress share this view. In this regard, specific references to several statements and letters are included in my written statement for the record.

Mr. Chairman, the U.S. insurance industry is not alone in calling for Japan's faithful implementation of the agreement. In fact, all foreign insurers anxious to expand in Japan are resolute in their support as well.

American insurers are among the most innovative and competitive in the world. The United States-Japan insurance agreement is intended to bring about a more open market. If faithfully implemented, we are confident that we can compete and bring tangible benefits to the United States and Japan.

I thank you for the opportunity to appear today.

[The prepared statement and attachment follow:]

**STATEMENT OF OAKLEY JOHNSON
AMERICAN INTERNATIONAL GROUP, INC.**

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to testify today on the U.S.-Japan Insurance Agreement. My name is Oakley Johnson, and I am Vice President for Corporate Affairs at American International Group, Inc. (AIG). AIG is a leading U.S. based international insurance and financial services organization, and the largest underwriter of commercial and industrial insurance in the United States.

It is my privilege also to appear with the support of the International Insurance Council, whose insurance and reinsurance member companies represent the overwhelming majority of U.S. companies operating worldwide.

AIG has been in Japan since the end of World War II. Through much hard work, perseverance, and innovation, we have become the largest foreign insurer in Japan. However, despite these efforts, we and other U.S. insurers have never been able to successfully penetrate the major life and non-life insurance sectors of the Japanese market. This is in contrast to the fact that we have had success in doing so in virtually every other significant market in the world.

This lack of fair market access was the prime reason the Clinton Administration undertook to negotiate the U.S.-Japan Insurance Agreement, which was signed in October, 1994.

The Japanese insurance market is the second largest in the world, with private sector premium volume of over \$350 billion. Japan's life insurance market is the world's largest, with a premium volume of nearly \$300 billion.

Historically, the insurance business in Japan has been tightly regulated by the Ministry of Finance (MOF). The market is dominated by a few giant, domestic companies which maintain a powerful presence from Keiretsu and/or cross shareholding relationships, often to the exclusion of newcomers. Japanese companies control more than 97 percent of the market; all foreign firms combined have 3 percent. By way of contrast, foreign penetration of the U.S. market and the EU market are in excess of 10 percent and 30 percent, respectively.

In the late 1980's, Japan developed an awareness of the fundamental need to modernize the regulation of its insurance market. The Ministry of Finance initiated a process designed to develop a consensus on how to bring this about. Following three years of deliberations, an advisory group to the Ministry (called the Insurance Council) issued a report in 1992 which contained early warnings of some troubling recommendations which would surface later.

In June, 1993, several leading American business groups issued a joint analysis of the Council's report raising serious concerns about the Insurance Council's recommendations. The report noted that:

"There is concern on two fronts... First, many industry experts believe that the MOF will target the Third Area^{*} for more rapid and/or more comprehensive liberalization than the primary areas. Given that the Third Area is significantly more important to foreign insurers than to local companies, any deregulation of the Third Area without first liberalizing the primary insurance areas would constitute de facto targeting of foreign companies, seriously damaging them and probably forcing some of them to leave the market. Second, reform by the Ministry of Finance and the Diet will be flawed if it does not fully address Keiretsu, cross-

^{*}See next page for definition.

shareholding, and other structural barriers which restrict penetration by foreign insurers into the primary insurance areas. From the perspective of insurance consumers and small/foreign insurance companies, all de facto and de jure barriers to fair and open competition in the primary areas should be targeted for reform by the MOF and the Diet. Otherwise, large/Keiretsu insurers will continue to be protected by structural advantages in large "captive" markets and use that strength to overwhelm foreign companies in the Third Area."

[Excerpt from Japan's Financial Services Market: The Case for Expanded Access, June, 1993, prepared by the U.S.-Japan Business Council, American Chamber of Commerce in Japan, and the U.S. Financial Services Group of the Coalition of Service Industries.]

Significance of the Agreement

Shortly after taking office, President Clinton and then Japanese Prime Minister Miyazawa launched a new effort to address trade matters. Called the U.S.-Japan Framework for a New Economic Partnership, one of its key goals was to "increase access and sales of competitive foreign goods and services...". Insurance was selected as one of the four "priority" sectors (along with autos and auto parts, government procurement, and flat glass).

Pursuant to the Framework, the respective governments began negotiations with the objective of opening Japan's insurance market. The negotiations lasted over fifteen months, during which time the U.S. insurance industry consulted closely and regularly with the U.S. Trade Representative (USTR).

The U.S.-Japan Insurance Agreement is unprecedented. It is the first bilateral insurance agreement in which such detailed obligations are undertaken. Among its many provisions, the Agreement provides for:

- A more open regulatory process, where foreign insurers are to have the same access to information as domestic insurers;
- Assurance that procedural protections are provided and that administrative guidance will be consistent with legal constraints;
- Vigorous application of anti-monopoly laws to insurance, including industry association activities;
- Liberalization of rate and form in accordance with three stages of deregulation, and;
- Regular monitoring of the Agreement by means of qualitative and quantitative indicators to determine whether and how foreign opportunities and market access are increasing.

But perhaps the most important, and certainly most controversial, provision in the Agreement deals with the linkage between the "primary" sectors (all major types of life and non-life insurance) and the so-called "Third Sector" (niche products such as personal accident, cancer insurance, long term disability).

The primary sectors represent over 95 percent of the premiums collected in the market and are dominated by a small number of large Japanese firms. The less than 5 percent represented by the Third Sector is critical because it is the only area where foreign firms have been able to establish a meaningful market position. Some interests in Japan have alleged that foreign firms have a "monopoly" in this tiny area, whereas

the actual foreign presence is 36 percent of the total.

It is important to mention that, several years ago, the MOF authorized a handful of foreign companies to begin developing what today represents the Third Sector. After much hard work and considerable investment, this market niche began to grow from scratch. Then, just a few years ago, the large domestic companies began to take notice, and sought to target the sector for entry.

Foreign companies (and smaller domestic companies) have brought substantial benefits to Japanese customers in the form of creative new products, marketing practices and services through the limited Third Sector. However, through a variety of formal and informal barriers, we have been denied the opportunity to provide these same benefits in a wide range of life and non-life products, including voluntary automobile insurance, which represents a significant proportion of the market overall.

Now, under the guise of "deregulation" and under pressure from the larger companies, the Ministry of Finance is taking aim at the tiny fraction of the market where Americans have a sizeable presence. They are trying to do this despite the prohibitions in the Agreement, while leaving the overwhelming bulk of the market virtually untouched.

The MOF seems to define deregulation as simply the introduction of more competitors. They are leaving in place a highly structured regulatory environment where there is little, if any, differentiation in rates, forms and methods of distribution. They are not addressing many of the practices common in Japan, where everyone uses the same rates, same forms, and where consumers can only purchase insurance products through agents. Automobile drivers, for example, are charged the same whether they live in Tokyo or rural Hokaido.

In essence, the Agreement is intended to set the stage to make possible an increase in the foreign insurance presence in Japan. This is to be done by liberalizing the "primary" areas of life and non-life, to allow foreign insurers to apply their established strengths of creativity and innovation to benefit the Japanese consumer. Only after the primary areas have been substantially liberalized for a reasonable period of at least three years may the Third Area then be deregulated.

The Japanese Government recognized in the Agreement that:

"[the] dependency of small to medium [domestic] and foreign insurance providers on the Third Sector is high, and that these medium to small and foreign insurance providers have made the efforts to serve the specific needs of consumers in the Third Sector."

The Agreement states further that, based on this dependency:

"... it is appropriate to avoid any radical change in the business environment, recognizing that such changes should depend on medium to small and foreign insurance providers first having sufficient opportunities (i.e., a reasonable period) to compete on equal terms in major product categories in the life and non-life sectors through the flexibility to differentiate, on the basis of the risk insured, the rates, forms and distribution of products."

MOF's current deregulation plans threaten to do just the opposite.

The Current Situation

The high expectations of the October, 1994 Agreement are reflected in a press statement issued by the International Insurance Council at the time:

"This agreement offers meaningful possibilities for all our members, and we expect it to increase their business significantly. Those already active in Japan, seven at present, can be confident that progress to date will not be wiped out by radical change in the Japanese regulatory approach to niche markets, and those seeking expansion or new entry will benefit greatly from a commitment to clearer administrative processes and to rate and form flexibility that will serve both insurance companies and their customers. Effectively implemented, we would expect that the agreement will result in foreign insurance providers earning upwards of \$1 billion additional in premium in their Japanese operations over the next several years."

Regretfully, despite vigorous, concerted efforts by the Administration, those high expectations have not been realized. Beginning in mid-1995, the U.S. industry and USTR developed serious concerns when it became evident that the MOF was preparing draft ordinances to implement the newly-passed Insurance Business Law which failed to take into account core provisions in the Agreement.

In a recent letter to Congress, Ambassador Kantor noted that, during USTR's November 1995 consultations with the Ministry, the MOF had "for the first time set out an understanding of key provisions of the Agreement which we view to be clearly at odds with the commitments Japan made under the Agreement."

The new law is scheduled to begin taking effect next week. If the MOF does not alter its plans, the U.S.-Japan Agreement will be grossly violated.

There is strong evidence that the Congress and the Administration justifiably share this view. Several bilateral consultations have been held at the highest levels over the past several months, but these concerns have not abated. Ambassador Ira Shapiro stated in a February 28 speech before the American Chamber of Commerce in Japan:

"... Japan has failed to implement important provisions of the insurance agreement concluded in October, 1994. We have made it clear to the Japanese Government that we view this issue as the most important implementation problem facing our two governments."

During a March 14 speech at the Foreign Correspondents' Club in Tokyo, U.S. Ambassador Walter Mondale said:

"We are pressing Japan to honor their commitments under the 1994 agreement... there's a real chance that Japan will simply open the Third Sector and ignore what we think are the clear terms of the insurance agreement. So that is very worrisome."

In a March 14 letter to Japanese Ambassador Saito, Chairman Bill Archer of the House Ways and Means Committee wrote about the Agreement:

"Only full and prompt compliance with all its terms will remove the cloud of uncertainty now surrounding implementation."

In a March 13 letter to Ambassador Saito, Senator William Roth, Chairman of the Senate Finance Committee, said:

"... Japan's good faith in carrying out its obligations under an important bilateral agreement is in question."

And in a March 19 letter to President Clinton, 20 Republican and Democratic Congressional leaders said:

"...should the MOF follow through with plans discussed with Japan's domestic insurers, U.S. firms would likely face a reduction in market share. Such MOF actions would unquestionably violate this agreement. Should such violations occur, we would support any and all appropriate action, including the imposition of sanctions as required under our applicable trade laws."

The U.S. International Insurance Council is deeply concerned about the current situation and expressed its views recently in a letter to Ambassador Kantor, which is attached to this statement.

The letter strongly supports the Administration's efforts to ensure faithful implementation of the Agreement prior to the April 16-18 summit between President Clinton and Prime Minister Hashimoto in Tokyo. The letter addresses the following items in particular:

- Deregulation must result in genuine deregulation, not re-regulation;
- There is a critical need to liberalize the primary sectors before granting additional access to the Third Sector;
- Adherence to the important commitments on transparency of regulation must be honored, and;
- There should be prompt implementation of the joint study of Keiretsu practices, as specifically called for in the Agreement.

Mr. Chairman, I would like to emphasize that the United States is not the only voice calling for faithful implementation of the Agreement. The leading representatives of all foreign insurance interests in Japan as represented by the Foreign Non-Life Insurance Association (FNLIA) are resolute supporters of the U.S.-Japan Insurance Agreement. In addition, it is our understanding that the European Union has consistently supported efforts to gain MOF compliance with the Agreement.

As the terms of the Agreement are accorded on a most favored nation (MFN) non-discriminatory basis, all foreign insurers have a direct stake in the MOF acting in accordance with its obligations under its Agreement with the United States. If Japan proceeds with its current plans, the total foreign, as well as American, presence in the market will decline, not increase.

Several Japanese industry leaders and government officials have argued that U.S. insistence on maintaining the status quo in the Third Sector "goes against the trend of liberalization." Some have even suggested that all the U.S. industry wants is protection from increased Japanese competition in the Third Sector area.

This is disingenuous, to put it mildly. Government regulation and restrictive business practices (Keiretsu) have limited foreign companies to a tiny share of the second largest market in the world. While providing no meaningful liberalization of the primary sectors, the MOF now intends to "deregulate" the Third Sector to benefit the largest Japanese insurers. Given the resources, market power and extensive sales forces of these large companies, it will only be a matter of time before the foreign market presence in Japan is even lower.

The voices of opposition we are hearing today are the same voices that were taken into account during the fifteen months of negotiation leading up to the October, 1994 Agreement. When it was concluded, there was no misunderstanding between the negotiators. Within days after the Agreement was signed, USTR briefed the U.S. industry to ensure that all interests were properly informed of the details.

Conclusion

Mr. Chairman, may I leave you and the Committee with this thought. U.S. insurers are among the most innovative and competitive firms in the world. We favor real deregulation and liberalization of the entire market, not new MOF control of the market. We make a positive contribution to the U.S. balance of payments, and we favor open markets where we can compete on an equal footing.

The U.S.-Japan Insurance Agreement is intended to bring about a more open market. If faithfully implemented, we are confident that we can bring tangible benefits to Japanese businesses and consumers alike.

Thank you.

Attachment



INTERNATIONAL
INSURANCE
COUNCIL

1212 New York Avenue, N.W. • Suite 250
Washington, D.C. 20005 (202) 682-2345

February 14, 1996

By Hand Delivery and Facsimile

The Honorable Michael Kantor
United States Trade Representative
Office of U.S. Trade Representative
600 17th Street, NW
Washington, DC 20506

Dear Mr. Ambassador:

The U.S. international insurance and reinsurance industry has strongly supported USTR efforts to ensure faithful implementation of the U.S.-Japan Insurance Agreement. Over the last several months, we have met regularly with USTR officials in connection with the several consultations that have been held between USTR and the Japanese Ministry of Finance (MOF). We express our gratitude and offer our continuing support for USTR's vigilant efforts to ensure that all the Agreement's objectives are met.

It is widely known that the U.S. international insurance industry supports liberalization of Japan's insurance market because it will lead to increased benefits for Japanese consumers and new opportunities for foreign insurers. In this context, we believe that the following points are crucial to achieving those benefits and acting on those opportunities, and we urge USTR to emphasize them in its upcoming meetings with officials from the Ministry of Finance:

- It is critical that the de-regulation process result in genuine de-regulation, and not re-regulation;
- Substantial liberalization of rate, form, and distribution, particularly in the First and Second Areas, must be achieved so that both foreign and Japanese firms may soon bring new products to market;

The Honorable Michael Kantor
United States Trade Representative
February 14, 1996
Page 2

- Strict compliance with the Agreement's terms relating to the Third Area must be obtained. There is a crucial relationship in the Agreement between the ability of foreign companies to compete on equal terms with Japanese companies in the First and Second Areas and any authorization to Japanese companies to increase their presence in the Third Area. Failure to implement the Agreement's terms concerning that relationship would be extremely harmful to the progress U.S. companies have made in Japan to date;
- Japan has made important commitments with respect to transparency of regulation, and those commitments must be respected;
- The *Keiretsu* Study called for by the Agreement is seriously overdue, it must be completed without further delay. To be worthwhile, it must deal adequately with case agents and must differentiate in a statistically valid way among the various types of *keiretsus*.

We pledge our continuing support for the Administration's efforts to ensure full and faithful compliance with this important Agreement. We encourage Japanese and U.S. negotiators to resolve outstanding differences concerning the Agreement prior to the upcoming April summit meeting between President Clinton and Prime Minister Hashimoto in Tokyo.

Sincerely,



Gordon J. Cloney
President

Chairman CRANE. Thank you, Mr. Johnson.
Mr. Rozynski.

**STATEMENT OF ED ROZYSKI, SENIOR VICE PRESIDENT FOR
GLOBAL STRATEGY AND ANALYSIS, HEALTH INDUSTRY
MANUFACTURERS ASSOCIATION**

Mr. ROZYSKI. Mr. Chairman, thank you for the opportunity to testify. My name is Ed Rozynski, and I work for the Health Industry Manufacturers Association. HIMA represents more than 700 member companies that manufacture medical devices, diagnostic products and health information systems. Our industry is globally competitive. We account for about half of the world's sales of medical technology.

Our industry has never run a trade deficit. In 1995, our trade surplus measured \$5.7 billion. However, our market share in Japan lags behind our market share in other countries. Outside of the United States, our average market share is about 40 or 45 percent. In Japan, it hovers around 20 or 25 percent. However, before identifying a specific concern that we have in Japan, I would like to mention that the biggest trade barrier facing this industry is the way our own FDA regulates medical technology in this country. FDA policy is pushing U.S. industry, U.S. jobs and patients to Europe to access American-made medical technology.

I would urge you to join us and more than 300 patient and doctor groups to address this growing problem by supporting the bipartisan FDA reform legislation that is currently working its way through the Senate and soon the House.

Back to Japan. We enjoy good relations with the Ministry of Health and Welfare leadership because we share the same basic goal, and that is to get quality products and care to patients. The U.S. industry is recognized as the world leader in this area. I would like to highlight, though, one problem that we do have there. While it is relatively easy to get your product approved in Japan, it is very difficult to get your product on the market in Japan, and that is because a handful of midlevel Ministry of Health officials tell you what gets on the market, when it gets on the market, and at what price you will be reimbursed. They call that a market system.

You cannot sell an approved product until MHW gives you that reimbursement price. Moreover, MHW systematically lowers the price of many products every 2 years. Recently, we negotiated a deal with the Health Ministry to reduce the chance that products brought under their price control system would have their prices unfairly and significantly cut every 2 years. Unfortunately, a few midlevel officials are now making noises that they may unilaterally change a key assumption upon which that deal was struck. Two days ago, Commerce Secretary Ron Brown wrote a letter to the Japanese Health Minister urging him to not alter key aspects of this recently concluded agreement. We would urge this Subcommittee to send the same basic message to the Japanese.

Thank you very much.

[The prepared statement follows:]

**House Ways and Means Committee
Subcommittee on Trade
Hearing on General Oversight of U.S.-Japan Trade
March 28, 1996
2:30 p.m.**

**Testimony
by
Ed Rozynski
Senior Vice President for Global Strategy and Analysis
Health Industry Manufacturers Association**

Good afternoon, Mr. Chairman. My name is Ed Rozynski and I am senior vice president of global strategy and analysis for the Health Industry Manufacturers Association (HIMA). HIMA is a Washington, D.C.-based national trade association representing more than 700 manufacturers of medical devices, diagnostic products, and health information systems. HIMA's member companies comprise one of America's most globally competitive industries, supplying almost one-half of the \$112 billion global market for medical technology.

It is a privilege to be here today to discuss the state of U.S.-Japan trade in our industry. I would like to briefly share with you our recent successes in Japan and our hopes for the future of our trading relationship. I would also like to bring to your attention one single issue that could potentially undermine some of our efforts to date to open Japan's market for medical devices and to positively influence Japan's health care system.

Finally, I would like to state for the record that the biggest trade barrier facing our industry is not Japanese trade-related policies, but rather it is the way our own FDA regulates medical technology in this country. In this regard, you can take a major step to promote U.S. competitiveness and better access to quality health care in this country by supporting the bipartisan FDA reform legislation that is currently working its way through both the U.S. Senate and House of Representatives.

Background on U.S. Medical Device Industry Trade with Japan

Japan is the world's third largest market for medical technology. With a market size estimated at

\$20.3 billion, it trails only the United States (\$47.7 billion) and Europe (\$29.2 billion) in its importance by value. In recent years, the Japanese market has been an important focus of U.S. manufacturers not only because of its sheer size, but because our companies have traditionally not been as successful there as they have been in other foreign countries. Indeed, U.S. market share in Japan prior to 1990 had amounted to only about 20 percent, or about one-half of our average foreign market share of more than 40 percent.

Over the past seven years, I have seen U.S. industry take a number of steps that have successfully resulted in an improvement in our market position in Japan. One such step has been to work closely with key officials in the Japanese Ministry of Health and Welfare (MHW) and the U.S. Government. The Commerce Department's Office of Japan, part of the International Economic Policy Division, has been a key player for the past ten years in helping to create an environment in Japan that is much more receptive to imports of the innovative, life-saving and life-enhancing products that this industry produces. Our companies, too, have consistently increased their investment in their Japan sales efforts. I am happy to report that, as a result of a coordinated U.S. Government - U.S. industry strategy, U.S. exports to Japan of medical technology are consistently growing, even while the overall Japanese market for medical technology products is relatively stagnant. This growth is a testimony to U.S. industry's ability to develop innovative medical products that patients need and that improve the overall quality of health care. HIMA now estimates U.S. market share in Japan at about 25 percent, representing a sustained increase in market share since 1990. We hope to be able to further penetrate the Japanese market until our performance in Japan rivals our performance in other foreign markets.

As a general matter, we are pleased with the discussions that we have had with MHW regarding their plans for next week's scheduled price revision and also for their decision to reimburse some important new medical devices starting next month. I must say that HIMA's relations with the leadership at MHW are very good at this time. Moreover, we look forward to working with them as they contemplate some very critical structural changes to their health care system, such as a new health care program for the elderly.

Japan's Health Care System

As some of you may know, Japan has a national health insurance system, under which all health care is directly or indirectly controlled by the national government. The goal of MHW is to offer quality health care to everyone at an affordable price.

As the leading manufacturers of new life-saving medical technology, we also have a keen interest in helping to provide high-quality, affordable health care. However, we do have a few specific concerns with how MHW tries to achieve this shared goal. Japan is one of the few countries in the world that maintains a system of centralized technology assessment where a handful of mid-level MHW officials decide when a new technology will be allowed on the market and at what price the new technology will be reimbursed. Under arcane rules in Japan, new medical technology may only be introduced on April 1 of every even numbered year. These types of bureaucratic barriers disadvantage both patient and companies alike because they slow the introduction of new medical breakthroughs even when those medical breakthroughs are cost-effective compared to existing treatments.

Furthermore, MHW sets the price for a new medical technology based on a straight-forward cost accounting estimate of the price of the new technology multiplied by its expected usage in the future. Because decision-making in MHW is compartmentalized, these mid-level MHW officials have no responsibility to consider whether the new medical technology is, for example, cost-effective in shortening a patient's hospital stay or replaces an existing more invasive and expensive form of treatment. This self-imposed, narrow view of new medical technology creates structural *de facto* discrimination, especially against U.S. firms, as we lead the world in breakthrough medical advances. Working with MHW to overcome some of these inherent inefficiencies in their health care system will help to reduce the *de facto* discrimination that efficient, high-tech companies face in that country.

The most prominent example of inefficiency in the Japanese health care system is the handling of long-term care for the elderly. In Japan, the average length of stay in a hospital is over 30

days, more than five times the average length of a hospital stay in the United States. What accounts for this difference is that the Japanese have never really developed long-term care facilities or invested in home care for the elderly, so many elderly patients are confined to the hospital for extremely long periods of time. The inability to treat these patients in less expensive settings costs the government billions of dollars per year.

Fortunately, there are currently several enlightened government officials at the top of Japan's health care bureaucracy who genuinely want to implement a more efficient long-term care program. One such individual is the current Director-General of the Health Insurance Bureau, Mr. Nobuharu Okamitsu, with whom HIMA is working to exchange ideas on effective health care reform strategies. However, as is the case with any major structural reform, making progress will undoubtedly be extremely difficult, because Japan needs to reduce the number of hospitals and to redeploy health care personnel into more efficient long-term care facilities or home care delivery services. Moreover, paying for the proposed long-term health care program for the elderly will continue to be a significant political issue in Japan.

Another perplexing aspect of Japan's health care delivery system is its complex and multi-layered distribution system for medical technology and other health care products. With every layer of distribution comes an additional margin, and higher health care costs. The Japanese distribution system pushes up the price for medical technology, as it does many products in Japan, which frustrates MHW and industry alike. It also helps to render international price comparisons meaningless. Many of our companies have tried to by-pass the traditional distribution network and gain a competitive advantage by selling directly to Japanese hospitals, only to be told by hospitals that they will only buy through established distributors. While policy issues relating to distribution of health care products fall within the jurisdiction of the Ministry of Health and Welfare, action to address this age old problem and to enhance hospital efficiency is slow to materialize, again because this could mean the displacement of Japanese workers.

[A Specific Cloud on the Horizon for U.S. Medical Device Firms](#)

While the U.S. medical technology industry sympathizes with the difficulties facing our Japanese colleagues at the Ministry of Health and Welfare, we are not willing to finance inefficiencies elsewhere in the health care delivery system through measures to unfairly cut our prices. Such a measure is apparently now being contemplated, according to statements made by the Ministry of Health and Welfare at its most recent meeting with the U.S. Commerce Department under a decade-old trade agreement known as the Medical Pharmaceutical MOSS (Market-Oriented, Sector-Specific) talks.

To help understand the problem a little more clearly, let me explain how most medical technologies sold by U.S. manufacturers are reimbursed in Japan. The government sets reimbursement prices for most medical device products. Unlike pharmaceuticals which are priced individually by company brand, medical devices that are similar in function and performance all receive the same reimbursement price in most cases. Products may not be sold to hospitals at prices above the official reimbursement price, although distributors or other agents may offer discounts to hospitals. While a product's price may never rise under the price control system, even for reasons of high inflation or extreme exchange rate shifts, the official price can be reduced permanently if distributors (whose pricing decisions are not controlled by manufacturers) discount by an average rate exceeding 15 percent. Because most medical devices, of a similar type, are priced by function rather than by individual company brand, medical devices can be more susceptible to price reductions than pharmaceuticals.

U.S. industry is not always happy with this pricing scheme, but again, the scheme itself is not why we are here today. Rather, what we are troubled by is the Ministry's stated intention to change the rules of the system by reducing the allowable discount zone (also known as the reasonable zone, or "R-zone") from the existing 15 percent. Industry just finished a round of negotiations with MHW under which we had to agree to bring even more of our products under the overall price control system. The negotiations, which included agreement on what were fair initial prices for various products, were conducted with the understanding that the R-zone would continue to be 15 percent. While industry clearly asked MHW during the course of the negotiations whether the R-zone was to be reduced, MHW never indicated that indeed such a

plan was in the works for medical devices. No sooner than industry had agreed to new prices for new products to be brought into the system than did MHW tell the Commerce Department that a new, lower R-zone would be used to reduce product prices during the next two year cycle.

We do not know what the new R-zone would be under MHW's plan. However, we can tell you that during the last price revision, reimbursement prices for products brought under the price control scheme since 1990 were not reduced when the 15 percent R-zone was applied. Under a smaller R-zone, our prices would be permanently reduced, and for every five percentage point decrease in price for a product grouping, such as heart pacemakers or orthopedic implants, we estimate that U.S. industry would lose at least \$10 million per product grouping. If the prices of U.S. products sold in Japan were cut five percent across-the-board as a result of a smaller "R" zone, U.S. losses would amount to \$250 million every two years, and some U.S. product lines would become unprofitable in Japan.

The bottom line is that MHW should not seek to unfairly balance the Japanese health care budget on the backs of U.S. manufacturers of advanced medical technology products, and they should not be allowed to change some key assumptions in a negotiation after a deal has been struck. As previously indicated, while we are generally pleased with MHW's recent actions and leadership, we want to avoid situations, such as this, that can undermine some of our mutual trust.

HIMA and its member companies in the U.S. and in Japan are now working closely with the Department of Commerce to send a signal to the Japanese government that the policy change being contemplated is inappropriate for a number of reasons, and that MHW's suggestion that the R-zone for medical device products be reduced should be withdrawn. Along those lines, we would appreciate the subcommittee's assistance in sending that same signal.

Thank you.

Chairman CRANE. Thank you, Mr. Rozynski.
Ms. Smith.

**STATEMENT OF MAUREEN R. SMITH, INTERNATIONAL VICE
PRESIDENT, AMERICAN FOREST & PAPER ASSOCIATION**

Ms. SMITH. Thank you, Mr. Chairman, for this opportunity to testify on behalf of the American Forest & Paper Association regarding the market access problems of the U.S. forest products industry in Japan. Japan is a priority export market for our industry. The total Japanese market for paper and allied products is estimated at about \$60 billion and ranks second only to the United States. The Japanese wood products market totals about \$30 billion. The United States and Japanese Governments have concluded two separate trade agreements in this sector: The Wood Products super 301 Agreement of 1990 and the Paper Market Access Agreement of 1992. Although there have been some positive developments since these agreements were concluded, the bottom line is there has been no meaningful improvement in our ability to penetrate these markets.

Turning first to the wood products industry, our industry has had an aggressive promotion program in Japan for more than 10 years. We have worked with the U.S. Government to negotiate changes in Japanese standards and building codes to permit the greater use of wood in construction and interior applications. While progress has been made on some technical issues, the U.S. share of the Japanese market for value-added wood products has increased only marginally over this period, and even today probably averages less than 5 percent.

While there are several important steps which could be taken to ensure improved market access for U.S. wood products in Japan, the single most important step would be the elimination of Japanese tariffs. We believe that the central accomplishment of the upcoming Clinton-Hashimoto summit must be a Japanese commitment to early wood tariff cuts in the APEC process, and we would hope that the recently announced Hashimoto initiative would lead to the elimination of tariffs as part of Japanese efforts to reduce housing costs.

On the paper side, the story is much the same. The United States-Japan agreement on paper market access has failed to produce the results anticipated. Last year, the U.S. share of the Japanese paper market stood at 1.8 percent, only one-tenth of 1 percent higher than in 1991, the year before the agreement was concluded. Japan's paper and paperboard imports from all sources accounted for just about 4.2 percent of the country's consumption, the smallest such ratio in the world, and again, only slightly ahead of the figure for 1991, which was 3.7 percent.

U.S. industry believes that this is due to an array of Japanese business practices which are amazingly similar to those described in his testimony by Mr. Fisher and which are intended to deter the entry of new paper suppliers, particularly foreign suppliers. For a detailed description of how these practices have excluded foreign paper suppliers, I am submitting for the record a report which our industry submitted to USTR in December 1994.

[The report is being held in the Committee's files.]

The existence of these collusive business practices in the Japanese paper market was confirmed in surveys conducted by the Japan Fair Trade Commission in 1993 and again in 1994, and Japanese press reports continue to document discussions among Japanese paper producers regarding prices and other market conditions. I am submitting a representative sampling of these reports for the record. They include such intriguing headlines as: "Paper manufacturers to set up committee to construct new price structure for paper." I would think at a minimum, these practices and these headlines should have prompted JFTC inquiries, but there were apparently none.

[The information was not available at the time of printing.]

As a result of these developments, USTR placed the paper agreement on the super 301 watch list in October 1994 and again in September 1995 and initiated negotiations to improve Japanese compliance. Since that time, the Government of Japan has variously announced it would not negotiate, or, when discussions did take place, declined to negotiate seriously. And just last week, the English language Nikkei reported that MITI will refuse to renew the Paper Market Access Agreement when it is scheduled to expire in April 1997. While this may be a trial balloon, it is consistent with Japan's continuing refusal to negotiate about improving the agreement and thus merits a strong policy response.

U.S. acceptance of Japan's unilateral withdrawal from the agreement would reward a strategy grounded in a complete disregard of Japan's obligations under a trade agreement with the United States and set an unfortunate precedent for other agreements in other sectors. From the industry's point of view, the absence of a government-to-government agreement would mean that the substantial efforts which our companies have made to develop a Japanese customer base would be deprived of the impetus of U.S. Government pressure, which has been absolutely necessary for even the modest breakthroughs we have made. As a public policy matter, acceptance would fatally undermine the credibility of the NTE/super 301 process and indeed the whole framework approach to enforcing Japan's compliance with trade agreements.

We believe the example of our paper industry argues strongly for renewed attention to the enforcement of existing agreements, and we are fully supportive both of the enforcement capability which has been established at USTR and the complementary monitoring effort at Commerce. At the same time, we view the current Kodak case as a unique opportunity to come to grips with the pervasive market-distorting effects of Japanese business practices as they affect many segments of American industry, and we urge the administration to develop a negotiating plan which will fully take into account the broad precedential nature of the issues raised by Kodak.

Finally, we were gratified to hear Ambassador Shapiro's response to Vice-Minister Sakamoto and his reaffirmation that the administration will continue to make the fullest use of the remedies available under U.S. trade law to ensure that competitive American industries such as ours will have access to the Japanese market.

Thank you.

[The prepared statement follows:]

TESTIMONY OF
 MAUREEN R. SMITH
 INTERNATIONAL VICE PRESIDENT
 AMERICAN FOREST & PAPER ASSOCIATION
 ON
 UNITED STATES-JAPAN TRADE RELATIONS
 BEFORE THE
 HOUSE COMMITTEE ON WAYS AND MEANS
 SUBCOMMITTEE ON TRADE

MARCH 28, 1996

Thank you, Mr. Chairman, for the opportunity to testify on United States-Japan trade relations, and specifically on market access problems of the U.S. forest products industry in Japan.

I am testifying today on behalf of the American Forest & Paper Association (AF&PA), the national trade association of the U.S. wood and paper products industry. America's forest products industry accounts for seven percent of all U.S. manufacturing output and employs 1.6 million Americans. Our members grow, harvest, and process wood and wood fiber; manufacture pulp, paper and paperboard products from both virgin and recovered fiber; and produce solid wood products. The industry's shipments are valued at more than \$200 billion.

With 1995 paper and wood exports exceeding \$23 billion, our industry makes an important contribution to the U.S. balance of payments. In recent years, the growth in exports sales has outpaced the growth in domestic shipments. In order to maintain our strong export growth, our industry is committed to aggressively developing foreign markets, and supporting initiatives by our government to remove trade barriers to U.S. products.

Japan is a priority export market for our industry. The total Japanese market for paper and allied products is estimated at about \$60 billion and ranks second only to the U.S. The Japanese wood products market totals \$30 billion.

The U.S. and Japanese governments have concluded two individual trade agreements covering market access for U.S. forest products in Japan: The Wood Products Super 301 Agreement of 1990; and the Paper Market Access Agreement of April 1992. The goal of both agreements was to improve substantially U.S. access to the Japanese market. Although there have been some positive developments since the Agreements were concluded, there has been no meaningful increase in Japanese imports of wood and paper products.

Wood

The U.S. wood products industry has been committed to an aggressive promotion program in the Japanese market for more than 10 years and has worked with the U.S. government to negotiate changes in Japanese standards and building codes to permit greater use of wood in construction and interior applications. Progress has been made on certain technical issues but the U.S. share of the Japanese market for value added wood products has increased only marginally over this period.

Several important steps can be taken to ensure improved market access for U.S. wood products. These include tariff cuts, changes in Japanese building codes and standards, and joint data collection:

- We believe that the central accomplishment of the upcoming Clinton-Hashimoto Summit must be a Japanese commitment to early wood tariff cuts in the APEC process and we would hope that the recently announced Hashimoto initiative would encourage wood tariff reductions as part of Japanese efforts to reduce housing costs
- A commitment to a true performance basis in Japanese building codes would allow wood use in areas currently prohibited. Prescriptive height and area limitations, and regulations prohibiting wood frame structures in quasi fire protection zones, continue to inhibit the promotion of high quality, safe, and affordable housing.

- A Japanese Government commitment to a joint data collection system would provide both sides with the ability to monitor the operation of Japan's market for wood products, and to establish the ultimate credibility of the recently announced Hashimoto initiative.

We are appreciative of the U.S. government's efforts to translate the Hashimoto initiative on housing costs into meaningful market opportunities for U.S. wood suppliers. We regard this as a potential "win-win" which could match Japan's need to lower the cost of housing with our long-standing efforts to gain real access to the Japanese market. With the active engagement of the U.S. Government, we are hopeful that the Hashimoto initiative can provide concrete evidence of a serious commitment to reform Japan's regulatory system in ways which will achieve an open market in the solid wood building products sector, and assist the Government of Japan in achieving its priority reform objective of reducing housing costs.

Paper

The U.S.-Japan Agreement on Paper Market Access has failed to produce the results anticipated by either the U.S. negotiators or our industry. In 1995, the U.S. share of the Japanese paper market stood at 1.8%, only one tenth of one percent higher than in 1991--the year before the agreement was concluded. Japan's paper and paperboard imports from all sources accounted for just 4.2% of the country's consumption in 1995, the smallest such ratio in the world, and only slightly higher than 1991's import share of 3.7%. In fact, in kraft linerboard, one of the product categories covered by the 1992 agreement, the U.S. share, as well as the export volume, was actually well below what it had been in 1991.

The U.S. industry believes that the U.S. market share has remained minuscule because of the continuing existence of an array of business practices intended to deter the entry of new paper suppliers, particularly imports. Some of these barriers are:

- A complex and largely closed distribution system,
- Interlocking relationships between members of the same keiretsu, or corporate family, which include manufacturers, agents, wholesalers, trading companies, printers, publishers or other end users, and financial institutions,
- A lack of transparency in corporate purchasing practices,
- Inadequate enforcement of Japan's anti-monopoly laws.

Other common business practices in the Japanese paper market which have tended to lock out U.S. paper suppliers are the promissory note payments system and after-sale price adjustments provided by Japanese paper manufacturers to their major distributors. While MITI has reported that these practices have been discontinued, at least among the large manufacturers-distributors, we can not confirm this fact since these financial arrangements were not recorded in written contracts.

The existence of collusive business practices in the Japanese paper market was identified by surveys conducted by the Japan Fair Trade Commission (JFTC) in 1993 and again in 1994. However, the JFTC surveys concluded that the practices were not in violation of Japan's anti-monopoly laws. At the same time, the JFTC encouraged Japanese companies to desist from these practices. Nevertheless, Japanese press reports continue to document discussions among Japanese paper producers regarding prices and other conditions of the Japanese paper market. At the minimum, these practices should have prompted JFTC inquiries.

Beginning with the 1994 National Trade Estimate Report, USTR identified the failure of the Government of Japan to live up to its obligation in implementing the agreement as the underlying cause of the disappointing results in achieving greater access to the Japanese paper market. Emphasizing the gravity of Japan's non-performance, USTR placed the issue on the Super 301 Watch list in October 1994 and again in September 1995 and initiated negotiations to restructure the agreement in ways which would make the Japanese Government obligations more explicit and

thus improve results.

Since that time, the Government of Japan has variously announced it would not negotiate or, when discussions did take place, declined to negotiate seriously. And just last week, the English language Nikkei Weekly reported that MITI will refuse to renew the Paper Market Access Agreement which is scheduled to expire in April, 1997. While this might be a trial balloon, it is consistent with Japan's continuing refusal to negotiate U.S. proposed measures that would strengthen and enhance Japanese government and industry implementation of the 1992 Paper Agreement.

U.S. acceptance of Japan's unilateral withdrawal from the agreement would reward a strategy grounded in a complete disregard of Japan's obligations under a trade agreement with the United States--and set an unfortunate precedent for agreements in other sectors as well. From the industry's point of view, the absence of a government-to-government agreement would mean that the substantial efforts which our companies have made to develop a Japanese customer base would be deprived of the impetus of U.S. government pressure which has been necessary for even the modest breakthroughs we have achieved. As a public policy matter, acceptance would fatally undermine the credibility of the NTE/Super 301 process and indeed, the whole Framework approach to enforcing Japan's compliance with our trade agreements.

We believe the example of our paper industry argues strongly for renewed attention to the enforcement of existing agreements, and we are fully supportive both of the enforcement capability which has been established at USTR and a complementary monitoring effort at Commerce. At the same time, we view the current Kodak case as a unique opportunity to come to grips with the pervasive market-distorting effects of Japanese business practices as they affect many segments of American industry and we urge the Administration to develop a negotiating plan which will fully take into account the broad, precedential nature of the issues raised by Kodak.

Finally, we are gratified to hear the Administration's unequivocal response to Vice Minister Sakamoto, and the reaffirmation that the Administration will continue to make the fullest use of the remedies available under U.S. trade law to ensure that competitive American industries will have access to the Japanese market

i:\intl\unpj\jake@6\japan\japtest.1

Chairman CRANE. Thank you, Ms. Smith.

Mr. Patrick, you accused Kodak of the very thing that Kodak has accused you of. How can we get an impartial third party to examine on both sides of the ocean the question of whether there is implicit subsidization or kickbacks or special relationships that prohibit either your access here in our markets or their access over in Japan?

Mr. PATRICK. Mr. Chairman, that is an excellent question, and it is one that we have suggested needs to be addressed by USTR. All of the factual issues in this case are hotly disputed by Fuji, and as you point out, we have complained about their practices in the United States.

We have asked for a neutral fact-finding body. We have suggested, as I said in my statement, any neutral fact-finding body of USTR's choice. We have suggested that they could consider convening a panel of experts; appointing a U.S. administrative law judge as well as multilateral mechanisms. We are open to any mechanism, so long as it is a neutral fact-finding body that can sort out the different surveys and the different data that conflict with each other.

Chairman CRANE. And let me ask a quick question of Mr. Johnson, and that is who is responsible for the delay in beginning the keiretsu study that was required under the agreement?

Mr. JOHNSON. Well, Mr. Chairman, we have our own views about that. I would refer to the USTR for an authoritative view.

The study itself, as you probably know, was to have begun in December 1994. The private sectors in Japan and the United States, the insurance industry representatives, were called upon under the terms of the agreement to meet together to fashion the terms of reference for that study, and select the consultant or consultants that would conduct the study in keeping with the provisions of the agreement. Discussions between the private sectors began in the fall of 1994 with the objective of reaching that December deadline to begin the study, and as of today, that study has not begun.

The effort to come to agreement on the terms of reference, the selection of the consultants, took hundreds of hours of discussions between the two private sectors under the oversight of the Ministry of Finance and the USTR and only recently reached agreement to start the study.

But I think it does reflect a broader concern that you have heard addressed today, namely, how to verify some of the systemic and shareholding type pressures that exist in Japan that make it very difficult to penetrate their market. That is something that the Japanese do not want to have explained.

Chairman CRANE. Thank you.

Ms. Smith, does Prime Minister Hashimoto's imported housing initiative contain any better news for the U.S. forest products industry?

Ms. SMITH. We are optimistic. At the moment, it has not been articulated, and it does not contain very many specifics. But it would appear to make eminent good sense in that there is a Japanese political mandate to reduce the cost of housing in Japan. However, for us, the litmus test will be the tariff issue. If the objective is to lower housing costs in Japan, certainly deregulation will be

of some assistance, but there is one single step that would immediately substantially reduce the cost of housing, and that is the elimination of Japanese tariffs on wood products imports. And that is really going to be our measure of whether this initiative is going to be successful.

Chairman CRANE. And Mr. Rozyński, in the October 1995 agreement, the Japanese Government announced that it would use open bidding and instruct officials to consider foreign bids and establish an appeal process for losing bidders. Have these reforms been adequately implemented?

Mr. ROZYŃSKI. Yes; we are very pleased that those reforms have been implemented. We think that the Japanese have been very cooperative, and we have also been tracking the data fairly closely using consultants in Japan to go and measure the hospital purchases. So we do not have any complaints about that agreement at this time.

Chairman CRANE. Very good.

Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman.

I just want to confine my remarks to Mr. Patrick, since Kodak is a big manufacturing employer in my State. I was pleased to hear that you said that—is it the Government of Japan or Fuji is open to independent study of what the facts actually are? That is Fuji?

Mr. PATRICK. Well, Congressman, I cannot speak for the Government of Japan, of course.

Mr. RANGEL. No, no; I am asking you. You said Fuji is open?

Mr. PATRICK. Yes, Fuji is open to that, yes, sir.

Mr. RANGEL. OK; now, this matter is going before the U.S. Trade Representative, is it not?

Mr. PATRICK. Yes, sir.

Mr. RANGEL. Do you have any problem with them reviewing this?

Mr. PATRICK. Well, sir, this case, I think, is really an antitrust case. It is highly complex. It involves application of—

Mr. RANGEL. The facts on both sides are very difficult and complex, and you and Kodak are diametrically opposed. They say one thing; you are saying another. I am only asking is there any objection that the U.S. Trade Representative get involved in order to adjudicate it? Is that—

Mr. PATRICK. Yes, sir.

Mr. RANGEL. There is?

Mr. PATRICK. That is exactly our position.

Mr. RANGEL. You oppose it?

Mr. PATRICK. Yes, sir. Mr. Rangel, we believe the USTR is not equipped to handle this kind of investigation in a complex antitrust case. The issues are hotly disputed.

Mr. RANGEL. I know; but—you know—

Mr. PATRICK. Kodak submits surveys; we submit surveys.

Mr. RANGEL. I know. But now, you are saying the U.S. Trade Representative is not competent to understand what Fuji understands, right?

Mr. PATRICK. No, sir; not at all. The U.S. Trade Representative is highly competent to understand these issues. It is the verification of the facts that we have a concern with.

Mr. RANGEL. You believe that the facts are so complex that the U.S. Government will not be able to determine them; is that what you are saying?

Mr. PATRICK. Well, no, sir; I think I would not want MITI to decide this case either.

Mr. RANGEL. You would not want what?

Mr. PATRICK. I would not want the Ministry of International Trade and Industry to decide this case either. Both agencies are negotiating agencies of their respective governments. The Department of Justice in the United States and the FTC in the United States has jurisdiction over anticompetitive complaints. In Japan, the Japan Fair Trade Commission has jurisdiction over anticompetitive complaints. Our position is that this complaint should have been submitted first to the JFTC in Japan for review and for investigation.

Mr. RANGEL. And is it your understanding that this matter should be resolved by the Japanese courts?

Mr. PATRICK. This matter—I think Kodak would have had a much stronger argument if they had brought their case before the JFTC.

Mr. RANGEL. In the Japanese courts?

Mr. PATRICK. Before the JFTC in the first instance, yes, sir.

Mr. RANGEL. And the Japanese Government refuses to discuss this case, I understand, with the United States Government.

Mr. PATRICK. Well, again, I think what the Japanese Government has said—not speaking for them, but as I understand it—what they have said is that the JFTC has jurisdiction in Japan over complaints of anticompetitive practices and that Kodak has a remedy. Kodak has not exhausted its remedy in Japan.

Mr. RANGEL. We went through that. All I am asking, sir—

Mr. PATRICK. They have not even begun their first complaint in Japan.

Mr. RANGEL. All I want to know is that when you get to the bottom line—and I know you do not represent the Japanese Government, and I do not represent the U.S. Trade Representative. But it is my understanding that the Japanese Government for whatever reasons—maybe they have international legal reasons—will not discuss this matter with the U.S. Government; is that your understanding?

Mr. PATRICK. It is my understanding that MITI has refused to negotiate this case until such time as Kodak refers it to the JFTC.

Mr. RANGEL. Period, OK; I am not saying who is right or wrong. It just appears so—and I am an advocate for a constituent manufacturing company. But the bottom line is that the Japanese Government will not discuss it with the United States Government; Fuji will not discuss it with the U.S. Trade Representative. All of the things that I am asking—

Mr. PATRICK. Well, Congressman, we have discussed it with the USTR. Fuji Film has made a number of submissions rebutting each factual claim that Kodak has submitted. So we are definitely talking to USTR and cooperating with their investigation, yes, sir.

Mr. RANGEL. Then it is possible that you are cooperating with the 301 proceeding.

Mr. PATRICK. We are responding to Kodak's allegation, yes, sir, through USTR.

Mr. RANGEL. Well, do you not believe that this will be resolved in your favor and that this will take care of the whole thing?

Mr. PATRICK. Well, at this point, we have seen very little verification of the data that we have submitted.

Mr. RANGEL. Well, that inures to your benefit, does it not? Since they are incompetent and have not put it together while you have got your case together. And in your view, Kodak has not got a case that is worth anything.

Mr. PATRICK. Well, if Fuji Film had a complaint about anti-competitive practices in the United States and took that complaint to the Ministry of International Trade and Industry and said negotiate on our behalf, I suspect the first thing USTR would suggest is that we file suit in the United States. I think what we are suggesting here is that the real threat to 301 here from Kodak is that they have brought a complaint without going to the JFTC in the first instance, the organization that has the jurisdiction over the matter. That fundamental flaw, combined with a weak case on the facts, is the real threat to 301.

Mr. RANGEL. But that is 301. If Kodak's case is nearly as bad as you say it is, then they cannot prevail on the facts, can they?

Mr. PATRICK. Well, sir, I do not think USTR is equipped to adjudicate, make judicial judgments about factual disputes in the anti-trust area. These cases would normally take years to resolve in a U.S. court. They do not have the tools of discovery. They do not have verification of the data.

Mr. RANGEL. But you are saying that the only group that is competent to handle this is the Japanese Government, are you not?

Mr. PATRICK. No, sir; we have suggested a neutral fact finder, whether it is a U.S. administrative law judge—

Mr. RANGEL. Have you recommended any names of people that you would like to see on this—

Mr. PATRICK. We have suggested to the USTR a number of mechanisms, Congressman, that could include a panel of experts who could be chosen through a neutral arbitrator.

Mr. RANGEL. Is that in writing?

Mr. PATRICK. Yes, sir, it is; it has been submitted in writing.

Mr. RANGEL. Do you have this, Mr. Houghton? Do you have a copy of Fuji offering that? Does staff have what he is talking about? Would you give it to staff?

Mr. PATRICK. Yes, sir; we would be happy to provide that to the Subcommittee.

Mr. RANGEL. OK.

[The following was subsequently received:]



FUJI PHOTO FILM, INC.

P. O. BOX 1306
GREENWOOD, SOUTH CAROLINA 29649
TELEPHONE: (864) 223-2888, -1626, -0248
FAX: (864) 223-8171

April 1, 1996

The Honorable Philip M. Crane
Chairman, Subcommittee on Trade
Committee on Ways and Means
U.S. House of Representatives
1104 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

On behalf of myself and Fuji Photo Film, Inc., I want to thank you for giving me the opportunity to testify before the March 28 hearing of the Subcommittee on U.S. - Japan trade relations. I was most impressed with the wide range of viewpoints that the Subcommittee sought and the interest of the Members attending.

During the hearing, Representative Rangel requested that Fujifilm provide the Subcommittee staff with the correspondence between Fujifilm and USTR with respect to options for neutral fact-finding in this case. I am enclosing copies of the cover letter and options paper provided to USTR and USTR's response. I hope these will be helpful to the Subcommittee. I am also sending Mr. Rangel copies of these materials.

If you or your staff should have any questions or need any additional information concerning this case, please do not hesitate to contact me.

We were also happy to welcome you to the Fujifilm facility in your district, and we invite you to visit whenever you can. Again, thank you for your interest in Fujifilm's point of view, and for inviting me to the March 28 hearing.

Sincerely,

A handwritten signature in black ink, appearing to read "John Patrick", written over a circular stamp or mark.

John Patrick
General Counsel and Secretary

JP:lae

enclosure

DOWNEY CHANDLER, INC.

1401 I Street NW, Suite 1210, Washington, DC 20005

November 15, 1995

Honorable Michael Kantor
United States Trade Representative
Washington, DC, 20506

Dear Ambassador Kantor:

I appreciate the opportunity to follow up our earlier conversation regarding Fuji Photo Film's views of Kodak's request for Section 301 action on the consumer color photo film market in Japan.

The broad United States - Japan strategic relationship is at a critical juncture. The situation in Okinawa and the press reports of CIA intelligence gathering during the recent automobile negotiations have reinforced tensions significantly. It is important that "next steps" on United States - Japan issues be directed toward easing those tensions. U.S. economic and strategic objectives in the region need to go forward with as little bilateral conflict as possible.

I believe that there is an opportunity here for you to deal with our relationship with Japan in a way that will do credit to this Administration, move the whole process of resolving our trade disagreements forward and defuse the situation regarding the pending Section 301 petition. The accompanying paper presents an analysis of the situation and explores a number of options for resolving the factual disputes at the heart of the petition. I will briefly summarize the paper in the following paragraphs.

Before proceeding with this investigation, two issues must be resolved: whether, in fact, Fujifilm engages in practices in Japan which violate Japanese antimonopoly law and which are tolerated by the government and whether or not Fujifilm is denied "reciprocal opportunities" in the United States.

The almost total conflict between Kodak and Fujifilm's positions, coupled with Kodak's failure to use legal avenues open to it in Japan, seriously undermine Kodak's complaint and explain the Japanese government's unwillingness to negotiate. Kodak's amassing of allegations can in no way substitute for a rigorous investigation of the facts that these legal processes would entail. Nor can the issue of Fujifilm's reciprocal access to the market here in the United States be resolved without a rigorous investigation of our domestic consumer film market. There are options available to resolve the factual basis of the complaint in a manner that should be acceptable to all parties involved.

Honorable Michael Kantor
November 15, 1995
Page Two

Fujifilm supports a credible fact finding process in which 1) the fact finding is done by a neutral party acceptable to both Fujifilm and Kodak, 2) the fact finding also focuses on reciprocal access issues, 3) the process is transparent, and 4) there is an opportunity to address the applicable legal standards.

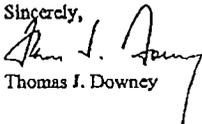
The first option is to use a working group of the Organization for Economic Cooperation and Development (OECD). U.S. business groups have advocated the use of an OECD competition law mechanism to address problems such as this. The second option would be for the World Trade Organization to use its already established and multilaterally accepted mechanism for dispute resolution.

The use of non-binding arbitration is a third option. The American Arbitration Association or the International Chamber of Commerce are two potential fora for neutral experts to find facts and make conclusions of fact and law. As a fourth option, Fujifilm, Kodak and USTR could agree to set up a panel of experts to hear submissions from both sides, pose questions and issue a report. This option would function in a way similar to a WTO panel.

As a final option, USTR could employ an Administrative Law Judge to determine the facts in this case. Agencies regularly use ALJs and there are many ALJs with the requisite expertise in competition policy and law. The International Trade Commission has adopted procedures in Section 337 cases for ALJs. The ALJ's report would then serve as the basis for USTR's decision.

I hope that this summary is helpful to you. The accompanying paper develops these ideas in greater detail and provides you with a possible sequence to pursue these options. I look forward to discussing this issue with you further.

Sincerely,



Thomas J. Downey

Enclosure

POSITION PAPER OF FUJI PHOTO FILM CO., LTD.
AND FUJI PHOTO FILM U.S.A., INC.

* * *

Proposals and Rationales for Mechanisms to Address the Legal and Factual Disputes in the Section 301 Investigation of the Consumer Photographic Color Film and Color Negative Paper Markets in Japan

November 15, 1995

Introduction

In the context of the current Section 301 investigation, the statute places two formidable burdens on USTR. First, USTR must determine whether Fujifilm is engaged in practices in Japan that violate the Japanese antimonopoly law or other norms of competition policy. Absent a determination that Fujifilm has engaged in anticompetitive practices, there can be no government toleration of such practices and no action is justified under Section 301.

Second, even assuming that it is determined that Fujifilm is engaged in anticompetitive practices in Japan and the Government of Japan has tolerated those practices, USTR still must determine, as required by Section 301(d)(3)(D), whether Kodak's exclusionary practices have denied "reciprocal opportunities" to Fujifilm in the U.S. market. Specifically, as stated in the House Report accompanying the enactment of this provision, the

foreign practice being examined must be compared to existing U.S. practice. Thus, complex factual investigations of the practices in both markets must be examined to provide a basis to determine whether any action under Section 301 is justified.

Before reaching these factual issues, however, USTR must determine what legal standards should be applied in this investigation. Kodak has not addressed satisfactorily the threshold issue of market power and would likely have its complaint summarily dismissed in a U.S. court or administrative agency. Since non-price vertical restraints such as alleged by Kodak to exist in Japan are in fact procompetitive unless exercised by a company with market power, USTR must decide what standard should be applied to determine the existence or absence of market power. If Kodak has no market power in the U.S. market as it has argued successfully in U.S. courts, then Kodak is arguably legally estopped from asserting a different definition of market power with respect to Fujifilm in Japan. USTR must determine whether it is appropriate under Section 301 to impose a different or more exacting standard on foreign companies than is imposed on U.S. companies under U.S. antitrust law.

These issues, and others, need to be thoroughly analyzed, briefed, and decided before beginning the factual investigations. These threshold questions significantly affect the scope of the factual investigation that will be necessary. After considering these threshold issues, we believe a neutral fact finder would deem many of the factual allegations raised by Kodak can be

ignored as being legally irrelevant to any discussion of anticompetitive conduct.

The Current Impasse in the Investigation

Both Fujifilm and the Government of Japan have urged USTR to dismiss the Kodak Section 301 complaint on the grounds that Kodak has not even attempted to use the legal mechanisms available in Japan to address its complaints. Kodak argues that the Japan Fair Trade Commission (JFTC) is part of the problem, not part of the solution. Whatever one thinks about the efficacy of JFTC enforcement, a party with an allegation of a violation of Japanese competition law should be required at least to try using the local remedy. Moreover, Kodak appears unaware of the fact that under Japanese law it could also pursue its complaint in a private action in the courts in Japan. Nevertheless, USTR does not appear disposed to require that Kodak, consistent with the norms of international law, exhaust its local remedies before bringing the matter to USTR.

Substantively, the Kodak-Fujifilm dispute is at a stalemate. After two major submissions by each party during the summer, another large submission by Kodak on November 6, and the promise of more to come, the parties disagree about both the history and the current situation of the Japanese photographic products market. Unlike other situations, where some non-Section 301 context provided a basis for a government-to-government dialogue, there appears to be no existing alternative mechanism for such discussions in this case. The strong belief that Kodak has

seriously misrepresented the facts reinforces the Government of Japan's refusal to negotiate.

USTR's priority at this stage should be to develop a core of neutral, credible facts. Kodak's allegations cannot serve as the starting point for negotiations, because the allegations are not true. Moreover, any unilateral action by the United States on the basis of Kodak's allegations would almost inevitably cause a negative reaction from Japan and the international community. There can only be issues for negotiation to the extent that Kodak's factual allegations are able to withstand neutral, critical scrutiny. If they do not, USTR has no legal or policy justification to continue the Section 301 investigation or take further action. Were USTR to take action based on unsubstantiated allegations, a WTO challenge to USTR actions would surely result.

Fujifilm devoted approximately eight man years of lawyer, economist and staff time to develop the facts presented in "Rewriting History." We assume Kodak has devoted comparable if not significantly greater resources. Both Fujifilm and Kodak continue to provide additional information to USTR. At this point, it should be obvious to USTR that a few casual conversations between USTR and Embassy officials and the Japanese Government, Fujifilm, distributors and retailers will not resolve the factual conflicts present in this investigation. Furthermore, other than Fujifilm's efforts, there has been no effort to develop facts related to the issue of Fujifilm's

reciprocal access to the U.S. market. It is simply not sufficient to assume that the U.S. market is open and the Japanese market is closed. There must be facts supporting the conclusions being drawn.

Under Section 301, however, there are no established procedures for conducting this kind of factual investigation. Section 301 does not provide for even the most elementary safeguards to ensure balance and an opportunity for all parties to address the facts. There is not even a requirement that parties be served information submitted in the course of the investigation. There are no provisions for protective orders for obtaining or validating information necessary to make a determination. In short, the current Section 301 procedures are clearly not adequate in investigations where the validity of the allegations are dependent on fundamentally disputed, highly fact-specific determinations and where the applicable legal standard is not clear.

Options

The key concept behind each of the alternatives discussed below is neutral, expert, credible fact finding. The objective is not to limit the authority of USTR under the statute as the decision-maker and negotiator. Rather, the objective is to create a fact-finding mechanism that would consider the relevant practices and result in a detailed factual report responding to the allegations and counter-allegations involved in the investigation. USTR could then decide, based on the report and,

in all likelihood, a hearing commenting on the report, whether to take further action and, if so, the nature of any such action.

For Fujifilm, the prerequisites for such an approach are:

(1) the fact finding is undertaken by someone neutral that is mutually acceptable to Fujifilm and Kodak, (2) the fact finding also focuses on reciprocal access in the U.S. market, as required by the statute, (3) the process is transparent, and (4) there is a full opportunity to address fully the applicable legal standards in the process. In other words, the process has to be fair and comprehensive, and insulated completely from "political" pressures.

If USTR is to avoid stalemate and confrontation in this case, it must devise a mechanism for resolving this dispute that has credibility with the international community. In this regard, USTR must recognize that a business-as-usual Section 301 investigation lacks such credibility. First, USTR is regarded internationally as a negotiator and an advocate, not a neutral fact finder. Second, the unilateralism inherent in Section 301 renders its legitimacy suspect in the eyes of the international community. In light of these unavoidable political realities, a constructive outcome to this dispute is possible only if USTR pursues a fact finding process that addresses these international concerns.

OECD Committees

The OECD has working groups and staff that could address this issue. The OECD already has working groups that address competition law issues. These working groups provide the necessary expertise to evaluate these complex facts and the related competition law issues. In a sense, the OECD staff could function as arbitrators -- reviewing submissions, asking questions, and preparing a factual report.

Interestingly, U.S. business groups have been advocating the use of an OECD competition law mechanism to address such problems. Given the broad-based support for the creation of such a mechanism, it is appropriate to consider seriously the option in this case.

The OECD mechanism may not have quite as much credibility as other alternatives, since there is a somewhat greater potential for political factors to influence the work of the staff. Nevertheless, the OECD option has more credibility than USTR's undertaking fact finding on its own.

WTO Panel

The WTO provides an established, multilaterally accepted mechanism for resolving disputes. A WTO panel would meet the requirements of neutral, credible fact finding. Depending on the particular individuals who serve as panelists, the WTO panel might not have as much expertise as the OECD working groups. But neutrality and credibility are more important considerations than technical expertise.

Some have questioned whether the Kodak complaint can properly be brought before the WTO. Decisions about the scope of WTO rules, however, should be decided by the WTO itself, not unilaterally by individual member countries. The issue is not whether the right to invoke national laws is reserved; the issue is whether multilateral solutions should at least be attempted before resorting to unilateral measures.

Non-binding Arbitration

Arbitration provides a mechanism for allowing neutral experts to undertake fact finding. The arbitral forum could be either U.S.-based (such as the American Arbitration Association) or international (such as the International Chamber of Commerce). Parties would agree on knowledgeable, neutral arbitrators. Parties would make factual submissions, the arbitrators would pose questions, request further facts, and the arbitrators could then issue a report.

Although it is doubtful either party -- Fujifilm or Kodak -- would agree to binding arbitration, non-binding arbitration should not be a problem. The arbitrators need not actually reach a decision -- they need only to find facts and make conclusions of fact and law.

Neutral Panel of Experts

This option would not involve any preexisting mechanism, and could therefore be tailored in whatever way the parties wished. Parties would agree on a panel of neutral, credible,

knowledgeable experts. These experts could be academics, former government officials, think tank scholars or recognized international experts on competition law issues. The panel would receive submissions by both sides, pose questions, and issue a report. The panel could function in a manner similar to a WTO panel.

Administrative Law Judge

Dozens of agencies use ALJs for fact finding pursuant to express statutory authorization. But other agencies also do so without express authorization. The Social Security Administration, for example, uses numerous ALJs for fact finding without express statutory authorization. The Department of Justice uses ALJs to fulfill its statutory responsibilities under the Newspaper Preservation Act. Interestingly, the DOJ uses ALJs when there is a factual dispute, and does not use them when there is no material dispute as to the facts.

ALJs offer two advantages. First, there is a well developed mechanism for using ALJs for fact finding. The ALJ issues a factual report, which is then used as a basis for ultimate decision making by the responsible agency. Second, many ALJs have specific expertise in the field of competition policy and law. The ALJ would thus have the necessary expertise to evaluate complex legal and economic facts. While the ALJ option would undoubtedly have to be adapted to allow prompt fact finding (*i.e.*, limits on discovery agreed to in advance) and avoid endless motions, this could be accomplished by an agreed upon

schedule and defined timetable for presentation of factual information. The ALJ option thus would easily allow USTR to have a credible, expert, neutral party undertake fact finding.

* * *

In terms of a sequence of events, we would propose the following:

- USTR would discuss with Fujifilm and Kodak a mechanism for comprehensive and neutral fact finding. All three would agree on the type of mechanism.

- All three parties would decide on procedures and tentative timetables for the factual investigation.

- Although tentative timetables are possible, it would be a mistake to create artificial deadlines for fact finding. The goal is accurate facts. Therefore, USTR should suspend the current Section 301 investigation. The recent USTR decision on the Section 301 investigation of the EU banana regime -- where it terminated one investigation and started another as part of a WTO complaint -- shows the great flexibility provided USTR under Section 301 procedures.

While reserving the right to discuss and agree upon the details of any procedure adopted, Fujifilm has no objection to procedurally fair, neutral fact finding. Fujifilm is not afraid of the facts. If Kodak continues to resist efforts at neutral fact finding, USTR should be very skeptical of the underlying merits of Kodak's complaint.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON, D.C. 20506

DEC 10 1995

The Honorable Thomas J. Downey
Downey Chandler, Inc.
Suite 1210
1401 I Street, N.W.
Washington, D.C. 20005

Dear Mr. Downey:

Thank you for your letter of November 15, 1995 concerning the pending Section 301 investigation of color photographic film and paper. As the Chairman of the Section 301 Committee, Ambassador Kantor has asked me to respond on his behalf.

I certainly appreciate your suggestions for ways to resolve the factual disputes between Kodak and Fujifilm regarding Fuji's business practices and their impact. However, our section 301 investigation concerns market access for foreign color photographic film and paper in Japan and related practices of the Government of Japan. This is an important bilateral trade matter between the Government of the United States and the Government of Japan -- not between Kodak and Fuji -- and we will conduct the investigation accordingly. Therefore, there is no basis for USTR to delegate investigatory and decision-making authority to third parties such as the OECD, arbitrators, a panel of experts, or an administrative law judge.

As your letter points out, section 301(d)(3)(D) does provide that "[f]or purposes of determining whether any act, policy, or practice is unreasonable, reciprocal opportunities in the United States for foreign national and firms shall be taken into account, to the extent appropriate." I must disagree, however, with your position that this provision requires USTR to determine "whether or not Fujifilm is denied reciprocal opportunities in the United States," and more specifically, whether "Kodak's exclusionary practices have denied 'reciprocal opportunities' to Fujifilm in the United States."

Section 301(d)(3)(D) is a discretionary provision intended to facilitate the determination of whether a foreign government's acts, policies, or practices are unreasonable by considering the lack of reciprocal access afforded U.S. companies in foreign markets relative to foreign companies' access to the U.S. market. Congress' clear objective was to promote greater access to foreign markets by U.S. firms, not create a procedure for examining whether the U.S. market was sufficiently competitive. Both the Senate Finance Committee and the House Ways and Means Committee used identical language to express this objective:

The Honorable Thomas J. Downey
Page Two

The amendment provides that in determining the existence of an "unreasonable" act, policy or practice, appropriate consideration could be given to the denial by a foreign government of access to the market in that country and opportunities within that market generally reciprocating those available within the United States.

S. Rep. 100-71, 100th Cong., 1st Sess. 87 (1987), and H. Rep. No. 100-40 Part I, 100th Cong., 1st Sess., 69 (1987) (emphasis added). Neither the plain language of the statute nor its legislative history support the interpretation that section 301(d)(3)(D) requires USTR to ensure "reciprocal opportunities" in the United States. In fact the House Ways & Means legislative history cited above further provides: -

... even if the market opportunities provided in the foreign market equaled or exceeded those provide in the United States, the particular foreign practice could be actionable if it were nonetheless unfair and inequitable. ...

Id. Nor does the plain language of the statute and its legislative history support the interpretation that section 301(d)(3)(D) requires USTR to apply a "clean-hands" test to Kodak. Even if that interpretation were in accordance with the law, it is difficult to see its relevance in this case given that the United States Court of Appeals for the Second Circuit affirmed the district court's holding that Kodak was not engaged in anti-competitive practices in the United States.

As you know, your client Fujifilm is invited to submit any information it deems relevant for the record of the Section 301 investigation. My staff has been, and will continue to, review all submissions carefully. In addition, we are available to meet with you as needed to discuss both factual and legal issues.

Sincerely,



Irving Williamson
Acting General Counsel

Mr. RANGEL. Thank you, Mr. Chairman.

Chairman CRANE. Thank you.

Mr. Houghton.

Mr. HOUGHTON. No questions.

Chairman CRANE. Mr. Camp.

Mr. CAMP. Thank you.

What I understand you are saying, Mr. Patrick, is that you would like a neutral arbitrator to verify the facts and then take it before the JFTC or ultimately to MITI after that? Is that what I understand? Or maybe I misheard that.

Mr. PATRICK. I think yes, sir. I think MITI has suggested it be taken to JFTC first. What Fuji Film has suggested is that there be some neutral fact-finding body that will review these facts.

Mr. CAMP. And establish a factual basis first?

Mr. PATRICK. Yes, sir.

Mr. CAMP. And then go to the appropriate entity—

Mr. PATRICK. Exactly.

Mr. CAMP. Thank you; I appreciate your answer.

No further questions.

Chairman CRANE. Mr. Coyne.

Mr. COYNE. No questions.

Chairman CRANE. Mr. Graham.

Mr. GRAHAM. Thank you, Mr. Chairman.

One brief question, Mr. Patrick. You seemed to get all the questions here. There was a mention about the Japanese Government's role in providing information and cooperating. And your suggestion—this is what I am trying to understand here—is that you want to pick a neutral independent party, as the gentleman just said, to arbitrate the facts? And if the Japanese Government refuses to cooperate with that independent body, that is a bridge we will cross when we get there?

Mr. PATRICK. Yes, sir; I think so. As we understand it, 301 is supposed to be a tool of last resort rather than first resort.

Mr. GRAHAM. Thank you.

Chairman CRANE. Well, I thank all of you folks for your patience and endurance, and we will include any printed matter you have that you did not deliver in testimony in the record.

And I would like to now call our last panel: Dr. Ellen Frost, senior fellow, Institute for International Economics; Stanton D. Anderson, counsel, Electronic Industries Association of Japan on behalf of the Japanese semiconductor industry; Cyril Murphy, vice president, international affairs, United Air Lines; and Dr. Don Hilty, senior fellow, Economic Strategy Institute.

And Mr. Graham, do you have a unanimous consent request?

Mr. GRAHAM. Yes, Mr. Chairman. I would like to make a 2- or 3-minute statement for the record to give the Subcommittee some information about my district and how this relates.

Chairman CRANE. Without objection, so ordered.

STATEMENT OF HON. LINDSEY O. GRAHAM, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH CAROLINA

Mr. GRAHAM. Thank you, Mr. Chairman. I have enjoyed being here, and I have learned a lot. I am obviously not on the Subcommittee, and I have a lot to learn about trade issues. But I have

been a lawyer before I was in Congress, and I do have a fairly good sense of fairness. I have been in a lot of courtrooms where you go into the courtroom and you wonder "Hmm, I wonder if this crowd is going to give me a fair trial?" And what I want to speak to here today is not so much who is right and who is wrong but about a procedure that I think could take our Nation forward and will help resolve a potential problem greater than free and fair trade, and that is the way you arbitrate disputes.

Let me tell you a bit about the Third District of South Carolina. We have in our district an evolving economy that reflects what is going on in the world very much so. We have felt directly the impact of industrial change in America and around the world. During the primary in South Carolina, you had Mr. Buchanan in front of closed textile mills railing on NAFTA and GATT, and you had Senator Dole at the BMW plant sitting in a car. And I thought it brought it all home what is going on in the world and what is going on in America, and it is going on in my district where you have one area of the economy that is suffering, and you have a district in the South where the average income is \$13,200. That is the per capita income in the Third Congressional District of South Carolina, \$13,200. We are a poor district but very proud. We are trying to grow, and we are trying to get good jobs into the district.

The textile industry has suffered greatly through trading conditions in the world, and in my opinion, some of them have been unfair. You have unfair labor practices in China, government subsidies throughout the world that have hurt the textile industry. We have lost 9,500 jobs as a result of trying to balance the budget and downsize the Department of Energy facility in my district, Mr. Chairman, the Savannah River site, which is the largest site in the chain.

Some good news has been Fuji. Fuji has chosen South Carolina for billions of dollars in investments in modern, clean, efficient plants. These plants have provided high wage employment opportunities to an enormous pool of enthusiastic and committed workers. I would like to highlight the Fuji story just for 1 minute so the Subcommittee can understand how this talk impacts a district in South Carolina with an average income of \$13,200. Fuji began in 1989 in Greenwood, South Carolina, in the middle of my district, producing photographic plates. A second facility for producing VHS videotape was completed in 1992. It may be of interest to the Chairman that all of the Fuji one-half inch VHS videotape sold in Japan is manufactured in Greenwood, South Carolina.

In 1995, Fuji Greenwood completed a third facility that produces one-time use, quick-shot, quick-snap cameras, and I have a lot of them in my office. We are trying not to violate the gift ban, but we will be glad to show you one of them.

Fuji Greenwood will soon bring online a facility for the production of color photographic paper. Fuji Greenwood began this year by announcing plans to build a central distribution and graphic arts film plant in Greenwood, and less than a month ago, Fuji announced again that it will soon open a facility that will package more than 10 million rolls of 35 millimeter Fuji color film every month in Greenwood, South Carolina. In all, by completion date 1997, employment at the Greenwood manufacturing complex will

exceed 1,200 American associates. Factory space will total almost 2 million square feet, and total investment in Greenwood, South Carolina will be approximately \$700 million.

As you saw from the many news reports during the primary, what is going on in South Carolina and what is being talked about in the world, I can tell you that Fuji has been a good corporate citizen and that they have been doing good things for the economy of a district that is poor and needs all of the jobs it can get. It is my understanding that the situation between Fuji and Kodak is unique in the sense that the Kodak Co. has chosen to go to the 301 complaint route without following the traditional complaint process. Japan has acknowledged problems in the past in other areas and has sat down at the table. Unfortunately, in this case, we never got to that step in the process; we have gone directly to the American Government to say decide this.

Because all of the facts are in question, it is impossible for me to know who is right. For every chart that they produce at Kodak, Fuji has a chart. Now, I am not beginning to tell you I know the answer, but I do know this: That what we need to do is have some semblance of fairness. And I will say this in answer to Mr. Rangel's question that I believe the U.S. Trade Representative has a role to play, but he should not be the prosecutor, the judge and the jury. I believe that is an extension of his powers beyond what was intended and will set up a dynamic that will be bad for America, because if you have multinational corporations located in America, like they are in my district, it is unfair, I think, for an American company to make a complaint, bypass traditional complaint methods and make allegations and ask the person who is negotiating for American businesses, who can impose sanctions, to be the fact finder.

All I am asking—and I do not know what the facts are—is that some party other than the U.S. Trade Representative, who has too many hats to wear in this case, decide what the facts are in a neutral, unbiased way, and if the Government of Japan does not cooperate, that is something that we need to know and we need to fix. But get a third party in to decide the facts; then, we can act and act responsibly. If we go down this road in this case, it is going to lead to a situation that will not only create the perception of unfairness for multinational businesses who want to locate in America but will chill foreign investment; and foreign investment in my district has been positive.

Thank you.

Chairman CRANE. Mr. Houghton.

Mr. HOUGHTON. Yes; I would just like to add on to what my colleague has said. Kodak is not in my district; it is in Bill Paxon's district and others, probably Louise and probably John LaFalce's. But I do know the Kodak people, and everything that I have known about them, they have been decent, forthright, honest people to a fault. And I think that they would dearly love—and I really cannot speak for them—but my impression is they would dearly love to be able to do in Japan—which they are not allowed to do because of access to the market—what Fuji has been able to do here because they do have access. Thank you.

Chairman CRANE. Very good.

Dr. Frost.

**STATEMENT OF ELLEN L. FROST, SENIOR FELLOW, INSTITUTE
FOR INTERNATIONAL ECONOMICS**

Ms. FROST. Thank you very much, Mr. Chairman.

Although I spent 10 years working for two multinational corporations that were seeking to expand business in Japan, I am not going to comment specifically on the business conflicts that have dominated this hearing. What I will try to do instead is to sketch the broader context in which these disputes are unfolding. My bottom line is twofold: First, changes in the global pattern of business dictate a shift in priorities with respect to our trade policy toward Japan; and, second, that new regional and global institutions give us an opportunity to pursue those priorities more effectively. With respect, I submit that these are the areas that the Subcommittee should be focusing on, and not bilateral statistics or empty rhetoric.

My first category is changes in the pattern of global business. The first change that I single out in my written testimony is the importance of investment, services and intellectual property. This stems directly from changes in the way companies are beginning to do business around the world. The much touted word globalization has very specific meaning, as I observed in the private sector. It means first and foremost that thanks to the revolution in transportation, information and communication, companies can engage in flexible manufacturing and customized production in local markets around the world. It means that they can disperse different phases of the industrial life cycle throughout different countries, from research and development through production of components, system integration, final assembly, marketing, and aftermarket sales and services. And to do all of this, they have to move knowledge around the world. In a nutshell, that is my sketch of globalization.

Taken together, these changes have three major implications for U.S. trade policy. The first is that trade has become inseparable from investment. The second is that merchandise trade has become inseparable from trade in services. The third is that this diffusion of knowledge requires the protection of intellectual property.

So to begin with, I would say that the main focus of U.S. trade policy vis-a-vis Japan in the first instance ought to be investment, services and the protection of intellectual property. Of these areas, Japan is something of an outlier in investment as other witnesses have noted. In the United States, foreign direct investment is on the order of 7 percent of GDP, but in Japan, it is well under 1 percent. This is certainly a problem that impedes the opening of the market.

The key role of investment leads directly to another feature of the changing global business environment, and that is the importance of deregulation and competition. As companies become active in more and more countries, it matters more and more how they are treated in those domestic markets. In other words, how they are treated in domestic markets affects their international competitive position around the world. This is why the scope of trade rules has been expanding steadily to encompass practices hitherto considered domestic.

Unfortunately, one of the domestic practices that is most relevant here is not yet covered by the rules of the World Trade Organization, and that is competition policy. Clearly, as you have heard this afternoon, anticompetitive behavior can impede access to markets. This is a frontier policy area about which considerable thinking is going on, but there is as yet no consensus about how to coordinate policies in this area. The United States and Japan are already cooperating to some extent, but they need to go even further.

But competition policy needs to be accompanied by deregulation. There is a lot of talk about deregulation in Japan. Just as Mark Twain used to say about giving up smoking, the Japanese Government has announced deregulation packages dozens of times—with results that are still rather limited. In addition to bureaucratic caution and vested interests, I think the Japanese tend to hold the government responsible for safety and order in ways that an American would not understand. I remember that at the time of the Tylenol poisoning case, some Japanese friends of mine said, “Why didn’t you blame the government?” Frankly, it would not occur to Americans to blame the government. Some madman got into the Tylenol and put poison in the bottles; it wasn’t the government’s fault. This difference feeds a large amount of bureaucratic caution in Japan that makes deregulation even more difficult than it would be here.

The fact is, as Congressman Dreier noted, that competition policy and deregulation are the keys to opening up the Japanese market, and they must go together.

So to sum up so far, I would emphasize investment, services, intellectual property, competition and deregulation as central targets of U.S. trade policy toward Japan.

The third change in the global business environment is the sea change in developing countries. I added this because I want to put United States-Japan disputes in perspective. The developing world is where the real growth is going on, particularly Latin America and East Asia. Growth rates in some regions are two or three times higher than they are in the United States or Japan. When asked why he robbed banks, Willie Sutton said, “Because that is where the money is.” The Clinton administration has looked at these regions and said, “That is where the growth is.” Hence the importance of regional trade initiatives. If handled correctly, these regional agreements can ratchet up multilateral standards, but that is a subject for another day.

I think the growth in developing countries has implications for both Japan and the United States. In my written testimony, I single out three real opportunities for the United States: Goods and services associated with the American lifestyle, ranging from blue jeans to American films, where there is just no competition from Japan at all; goods and services associated with productivity; and goods and services associated with modernizing the infrastructure, broadly defined to include everything from roads to telecommunications. We are tremendously competitive in these areas.

The implication of this same sea change for Japan is that Japan needs to continue to expand manufactured imports from developing countries, not just from the United States. Along with growing faster, this is the best thing that Japan could do for these regions.

The second category of change that I want to bring to your attention has to do with the institutional environment. In my testimony, I single out the Asia-Pacific Economic Cooperation Forum or APEC and the new dispute settlement mechanism in the World Trade Organization.

There are several features of APEC that have direct bearing on United States-Japan trade tensions. The first is that APEC offers an institutional mechanism in which not only the United States but other countries can work in a cooperative atmosphere to open the Japanese market. APEC leaders have committed themselves to address all barriers to trade and investment, ranging from agriculture to competition policy. This is a potentially significant contribution. In Osaka specifically, the APEC leaders beat back challenges to scale back the comprehensiveness of APEC's commitment to free trade.

Moreover, APEC can help depoliticize United States-Japan trade disputes and offer a larger role to business. Finally, APEC offers both countries the chance to become more firmly embedded in the emerging Asia-Pacific community, and I think that enhances the security and stability of the region. Clearly, APEC offers no short-term results, but I think a historical process is beginning to operate.

With respect to the new WTO dispute settlement procedures, the United States has a tremendous opportunity. Some Japanese have recently claimed that these procedures mean that bilateral disputes are now unnecessary because the age of bilateral trade is behind us. Actually, the WTO dispute settlement procedure encourages bilateral discussions in the first instance. In addition, there will be disputes that are not yet covered by WTO rules, so I think this prediction is a little bit premature. Nevertheless, there are many more areas that are covered by WTO rules, and we thus have more opportunities to address our concerns in the World Trade Organization.

On a different topic, I want to say just a quick word about both substance and style in United States-Japan relations. On the substance, I notice that every time the Commerce Department releases its statistics, there is a great scramble to put a spin on the bilateral trade numbers. But the truth is that bilateral trade statistics are being blown way out of proportion. For reasons I have already explained, they are becoming somewhat irrelevant to the real life of global business. They disguise rather than illuminate the trends that I have been describing. And, in purely economic terms, of course, they have always been irrelevant, because what counts is a country's global current account surplus. This is the distorting element in the world trading system: The size of the Japanese surplus. Here, the news is modest but good; the Japanese current account surplus is coming down noticeably, from 3.2 percent of GDP in 1992 to 2.2 percent in the third quarter of 1995.

Another weakness of these trade statistics is that they often exclude services, in which the United States is so competitive. As you know, our service surplus last year offset more than a third of our deficit in goods.

I also want to comment on the issue of style. This is a delicate matter, but I believe that an unduly aggressive and self-righteous

public posture vis-a-vis Japan helps to explain why Japan won the public relations contest surrounding managed trade. It is staggering to think that Japan and the European Union accused Washington of managed trade when, in fact, they have been engaging in managed trade for years. The purpose of our trade policies is to open markets, not to limit trade, but we seemed to lose our case in the court of public opinion. Now, you might well ask, what does it matter? Who cares? Foreigners do not vote. We are not in a popularity contest. But public opinion abroad makes a difference: It influences the political climate in which a trade official has to operate when he or she is coming to Washington. I believe that hostile publicity worsens the situation for U.S. negotiators, because that official is under domestic pressure not to give in to U.S. bullying.

Finally, I want to comment very briefly on what Congressman Dreier said about public education and support for open trade. At my institute, we think a lot about this, and we agree that it is a serious problem. In fairness, however, I would not limit the failure to educate the public to the Clinton administration. The explosion of trade in our economy ever since the late seventies has not been accompanied by corresponding efforts to educate the public by administrations of either party. I encourage the Subcommittee to address this problem.

Thank you very much for this opportunity to present my views.
[The prepared statement follows.]

U.S.-JAPAN TRADE: THE BROADER CONTEXT

Dr. Ellen L. Frost
Senior Fellow, Institute for International Economics

Testimony Before the Subcommittee on Trade
Committee on Ways and Means
U.S. House of Representatives

March 28, 1996

Mr. Chairman, and members of the Subcommittee, my name is Ellen Frost. Roughly half of my 24-year career in Washington has been spent in the private sector, and half in the U.S. Government. Until last June I served as Counselor to U.S. Trade Representative Mickey Kantor, a non-legal position roughly analogous to Director of Policy Planning. I am currently a Senior Fellow at the Institute for International Economics, headed by C. Fred Bergsten. The Institute is a private, non-profit, non-partisan research institution devoted to the study of international economic policy.

I will not attempt to evaluate the specific conflicts that dominate much of today's hearing. Instead, I will try to sketch the broader context of these disputes. My "bottom line" is that changes in the pattern of global business dictate a shift in priorities vis-a-vis Japan, and that new regional and global institutions give us an opportunity to pursue those priorities more effectively. These are the areas the Subcommittee should focus on, not bilateral statistics or overheated rhetoric.

I. CHANGES IN THE PATTERN OF GLOBAL BUSINESS

A. The Importance of Investment, Services, and Intellectual Property Protection

Changes in the way companies do business around the world have specific implications for U.S. trade policy toward Japan.

The twin revolution in information and transportation enable companies to engage in flexible manufacturing and customized production for local markets. Mass production in a single location is disappearing. In globally traded sectors, companies are dispersing different phases of the industrial life cycle among different countries: research and development, production of components, system integration, final assembly, marketing, and after-market sales and service. Dispersing these various phases means moving a company's knowledge around the world.

Taken together, these changes have at least three major implications for U.S. trade policy. First, trade has become inseparable from investment. More than 40% of U.S. exports go to U.S. subsidiaries abroad. Second, merchandise trade has become inseparable from trade in services. U.S. service exports are now equivalent to about 40% of merchandise exports, and they are catching up rapidly. World trade in services are expanding at roughly 12% a year, leading some observers to believe that trade in services will exceed trade in goods within a decade or so. Third, the diffusion of knowledge requires adequate protection of intellectual property.

These trends suggest that the main focus of U.S. trade policy vis-a-vis Japan should be on investment, services, and the protection of intellectual property. Product-specific disputes should be pursued as usual, but they should not be blown out of proportion.

In the area of investment in particular, Japan is an "outlier." In the United States, foreign direct investment is equivalent to over 7% of GNP, but in Japan that figure is less than half of one percent. In 1994 U.S. investment in Japan amounted to only \$37 billion, while Japanese investment in the United States

was \$103 billion. By contrast, U.S. investment in Europe exceeded \$300 billion, as did European investment in the United States. This gap reflects a number of obstacles: structural barriers associated with the corporate groupings known as keiretsu, the exorbitant price of land, and excessive regulation, to name a few. The current economic recession in Japan only makes things worse.

All three of these priorities -- investment, services, and intellectual property -- are the subject of multilateral agreements negotiated during the Uruguay Round. Along with Europe, Japan and the United States share a common interest in strengthening these agreements. Scheduled reviews of Uruguay Round agreements and the December ministerial meeting in Singapore should provide opportunities for closer U.S.-Japan collaboration.

B. Deregulation and Competition Policy: The Twin Essentials

As companies become active in more and more countries, it becomes increasingly important to improve the way they are treated in domestic markets. It does little good to achieve free trade at the border if domestic barriers effectively block new entrants to the market.

This is why the scope of trade rules has expanded over time from border-based measures such as tariffs and quotas to a variety of measures hitherto considered "domestic." Examples encompassed in the Uruguay Round include government procurement, subsidies, and protection of intellectual property. Since the United States is already a relatively open economy, with few domestic barriers to new business, we stand to gain considerably from this trend.

One key area is not covered by Uruguay Round agreements, however, and that is competition policy. In 1948, the Havana Charter explicitly recognized that anti-competitive behavior could act as a barrier to market access. But the Charter never came into effect, nor was it revived during the Uruguay Round negotiations. Many U.S.-Japan trade disputes stem from anti-competitive behavior in Japan, not because Japan lacks adequate laws, but because they are not enforced. In the absence of WTO rules, the United States has no choice but to use bilateral or even unilateral measures.

Along with competition policy comes deregulation. The Japanese government recognizes the need and has firmly committed itself to deregulation. But like Mark Twain's effort to give up smoking, officials have done it hundreds of times, with only limited results. Bureaucratic caution and vested interests impede the process. More than most other societies, the Japanese tend to hold the government responsible for safety and order in ways that would not occur to the average American.

Competition policy and deregulation are the keys to a more open Japanese market, and they go together. Deregulating an industry will not open up opportunities for new entrants to the market unless an effective competition policy is in place.

C. The Sea-Change in Developing Countries

To put U.S.-Japan trade disputes in perspective, the biggest single change in the global environment since the declining years of the Cold War is the sea-change in policy in developing countries, especially those in Latin America and the Asia-Pacific region. As a result of a shift toward market-oriented policies, many developing countries are exhibiting rates of growth that are two or even three times higher than growth rates in developed countries. This sea-change has consequences for both the United States and Japan.

A major consequence for the United States is that the growth that is now taking place in developing countries has sparked an enormous demand for goods and services that Americans excel at

producing. First, the population of these countries includes a very high proportion of young people hungry for products of the American lifestyle, from blue jeans to American movies. In this huge and lucrative market, American exporters face virtually no competition from Japan. Second, there is a growing demand for the goods and services associated with productivity -- the same goods and services that have given rise to the revolution in American manufacturing. Third, there is a pressing need to modernize the infrastructure of these countries, from ports and roads to modern telecommunications and environmental products and services. Again, Americans are world-class competitors in these areas.

A major consequence for Japan is that the Japanese market needs to more open to manufactured exports from developing countries in order to sustain their growth. As the world's second biggest national economy, Japan has a responsibility to help promote global growth. By any measure, however, Japan accepts a far lower proportion of manufactured exports from developing countries than other industrialized countries. There are definite signs of improvement, much of which stems from Japanese investment abroad, but progress is hampered by the sluggish rate of growth in Japan. The best contributions that Japan could make to developing countries would be to further open its markets to non-Japanese affiliated companies and to grow faster.

II. CHANGES IN THE INSTITUTIONAL ENVIRONMENT

A. The Role of APEC

The new factor in U.S.-Japan trade relations is the Asia-Pacific Economic Cooperation forum (APEC), whose eighteen members account for about half of the world's output. At the 1994 APEC summit, APEC leaders made a political commitment to achieve "free and open trade and investment" in the region by 2010 for industrialized countries (which account for about 85% of APEC's trade) and 2020 for the rest. APEC's Osaka Action Agenda, announced last November, reaffirmed this commitment and declared that APEC economies "will take the lead" in strengthening the open multilateral trading system, possibly including initiatives for the first WTO Ministerial Meeting in Singapore.

Several features of APEC have bearing on U.S.-Japan trade tensions. First, APEC offers an institutional mechanism in which many nations, not just the United States, can work to open Japanese markets. At Osaka, APEC leaders beat back challenges to scale back the comprehensiveness of their commitment to free trade and investment, notably from Japan and South Korea on agriculture. Second, APEC's goal is to identify and remove all barriers to free trade and investment, including competition policy. Since many U.S.-Japan trade disputes arise from anti-competitive behavior, and since competition policy is not yet encompassed by WTO rules, APEC can make a real contribution here. Third, APEC can help to de-politicize U.S.-Japan trade disputes by offering regional mediation services and allowing a bigger role for business.

APEC has other positive effects as well. As nations scramble to compete for investment, APEC stimulates what C. Fred Bergsten calls "competitive liberalization" and thus reduces the chances of mercantilism and protectionism. Moreover, APEC offers opportunities for leverage. For example, U.S. interest in APEC and Latin America arguably helped to bring about a conclusion to the Uruguay Round by sending a signal to European leaders that the United States had alternatives.

Finally, APEC has geopolitical significance. In the words of trade expert Geza Feketekuty, Director of the Center for Trade and Commercial Policy in Monterey, regional free trade agreements have become "the principal focus for organizing relations among states." APEC offers both Japan and the United States a chance to become more firmly embedded in the emerging Asia-Pacific community and

thus to enhance the stability of the region. It is probably healthy for both countries to stop loading so much onto the bilateral relationship alone.

B. WTO Dispute Settlement Procedures

Another change in the institutional environment is the enormous improvement in dispute settlement procedures in the World Trade Organization. With the active encouragement of the Congress, U.S. negotiators fought for and won strong and disciplined language on dispute settlement in the Uruguay Round. This was an important victory. Because its interests are global, the United States historically brings more complaints against other countries than they do against the United States. The new procedures will prevent Japan from stonewalling a U.S. complaint.

As my colleague Jeffrey J. Schott testified before this Subcommittee on March 13, the new WTO dispute settlement mechanism has handled about 30 requests for consultations. The United States has directly challenged foreign practices in eight cases and has joined plaintiffs in other disputes as an interested third party. Three cases have been brought concerning U.S. practices.

Some Japanese have recently claimed that the existence of these new procedures means that the United States and Japan have outgrown the era of bilateral trade negotiations. Such statements reflect misunderstanding of the way dispute settlement works. The WTO process encourages bilateral resolution of disputes and provides a positive framework within which bilateral discussions can be pursued.

III. SUBSTANCE AND STYLE IN U.S.-JAPAN TRADE RELATIONS

A. "Damned Lies and Statistics"

Whenever the Commerce Department releases U.S. trade statistics, both the Japanese government and the U.S. Executive Branch scramble to prove that the bilateral imbalance is improving. Much of this showmanship is aimed at the Congress.

The truth is that bilateral trade statistics are being blown way out of proportion. In terms of changes in global business patterns, they are becoming irrelevant. They disguise rather than illuminate the trends in global competition that I have just described. In purely economic terms, they have always been irrelevant. What counts is a country's global current account position, which includes returns on investment. From this perspective, the news is good: Japan current account surplus has fallen from 3.2% of GDP in 1992 to 2.2% in the third quarter of 1995.

Another weakness of bilateral trade statistics is that they often omit trade in services. Last year, the U.S. ran a surplus in services that offset more than a third of our deficit in goods.

Emphasizing bilateral trade balances reinforces the wrong-headed idea that trade policy determines the size of the trade balance, which is not the case. Trade policy has a lot to do with the distribution of trade and the composition of jobs, but trade balances are primarily determined by macroeconomic policy, and specifically by the size of the gap between what a country saves and what it spends. Growth rates and exchange rates also play a part. As long as we spend more than we save, we are going to have a trade deficit with someone. As long as Japan is experiencing such flat growth, the demand for imports will remain sluggish. It is precisely because our economy is so healthy that our appetite for imports is so vigorous. Members of the Subcommittee should not be misled by the "spin" placed on bilateral trade statistics.

B. Style Matters

The Japanese word ijime means bullying or hectoring. Ijime among schoolchildren is something of a national problem in Japan. When Americans appear to be resorting to it in the context of trade, reactions can be swift and negative. The result strengthens the hand of precisely those groups least willing to accommodate U.S. interests. It certainly helped Mr. Hashimoto to become prime minister.

I believe that an unduly aggressive and self-righteous public posture vis-a-vis Japanese trading practices helps to explain why, in the context of last year's auto parts dispute, Japan won the public relations contest on "managed trade." It is staggering to think that Japan and the European Union accused Washington of "managed trade" when they have been managing trade between them for years. The goal of U.S. trade policy is to expand trade, not to limit it. The use of quantitative indicators is one way of measuring what the market would have achieved if the market were free to operate. Yet the United States took a drubbing in the court of world opinion.

Why does it matter? Well you might ask. We are not in a popularity context, and foreigners don't vote. But it does matter, for a very simple reason. When a country's newspapers are full of emotional articles accusing the United States of bullying and urging politicians not to back down, a trade minister who comes to Washington to negotiate is not going to have as much flexibility as he or she would have otherwise. We will do better in Japan if we stop grandstanding, respect the courtesies, and adopt the style of patient endurance that the Japanese admire.

Thank you for this opportunity to present my views.

Chairman CRANE. Thank you, Dr. Frost.

Mr. Anderson, what are the time constraints for your opening remarks?

Mr. ANDERSON. My constraints?

Chairman CRANE. The reason I asked is, as you know, we have two votes back to back coming up right now, and we might recess if it is all right with you—

Mr. ANDERSON. Sure.

Chairman CRANE [continuing]. And come back here right after these two votes.

The Subcommittee stands in recess.

[Recess.]

Chairman CRANE. Everyone back? All right.

Mr. Anderson.

**STATEMENT OF STANTON D. ANDERSON, COUNSEL,
ELECTRONIC INDUSTRIES ASSOCIATION OF JAPAN**

Mr. ANDERSON. Thank you, Mr. Chairman, for the opportunity to testify here this afternoon on the United States-Japan semiconductor arrangement. I am here on behalf of the Electronic Industries Association of Japan or EIAJ. EIAJ is a trade association made up of approximately 600 members, representing both Japan's semiconductor manufacturing industry as well as companies that use semiconductor chips.

Mr. Chairman, the message I would like to convey here today is that the mission of the semiconductor arrangement has been accomplished. Its objectives have been achieved in full. And because the objectives have been achieved, we believe the arrangement should expire as scheduled at the end of July. The arrangement was intended to be temporary. It was not intended to be a permanent, government-sponsored affirmative action program for the U.S. semiconductor industry.

The arrangement had two basic objectives. The first was to increase market access opportunities in Japan for foreign semiconductor companies. The second was to prevent dumping of semiconductors. Since there have been no allegations of dumping in many years, I would like to focus on the market access side of the arrangement.

The record of foreign success in the Japanese chip market over the past decade is remarkable. Foreign market share has exceeded the U.S. industry's 20 percent expectation for the past 2 years. The figures released earlier this month for the fourth quarter of 1995 show that foreign share in the Japanese market now is up to nearly 30 percent. Foreign sales have increased more than tenfold over the past decade, from about \$900 million in 1986 to more than \$9.5 billion in 1995. Design-ins have gone up in a similar fashion, rising nearly 900 percent between 1986 and 1995. Close business relationships have been forged between United States and Japanese semiconductor companies.

As you know, there was some dispute as to how much of this dramatic change is attributable to market forces and how much is due to the arrangement itself. U.S. observers tend to credit the arrangement; frankly, we do not. We believe market forces have been

the prime mover behind increased foreign sales in the Japanese market.

The past couple of years have seen a digital revolution in electronic products, including most consumer products, personal computers and portable telephones. U.S. semiconductor manufacturers lead the world in digital semiconductor technology. As a result, Japanese semiconductor users have turned to foreign suppliers, mostly American, to provide them with cutting-edge devices based on this new digital technology.

Whatever the answer, the inescapable fact is that foreign chips are doing extremely well in the Japanese market. Remember the United States defined its expectation under the arrangement as 20 percent foreign market share. SIA said in 1990 that the 20-percent figure was a threshold after which market forces should be allowed, "to take over and operate." We are now at 30 percent. We do not believe that there can be any real dispute that the objectives of the arrangement have been achieved.

While these dramatic increases in foreign chip sales have been occurring, the structure of the global semiconductor manufacturing industry has undergone fundamental changes as well. There has been an explosion in joint ventures and other types of long-term alliances between major chipmakers around the world. Driven in part by huge capital requirements, the biggest names in the semiconductor industry have joined hands in R&D, production and marketing in the latest generations of semiconductor products.

Ten years ago, bilateral issues dominated the semiconductor sector. Over the past decade, a new global semiconductor industry has emerged, with trade, investment and production focused in many parts of the world, including Southeast Asia, Korea and Taiwan. In this new global environment, the challenges facing the semiconductor industry demand multilateral private sector solutions. The era in which problems in this sector can be solved bilaterally between governments of the United States and Japan is over.

In closing, Mr. Chairman, let me repeat that the mission of the semiconductor arrangement has been accomplished. Its objectives have been achieved in full. We believe, therefore, it is time now to get the government out of the semiconductor sector and let the companies and the market dictate the shape of the future.

Thank you.

[The prepared statement follows:]

STATEMENT
OF
STANTON D. ANDERSON
COUNSEL, ELECTRONIC INDUSTRIES ASSOCIATION OF JAPAN
BEFORE THE
HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON TRADE
HEARING ON U.S.-JAPAN TRADE RELATIONS
MARCH 28, 1996

Thank you for the opportunity to testify here this afternoon on the U.S.-Japan Semiconductor Arrangement.

I am here today on behalf of the Electronic Industries Association of Japan, or "EIAJ". EIAJ is a trade association made up of approximately 600 members, representing both Japan's semiconductor manufacturing industry as well as companies that use semiconductor chips.

The U.S.-Japan Semiconductor Arrangement was concluded 10 years ago as a temporary measure to deal with allegations raised by the U.S. semiconductor industry of barriers to access to the Japanese market and injurious dumping of Japanese semiconductors in the U.S. market. The objectives of the Arrangement were to increase market access opportunities in Japan for foreign semiconductor companies and to prevent dumping of semiconductors.

Today, ten years later, the mission of the Arrangement has been fully accomplished.

Although U.S. observers tend to attribute the change to the Arrangement, we firmly believe that market forces have been the prime mover behind this accomplishment.

- The demand structure of the Japanese semiconductor market has changed considerably over the life of the Arrangement, opening up a wide range of new business opportunities for foreign semiconductor suppliers. Historically, Japanese demand was dominated by consumer electronics. American companies are not highly competitive in this market segment. In the past several years, however, sales of personal computers and portable telecommunications equipment have increased rapidly. With the arrival of the new multimedia era, consumer electronics products have become more sophisticated due to developments in digital technology.

As a result of these and other advances in technology, the Japanese market has provided a wide range of new business opportunities for foreign semiconductor companies.

- The U.S. semiconductor industry has regained its competitiveness over the course of the Arrangement. American companies occupy dominant positions in key product areas, from microprocessors to flash memories, on the strength of their technological superiority. Many of the problems which the U.S. industry suffered in the 1970's and early 1980's in the areas of quality, supply, performance, cost and service have been solved.

In the mid-1980's, only a handful of U.S. companies had sales offices in Japan. Even fewer American companies had support departments to handle technical problems or design and testing operations, which were important to Japanese customers. Moreover, in the early 1980's U.S. chips suffered from high defect rates and a reputation for inferior quality. In the past

ten years, the situation has changed dramatically. U.S. companies have made significant efforts and committed large amounts of financial and human capital towards fulfilling the needs of the Japanese market. American products have improved significantly while U.S. companies have established numerous design centers in Japan to provide customer service.

- The changes in Japanese demand structure, the regained competitiveness of the U.S. semiconductor industry and the massive increases in design-in activities (involving foreign semiconductor manufacturers in the design of a product from the initial development stage) have led to skyrocketing foreign sales in the Japanese market. Foreign market share in Japan has exceeded the U.S. industry's 20 percent expectation for nine consecutive quarters. In 1990, SIA said that the 20 percent figure was a threshold, after which market forces should be allowed to "take over and operate." The latest figures put foreign market share at nearly 30 percent. Foreign sales (according to Dataquest) have gone up more than ten fold over the past decade, from \$900 million in 1986 to more than \$9.5 billion in 1995. Design-ins have gone up in similar fashion, rising nearly 900 percent between 1986 and 1995. Inevitably, close cooperative ties have been forged at a business level between the U.S. and Japanese semiconductor industries. Competitive foreign semiconductors have been firmly established as indispensable products in the Japanese market.

- In addition, new types of assembly operations are becoming increasingly common in the semiconductor industry. For example, in the computer segment, chips are being sold, not only as individual components, but also embedded on semi-finished products such as motherboards. These products are being sold internationally in increasing numbers, but the chips contained in these products sold into Japan are not counted as semiconductor imports for purposes of the Semiconductor Arrangement.

- Japanese user companies procure semiconductor products from competitive suppliers irrespective of nationality. The Japanese market is completely open to foreign semiconductors; no trade barriers exist. Success in the Japanese market is a function of meeting users' needs in terms of QCDS -- quality, cost, delivery time, and service.

- Cooperative activities among Japanese and foreign semiconductor companies have increased significantly. These cooperative activities have served to cement a network of commercial alliances between Japanese and foreign companies in this sector. One type of cooperative activity is the design-in project, which Japanese user companies actively engage in with foreign suppliers. Design-ins and other cooperative activities are promoted by EIAJ's Users' Committee of Foreign Semiconductors (UCOM), a group of 63 of the major semiconductor user companies in Japan. The International Semiconductor Cooperation Center (INSEC), made up of foreign suppliers and Japanese user companies, also promotes such activities. These organizations host seminars, dispatch trade missions abroad, receive trade missions from foreign countries, and arrange one-on-one business meetings between Japanese companies and foreign suppliers. These types of cooperative commercial activities have increasingly flourished, and have assisted in making foreign semiconductor suppliers a permanent fixture of the Japanese semiconductor market.

- The world semiconductor industry has experienced dramatic structural change over the past decade, becoming increasingly globalized and interdependent. There has been an explosion in joint ventures and other types of long term alliances between the major chipmakers in all countries. Driven in part by huge capital requirements, the biggest names in the semiconductor industry have joined hands in R&D, production, and marketing in the latest generations of semiconductor products.

The following are examples of major international alliances:

- Hitachi-Texas Instruments. Established a joint venture, called TwinStar Semiconductor, Inc. with production facilities in Richardson, Texas, for the production and development of the next generation of DRAMs.

- Toshiba-Motorola. Established a joint venture company, called Tohoku Semiconductor Corporation, with production facilities in northern Japan.

- Fujitsu-AMD. Established a joint venture company, called Fujitsu-AMD Semiconductor Limited, with production facilities in Japan, for development and production of flash memory devices.

- NEC-ATT. Engaged in the joint development of CMOS devices.

- Toshiba-IBM-Motorola-Siemens. Joint development of the next generation of DRAMs.

- Toshiba-IBM. Will establish joint production facility in U.S.

- The world's largest semiconductor manufacturers are teaming with each other on an international basis to develop, produce and market the latest generations of semiconductor devices. Given the global character of the industry, with operations being conducted on an increasingly borderless basis, the notion that it made sense to distinguish semiconductors according to nationality is no longer valid.

Indeed, distinguishing semiconductors by nationality leads to anomalous results under the statistical system used under the Semiconductor Arrangement. For example:

- Semiconductors manufactured in Japan by TI Japan, Nippon Motorola and IBM Japan are characterized as "foreign" products, even though they are manufactured in Japan, while semiconductors manufactured in other countries by Japanese capital-affiliated companies are considered "Japanese" products, so that their import into Japan is not treated as a foreign import for purposes of the Arrangement's statistical system.

- In the case of semiconductors manufactured by a U.S.-Japan joint venture company, half of a single product batch can be judged "foreign" and the other half "Japanese."

- Even more peculiar results can be found in the case of a factory that is purchased by a Japanese company. Chips that were classified as "foreign" suddenly become "Japanese" the day after the purchase, even though they are the same chips made in the same factory by the same workers.

While the statistical system used under the Arrangement is fundamentally defective, we believe that any system that seeks to employ numerical benchmarks is bound to be flawed given the dynamic nature of the global semiconductor industry and the complex structure of trade in this sector. Moreover, identification according to nationality leads to unfair treatment which is inconsistent with WTO principles.

- Worldwide sales of the U.S. semiconductor industry sales are expected to top \$70 billion in 1995, a 27% increase from 1994. The profits earned by the semiconductor industry as a whole are also increasing sharply, totaling \$9.95 billion in 1995, up 20% from 1994. Given its current profitability and prospects for future growth, this is the last industry in America that needs a permanent government-sponsored affirmative action program in the form of a continuing bilateral trade agreement with Japan.

- With the double-digit demand growth of the past several years expected to continue through the end of the century,

semiconductor manufacturers around the globe are engaged in new investments intended to keep pace with the direction of the market. Ten years ago, the U.S. complained that Japanese companies were engaged in a so-called capacity expansion race which led to excess capacity and dumping on the U.S. market to shed excess inventories when the market turned down. Today, this is not the case. Japanese investment is being carefully calibrated to be responsive to forecast demand. Indeed, a substantial amount of new Japanese investment is being made in joint ventures with American and other foreign business partners, who have a mutual interest in accurate forecasts of future demand and production capacity necessary to meet that demand.

- There are a series of reasons why a further governmental agreement in the semiconductor sector makes no sense.

- As noted above, Japanese user companies procure semiconductor products from competitive suppliers irrespective of nationality. The Japanese market is completely open to foreign semiconductors; no trade barriers exist. Success in the Japanese market is a function of meeting users' needs in terms of QCDS -- quality, cost, delivery time, and service.

- Market share is just one of the factors identified by the Arrangement to evaluate progress in market access. Even the Arrangement recognizes that market share is affected by commercial factors such as supply and demand structures, competitiveness of foreign products, sales efforts by suppliers, etc. As such, the rise and fall of the market share figure, which fluctuates based on long and short term commercial factors, bears no discernible relationship to whether the market is open or closed.

- Moreover, under the Arrangement the 20% market share figure is specifically stated to be an "expectation" of the U.S. industry, not a "guarantee, a ceiling nor a floor." Notwithstanding the clear and plain language of the Arrangement, the U.S. has unilaterally interpreted the 20% figure, not only as a numerical target, but as a Japanese promise or commitment. Moreover, the U.S. has consistently "re-interpreted" the Arrangement's call for gradual and steady improvement in foreign market access as mandating increases in foreign market share. The consistent U.S. policy of distorting the plain language of the Arrangement is clearly inconsistent with WTO principles and is another reason why any form of continuing agreement in this sector is unacceptable.

- We are now living in a new era of international trade rules established at the World Trade Organization (WTO), which became operational in January, 1995. Trade agreements that are consistent with WTO principles are necessary under this new regime.

- Given the facts as described above, it is clear that the objectives of the Arrangement have been achieved in full -- indeed, well beyond the expectations of the U.S. industry. And because the objectives have been achieved, the Arrangement should be allowed to expire as originally intended at the end of July. Moreover, since the 1991 Arrangement was concluded there have been no allegations of dumping by Japanese companies. Each company has been carefully implementing its own management of pricing.

In closing, let me repeat: First, the mission of the Semiconductor Arrangement has been accomplished. The objectives have been achieved. Second, the Semiconductor Arrangement has lost its *raison d'être* due to the dynamic structural changes in the semiconductor sector. Finally, the accession of the new WTO regime requires trade policy to conform with WTO rules. We believe, therefore, it is time now to get government out of the semiconductor sector and to let the companies and the market dictate the shape of the future.

Thank you.

Chairman CRANE. Thank you, Mr. Anderson.
Mr. Murphy.

**STATEMENT OF CYRIL D. MURPHY, VICE PRESIDENT,
INTERNATIONAL AFFAIRS, UNITED AIR LINES, INC.**

Mr. MURPHY. Perfect timing; did you notice the light went out just as he said the last word? [Laughter.]

I do not know if I can promise that kind of brevity.

Thank you, Chairman Crane, for allowing us to be here today. I wanted to commend the Subcommittee first of all for expanding its focus on United States-Japan trade relations this afternoon to include international aviation issues. I would like to take a few minutes to explain to you why it is critical for this Nation's policy-makers to examine aviation in the broader context of our overall trade policies.

We believe that a review of the role of aviation in our international economy is both timely and necessary. There are a number of reasons for this. First, aviation is an integral part of the travel and tourism sector of the economy. It has become too important to ignore in determining overall trade policy. For example, the Economic Strategy Institute, in its recent study entitled "Turbulence over the Pacific," reported that the aviation industry's direct and indirect impact had reached nearly 6 percent of U.S. GDP, supporting 8.8 million jobs. Dr. Hilty here is one of the authors of that report, and I am sure he will be expanding upon it.

But second, the aviation industry is itself becoming increasingly globalized as air carriers set up international networks of hub-and-spoke services similar to those which have proven so successful for carriers in the United States since domestic deregulation. An isolated system of bilateral agreements can no longer serve the needs of this industry.

Third, the importance of aviation to the world economy is gaining recognition in international trade organizations such as the Asia-Pacific Economic Cooperation Forum, APEC. APEC represents the first multilateral trade forum to include air transport as an integral part of its trade liberalization agenda. We recognize there are both opportunities and risks involved in dealing with aviation trade issues in a multilateral forum such as APEC. The bilateral focus of our aviation relationships, however, is now too constraining. Only by placing aviation in a broader multilateral context along with other trade issues can we expect to achieve the progress toward our goal of becoming a truly global industry. Just as one can today send one's voice to any part of the world, send a fax to virtually any destination or even find parcel services with global scope, the air transport industry needs to develop the same seamless system of services integrated into a global network. International multilateral trade forums such as APEC can provide the opportunity that the straitjacket of our present bilateral system cannot.

On the other hand, there is a risk that aviation issues may continue to be isolated, even in a broader trade negotiation. At the APEC meeting last November in Osaka, the members reached an agreement to liberalize trade, including aviation services, by 2010, and in the interim, they adopted an immediate standstill on the en-

actment of any new restrictions in any trade sector. The ink was hardly dry on the standstill agreement before the Japanese air transport officials continued their efforts to impose additional restrictions. A mere 2 months later, to blunt any possible adverse reaction from other Asian APEC members and to enlist the support of generally supportive Asian Transport Ministers, the Japanese called a transport meeting in Kyoto of a truncated APEC assembly from which key countries such as the United States, Canada, Hong Kong and Mexico were excluded. The Japanese used the gathering of Transport Ministers as a pretext for making it appear that they were not alone in effectively abrogating the APEC accord. Aside from being in violation of its air services agreement with the United States, Japan's blatant actions fly in the face of the multination agreement on the APEC action agenda.

The other risk we face in including aviation within a multilateral trade forum such as APEC is that an effort such as that recently made by the Japanese Ministry of Transport might succeed and become the model for other sectors seeking to also undercut their APEC commitment. The Japanese are seeking protection for their air carriers and may offer concessions to other Asian countries in other sectors in exchange for protection in the aviation area. Such "logrolling" could have a cumulative impact, substantially undercutting the overall APEC liberalization efforts. We have recommended to USTR that they prevent aviation from becoming an isolated issue, dealt with by Transport Ministers alone, and seek instead to ensure that it is handled at the level of Trade Ministers along with other trade issues.

United, for its part, will continue to play an active role within APEC in an effort to achieve progress on air service issues in this broader trade forum. We will be active participants in the upcoming transport meeting in Vancouver next month. More importantly, we hope to play an active role in the Trade Ministers' meeting in May.

With respect to our immediate aviation issues with Japan, it is important to understand how we got to where we are now. Throughout the eighties, aviation negotiations resulted in the trading of restrictions on the existing U.S. carrier rights in return for gaining limited access for new carriers. The damage done to consumer choice, and the competitiveness of the U.S. industry is more fully explained in my written testimony. In short, in an era of expanding global airline networks, the U.S. carriers are being prevented from including in their networks points in Japan and Asia which are the fastest growing aviation markets in the world.

The United States has recently recognized in its international aviation policy statement issued last year that it must "adjust its focus to bargain for the bundles of rights that will permit airlines to develop global networks." We have indicated an approach to our aviation negotiators who we feel is an absolute prerequisite to successful aviation negotiations with Japan. Nevertheless, even the most capable negotiator, using the most successful techniques, may face defeat unless he is operating in an environment that permits success and rejects even the possibility of failure.

With a nearly \$60 billion trade deficit with Japan, the one thing that the United States cannot permit Japan to accomplish is to iso-

late individual sectors of trade and manage the outcome where U.S. firms do well. Aviation has a long history of isolation that makes it particularly vulnerable to these techniques, but given its strategic importance, particularly in the Asia-Pacific marketplace, the United States cannot afford to present anything but an integrated, united front. This Subcommittee, we believe, is in a position to provide leadership to ensure that in this area as in others, the United States is speaking with one voice.

Thank you.

[The prepared statement and attachments follow:]

STATEMENT OF
CYRIL D. MURPHY
VICE PRESIDENT - INTERNATIONAL AFFAIRS
UNITED AIR LINES, INC.

Chairman Crane, Congressman Rangel, Members of the Subcommittee.
Thank you for allowing me to appear before you today. Testifying before this committee is a new experience for United Airlines and also for the Committee.

Aviation, of course, is not a subject that has often been discussed in an overall trade context. This is, in itself, rather novel. Imagine for a minute how much international trade would be impeded if we did not have air transport to carry our business men and women, as well as our high value products, to the world's trade centers.

A country without transportation integrated into its trade policy is somewhat akin to a corporation setting up a distribution department and then telling it to go off and do whatever it wants. On the other hand, many corporation departments function with a great deal of autonomy -- as long as they continue to meet the corporation's overall business needs.

Countries are not much different. In theory, one can isolate each sector of our trade and allow it to be administered individually -- again, as long as each is contributing to the overall needs of our international economy.

But whether in a corporation or a country, there must be periodic reviews of how the individual departments or sectors are functioning to serve the larger corporate or public interest.

We believe this is one of those times when just such a review of the role of aviation in our international economy is necessary. There are a number of reasons for the need to focus on aviation from a broader trade perspective at this time:

First: aviation is an integral part of the travel and tourism sector of the economy that has become too important to ignore in determining overall trade policy.

Second: the importance of aviation to the world economy is gaining recognition in international trade organizations such as the Asia Pacific Economic Cooperation (APEC).

Third: the aviation industry is itself becoming increasingly globalized as air carriers set up international networks of hub-and-spoke services similar to those that have proved so successful for U.S. carriers since the domestic U.S. market was deregulated.

We would like to address each of these reasons in greater detail before recommending an approach to resolving the huge issues that face this industry and, in particular, its problem with Japan in the context of the Asian-Pacific region.

The world's economies are becoming increasingly integrated. The growth of foreign trade and investment and the development of regional trading blocks reflects a natural evolution toward more global economic interaction.

This increased integration is in part attributable to the development and spread of international services such as aviation and telecommunications. As one recent report¹ observed:

¹ Economic Strategy Institute, *Turbulence over the Pacific*, March 1996, p 5.

If telecommunication services are the nerve system of the new international economy, then aviation services may be called its bloodstream. Airlines carry the nutrients of the system -- people, documents, and goods -- to its vital organs. Global sourcing, just-in-time delivery, technical support, technology transfer, multinational management, and global economies of scale and scope would all be impossible, or much more difficult, without extensive and efficient air service. Beyond this, long-distance leisure travel, and the massive tourism industry it has spawned, which is the driving force of economic development in many important regions, would have remained merely a perk of the wealthy elite without the growth of modern air services.

Yet despite its obvious importance to world trade and economic activity, air transport has historically been excluded in whole or in part from international trade agreements, such as GATS. Moreover, international air transport has been subject to significant impediments to trade and investment from the world's economies, primarily through restricted market access and disparate national treatment found in most bilateral aviation agreements or national law. This is exemplified in the 16 APEC economies, where the level of impediments to air transport services, particularly freight and passenger transportation, is among the highest of any service industry. (See Charts 8 and 9). As Mr. Cheong Choong Kong, Singapore Airlines managing director, stated recently at a Financial Times conference on commercial aviation in Asia-Pacific, "The minister who negotiates air service agreements pursues a policy philosophically opposed to that of the minister of trade, the person responsible for negotiating everything else."

Fortunately, it appears that more economies are recognizing the critical importance of aviation to them and to the world economy. The International Air Transport Association (IATA) estimates the impact of aviation on gross world product in 1992 at \$1 trillion, accounting for 22 million jobs. For every dollar spent by airlines and airports, at least three additional dollars of economic activity was generated. The industry has created 3 million direct jobs and 7 million indirect jobs. The multiplier effect is another 12 million jobs. The volume of passengers and freight carried by the world's airlines has risen at twice the rate of real GDP over the past ten years.

The importance of aviation to the U.S. economy is equally staggering. A recent study² found that the industry accounts for about 1% of private-sector GDP and is one of the largest industries in the U.S., ranking just behind the motor vehicle industry and ahead of other vital industries such as petroleum and textiles. Moreover, the industry generated nearly 6% of U.S. GDP in 1993 through the indirect impact of the off-airport activities of passengers and shippers, and the induced impact of successive rounds of spending by those who receive direct or indirect payments. Finally, U.S. air transport accounts for nearly 1 million jobs.

The travel and tourism sector of the economy, of which air transport is a leading part, is also important to Japan. According to the World Travel & Tourism Council (WTTC), travel and tourism accounted for 10.5 percent of Japan's GDP in 1995, contributing 10.6 percent of its total wages and salaries.

Even individual states, such as California, recognize the importance of efficient air transport services to their economies. In California, foreign trade, together with tourism and entertainment, are two of the key pillars of California's economy that rely on air transport services. In addition, the transportation sector contributes to California's job growth.³

The importance of aviation to international trade has begun to gain recognition. This is clearly evident in the U.S. The U.S. government has been advocating and actively seeking to establish "open skies" aviation agreements with other countries. The U.S. International Air Transportation Policy Statement noted, "The availability of efficient international air

² Economic Strategy Institute, supra.

³ Report of the Economic Advisory Council of the California Institute (October 11, 1995).

transportation will greatly enhance the future expansion of international commerce and the development of the emerging global marketplace.”

On an international level, the APEC organization is also working to remove some of the impediments to air transport services in its region. APEC was the first multilateral trade forum to include air transport specifically in its agenda, and has committed to its liberalization by 2010. APEC has also created a transportation working group to study this issue. At the APEC ministers meeting at Osaka, Japan in November 1995, an Action Agenda was adopted which, among other things, specifically addresses the progressive reduction of restrictions on trade in transportation, and calls for a “standstill” in the creation of new impediments.

The APEC initiative is of critical importance to the international aviation industry. According to IATA, the Asia-Pacific market already accounts for more than one-third of scheduled international passenger traffic. By 2010, according to IATA, this area is expected to account for over 50 percent of scheduled passenger traffic.

The APEC initiative is also vitally important to the U.S. As the U.S.T.R. Mickey Kantor recently stated:⁴

The Asia Pacific region is of growing importance to the United States. Our trade across the Pacific is 50% greater than our trade across the Atlantic -- our merchandise exports alone to Asia have grown over 50% in the last four years and support over two million high-paying U.S. jobs. If the United States maintains its current market share, Asia, excluding Japan, is estimated to be our largest export market by the year 2010, absorbing approximately \$284 billion of our goods. Growing U.S. services sales to Asia will add many tens of billions of dollars more to U.S. exports.

The APEC initiative to liberalize air transport services has, however, caused a reaction in at least one key member country. No sooner had APEC adopted an air transport liberalization agenda that included an immediate standstill in the spread of additional restrictions, than Japan violated that standstill agreement by pursuing more restrictive regulations. Barely two months after the APEC Osaka meeting, Japan sponsored a partial gathering in Kyoto, Japan of some APEC members that was designed to circumvent U.S. initiatives by formulating a more protectionist policy for Asian carriers. The U.S., Canada, Hong Kong and Mexico, all APEC members, were excluded from the Kyoto meeting. The Japanese used the gathering of transport ministers at the Kyoto meeting as a pretext for making it appear that they were not alone in abrogating the APEC accord. Aside from being in violation of its bilateral treaty with the U.S., Japan’s protective actions fly in the face of the APEC Action Agenda.

Because of its geography and large local population, Japan is a natural intermediate point for travel between the U.S. and the fast-growing Asian economies. In an effort to protect its airlines from their more efficient U.S. competitors, however, Japan has consistently used regulation to deny U.S. carriers increased access to both Japan and beyond to Asia, notwithstanding the existence of U.S. carrier rights under the 1952 U.S.-Japan Air Services Agreement. Japan’s recent actions in violation of the APEC Action Agenda indicate Japan’s continuing desire to keep competition out of the Asia-Pacific region.

APEC’s recognition of the importance of aviation reflects the increasing globalization of this industry. There are two major events that have contributed to this globalization process.

⁴ USTR Kantor Statement on White House Announcement of Chair and Vice Chair of Commission on U.S.-Pacific Trade and Investment Policy, March 14, 1996.

The first took place in 1958 with the establishment of transatlantic jet service. Within five years more passengers were traveling across the Atlantic by air than by ship, and a trend was established. The industry had also begun its shift from being a specialty service to becoming a mass mover of people and products. What the railroads were to the industrial age, the airlines would be to the century ahead.

The second turning point took place in 1978 with the deregulation by the U.S. of its domestic airline industry. Much has been said and written about the effects of that daring step -- and of the troubles it inflicted on airline managements, employees, and customers. History will note, however, that deregulation's most important contribution to the industry and to the economy is that it forced the airlines to become competitive, to exercise the judgment and apply the business standards long required in other sectors.

It took a while for the lessons to sink in, but today U.S. airlines are by a significant margin the world's most cost-effective and competitive. By making the huge changes demanded by competition, U.S. carriers opened air travel to the masses. Low fares and virtually shuttle service throughout the country revolutionized Americans' use of planes for both pleasure and business travel. To cope with the major rise in demand, carriers created the hub-and-spoke passenger distribution system to enable them to serve an ever wider range of markets efficiently, here and around the world.

Today, travellers expect global air service to be as seamless as global telecommunications. If you, Mr. Chairman, needed to make a call to Tokyo this afternoon, all you would have to do is dial one number. The telephone company would do all of the switching required to actually make the connection. No matter where you live in the world, you need only one number to reach your party. So it should be in aviation. A traveler who wants to go to Japan should be able to call one number and have all the necessary connections made behind the scenes to ensure a smooth, uninterrupted journey.

It is for this reason that United has wholeheartedly supported the Administration's efforts to sign open skies and liberalized agreements. These agreements allow competitive market forces to develop air service between countries that matches customer demand rather than supports outdated, protectionist policies.

To date, the U.S. has signed open skies agreements with 10 European countries, with Germany being the most recent example. In Asia, the U.S. has signed liberalized agreements with Korea, Singapore, and Taiwan. As Chart 6 shows, the impact of these agreements has been significant. Carriers in these three countries have expanded at almost double the rate of their Japanese counterparts since 1978. That means that more Koreans, more Singaporeans and more Taiwanese are spending money around the world.

Looking at it another way, as shown in Chart 5, in U.S.-Asia markets, these carriers have doubled their marketshare from 13 percent to 27 percent since 1978, while the market share of Japanese carriers, which are among the world's most costly and inefficient, has dropped from 30 percent to 18 percent.

These Asian carriers are poised for even greater growth in the next 20 years as Asia's consumer economy explodes. By 2010, as shown on Chart 3, 10 Asian markets will match or surpass the two current largest markets -- Tokyo and Hong Kong -- in the number of air passengers transported annually. In fact, as previously noted, IATA predicts that Asia-Pacific international passengers will account for more than half of the world's scheduled air traffic in the next 14 years.

Japan is trying to constrain U.S. participation in that growth. While the world economy presses relentlessly forward, outpacing regulation and demanding the freedom to move swiftly as demand dictates, Japan is seeking to increase restrictions on aviation. Rather than working with the U.S. to allow a seamless journey for all U.S. travellers who have interests in Asia not yet served under our existing agreement, Japan is seeking to monopolize its natural status as a gateway to Asia and protect its high cost carriers.

In 1952 the U.S. started out with a liberal, open-entry agreement with Japan. If its provisions had not been whittled down over the years, there would be no Japan access issues today. The 1952 Agreement guaranteed the U.S. the right to designate as many carriers as it wanted to serve Japan with as many frequencies as those carriers felt the market required, and to continue those flights beyond Japan to any point in Asia. How then did we get from there to here?

Well, according to a recent article by Mr. Hanyu, the Chairman of Japan's aviation delegation, the impetus for change was the British "success" in negotiating the highly protective Bermuda II agreement with the U.S. in 1977. To the Japanese bureaucrat, that agreement was a regulator's dream come true. With a Pacific version of Bermuda II, not only could Japan control every aspect of competition by U.S. air carriers, but it could structure the environment to favor Japanese carriers - - even when, as is the case today, U.S. carriers are more competitive.

According to Mr. Hanyu, in 1977 Japan had decided that it too wanted a Bermuda II style agreement with the U.S. It called for renegotiations.

To its credit, the U.S. had learned its lesson with the British. We did not jump at this opportunity to shoot ourselves in the other foot.

Then, in a tactic that has served it well over subsequent years, Japan simply ignored its commitments under the agreement. When the U.S. government in the late 1970's designated a new carrier, United, to operate to Japan from the Pacific Northwest, Japan refused to honor the designation.

What followed was a series of agreements and actions that step-by-step effectively gutted the liberal provisions of the 1952 Agreement. Those steps are outlined on Chart 1.

- In 1982, to resolve the dispute over United's new authorization, the U.S. agreed that all new designations would be negotiated with Japan and that they would not have the ability to operate hubs in Japan. This insured that all subsequent awards would be in the form of point to point authority, with no rights to operate beyond Japan. The MOU carrier concept was born.
- In 1985, the restrictions were expanded to include the 1952 carriers. U.S. carrier operations were capped to those U.S. points that the CAB had previously named in the '52 carriers' certificates at that time. Because of that, the U.S. cannot today integrate its highly efficient domestic hub structure with its international routes to the Pacific even for the original 1952 carriers. For instance, United, the biggest U.S. carrier to Asia, can fully integrate its Pacific routes with only one of its principal domestic hubs, San Francisco.
- In 1986, Japan designated a second Japanese carrier to perform international services and it began developing Asian hubs and seeking access from them to the U.S.
- In 1989, Japan expanded the number of U.S. routes and capacity under its regulatory control by limiting the expansion of new points to those only under MOU conditions.
- In 1994, Japan announced a freeze on both U.S. carrier passenger and cargo airport operating slots when the new Osaka Airport opened, foreclosing long-awaited growth in Japan's second largest city and, with Narita slot-constraint since 1989, the only potential for growth into and beyond Japan for the foreseeable future.

- Under domestic pressure, Japan agreed with U.S. carriers on a multi-year schedule of constrained growth at Osaka then reneged on that agreement only months later by disapproving our Seoul service and Fedex's Subic Bay service in early 1995.
- In 1995, Japan and the U.S. reached an understanding that Japan would honor most of the beyond rights of U.S. cargo carriers
- In March 1996, Japan is again threatening to withdraw those promised U.S. cargo rights. The U.S. passenger rights beyond Japan remain both frozen and unaddressed.

What we are left with now is a Bermuda II agreement without a formal document. The only remaining item outside Japan's formal control is the 1952 carriers' rights to operate hubs in Japan in order to serve the rest of Asia. And even there, as Fed Ex's experience and our own demonstrate, Japan now has its eyes on that last regulatory prize. Because of the rights previously surrendered, Japan can dangle the carrot of allowing some new service in front of our communities and carriers if in return they will support Japan's negotiating efforts before the U.S. government. That is where we find ourselves today with Access U.S.-Japan, and that is why the *Japan Times* can confidently predict -- as the excerpts in Chart 2 show -- that Access U.S.-Japan "is likely to be a strong supporter of Japan," and leading an MOU official to say that "Tokyo welcomes the efforts of the MOU carriers." Sad to say, Japan has succeeded in pitting U.S. carriers against each other, and should Japan succeed, the economic loss for the U.S. economy will far outweigh the incremental gains by one or two U.S. carriers.

Why then is Japan so set on tightly regulating U.S. participation?

The answer is that Japan's Ministry of Transport seeks to salvage a disastrous regulatory policy that has left JAL and ANA unable to compete effectively with U.S. and other lower cost carriers. This is illustrated in Chart 4, which plots a comparison of JAL and United's costs based on ICAO statistics. As you can see, as late as 1985, JAL's costs were below ours. By 1993, however, they were dramatically above ours and were continuing to trend in the wrong direction.

Not surprisingly, it was after 1985 that U.S. carrier share of the transpacific market began to exceed that of the Japanese carriers. Clearly the reason is relative costs -- but to admit that, Japan's MOT must confess that its regulatory policies are an abject failure. It is far easier, they believe, to repeat their myth that the underlying 1952 Agreement is somehow unfair.

Japan wants to salvage the reputation of its bureaucrats and carve out a protected market for its uncompetitive carriers by denying U.S. and foreign carriers the means to compete effectively. Japan's current objective, therefore, is to eliminate the right of U.S. carriers to operate hubs in Japan to serve the growing Asian market.

Equally important, we must recognize that no U.S. carrier today operates any nonstop service to any Asian point (except Japan) unless that carrier also operates a hub in Japan. These nonstop and hub services are complimentary, giving U.S. carriers a presence in an Asian city that is competitive with both Japanese and other Asian carriers. If we lose hub access beyond Japan, then all U.S. carriers will be in the same position that a number of U.S. carriers, most recently Delta, have been in when they tried and failed to maintain a system of service to other Asian points without a hub in Japan. It leaves Japan with the only efficient carrier networks in the Pacific.

Simply put, Japan intends to gain through regulation an advantage its carriers cannot win in the marketplace.

What should we do about it?

Just last month, Charles Hunnicutt, DOT's Assistant Secretary for Aviation and International Affairs, stressed the need for U.S. policy makers to concentrate on the long-term: "It is important to underscore that in our dealings with Japan, we ought not settle for short-term gains at the cost of sacrificing long-term needs into the next century."⁵ His comments echoed those of Secretary Peña in conjunction with his recent extended trip through Asia.⁶ We agree completely. It has been our concern about the future consequences of any negotiations with Japan that led us to commission Booz Allen and Hamilton to look at what the Japanese policies would mean to the U.S. in the coming decades. We believe that no policy can be relied upon if it is not based on economic reality. That is why we took the lead in gathering these facts.

The study conducted by Booz Allen and Hamilton concluded that over the next two decades the cumulative reduction in U.S.-Asian trade balance from restrictions on the U.S. expansion of passenger transportation in Asia through Japan could exceed \$100 billion. Japan, the Booz Allen study suggests, would be the primary beneficiary.

A subsequent independent study conducted under the supervision of Clyde Prestowitz of the Economic Strategy Institute reached much the same conclusion. In that analysis, a cap on U.S. carrier beyond rights would mean that in the year 2010, U.S. carriers as a group would earn almost \$3.2 billion less in the best case and \$5.4 billion less in the worst. In that same year, the cap would reduce U.S. employment by between 111,000 and 213,000 jobs and reduce U.S. trade receipts by up to \$5.1 billion in that year alone. Unfortunately, we believe the worst case is the most probable one.

These are real dollars and real jobs that will be lost to the U.S. economy if Japan has its way. And, just as it is now easy to criticize the mistake we made in Bermuda II, it will be easy in 2010 to recognize in retrospect the damage done by concessions to Japan in 1996. The challenge is to recognize those downsides in advance, and negotiate accordingly. In this regard the economic analyses of Booz Allen as well as the Economic Strategy Institute have armed the U.S. Government with the knowledge it requires. What is needed now is the political will to act to avoid the dominance of another successful U.S. industry by Japan. In our view, and we hope in yours, the responsible course requires that the U.S. first reconcile its well-crafted International Aviation Policy with its negotiating objectives. That Policy states that:

carriers wishing to establish global networks require a higher quality and quantity of supporting route authority than they have sought in the past. Airlines will become increasingly concerned with every market that enables them to flow passengers over any part of their system network. These airlines will be looking for broad, flexible authority to operate beyond and behind hub points, in addition to the hub-to-hub market between two countries. At present, governments operating in a bilateral context naturally focus on opportunities for their respective carriers to serve the local market between their two countries. In a bilateral context, services destined for or coming from third countries receive less consideration. In the future, governments will have to adjust their focus to bargain for the bundles of rights that will permit airlines to develop global networks. (Emphasis added.)

We cannot continue to proceed by committing the same mistakes in the 90's as we did in the '80's. As the International Policy recognizes, adjusting our focus should mean that integrating domestic and international hubs has to have the highest priority. Specifically, it

⁵ Response of Assistant Secretary for Aviation and International Affairs, Charles Hunnicutt, to ACCESS U.S. - Japan Announcement, February 21, 1996

⁶ "Peña Asserts Shift in Focus from Europe to Asia," Aviation Daily, November 1, 1995, p. 179

means that undoing the damage of the '80's must be undertaken so that those carriers that can still hub in Japan can once again have the ability to integrate those hubs with their domestic systems. Japan recognizes this need for its carriers. We can do no less for ours.

In addition, as indicated in Chart 7, we should approach negotiations with the following framework in mind:

- First, insist that Japan honor its current agreements;
- Second, steadfastly refuse to fall into the Japanese trap of accepting restrictions on existing rights as a way to secure other opportunities; and
- Third, set as our negotiating goals objectives which are first determined by economic analysis to be in the best interests of the U.S. as a whole.

Let us first be clear on what we are not recommending. We do not propose to demand simply the dismantling or wholesale restructuring of the network of agencies, congressional committees, laws and regulations, and other mechanisms that have generally served this industry well.

We are, however, strongly recommending that there are times when the larger public interest is better served by a more comprehensive approach to the issues facing this industry. Just as the National Economic Council was established by the President to oversee and coordinate the work of various agencies of the Executive Branch to ensure that they work together to achieve common and often broader goals than any one agency can handle, similarly, Congress should be open to working with other committees and agencies when the need occurs. This, we feel, is one of those times, and Japan is one of those countries where such a coordinated approach is necessary. The challenge we face is not limited to aviation; it is a basic challenge to our trade policy with Japan and our presence in the largest market in the world, Asia-Pacific. If Japan can isolate and effectively control this strategic area of economic activity where the U.S. has led the world since the days of Kitty Hawk, not only in operations but manufacturing as well, then Japan will feel emboldened to just say no in all such areas.

We have indicated an approach to our aviation negotiations which we feel is an absolute prerequisite to successful aviation negotiations with Japan. Nevertheless, even the most capable negotiator, using the most successful techniques, may face defeat unless he is operating in an environment that permits success and rejects even the possibility of failure.

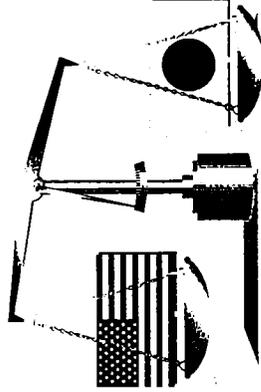
With a nearly \$60 billion trade deficit with Japan, the one thing the U.S. cannot permit Japan to accomplish is to allow them to isolate individual sectors of trade and manage the outcome in sectors where U.S. firms do well.

This pattern of isolating sectors where U.S. firms are competitive is not limited to aviation. In semi-conductors or photo film the response is similar. Where U.S. firms are competitive the Japanese adherence to free trade suddenly disappears. It quickly becomes heads I win, tails you lose. Where Japan has a competitive advantage, they demand and quickly exploit any freedom, but when the situation is reversed, they resort to a variety of techniques to prevent the comparative advantage of U.S. firms from being made available in the Japanese marketplace. If these practices are allowed to continue they will create an insurmountable barrier to ever achieving balanced trade with Japan. Moreover, many of the other countries in Asia will quickly adopt the same practices.

Aviation has had a long history of isolation that makes it particularly vulnerable to these techniques. But given its strategic importance, particularly in the Asia-Pacific marketplace, the United States cannot afford to present anything but a united front. This committee, we believe, is in a position to provide the leadership to ensure that in this area as in others, the U.S. is speaking with one voice.

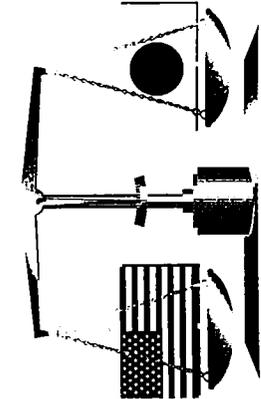
Chart I

U.S. - Japan Aviation Relationship 1952-1996



Bermuda I

- ✓ No limits on the number of designated carriers
- ✓ No limitations of frequencies
- ✓ No limitations on U.S. gateways
- ✓ Unlimited "beyond" rights to Asia



Bermuda II

- ✗ No limits on the number of designated carriers
- ✗ No limitations of frequencies
- ✗ No limitations on U.S. gateways
- ✗ Unlimited "beyond" rights to Asia

1952 U.S. Japan Civil Air Transport Agreement
 U.S. surrenders right to bilaterally designate new carriers. "MOU" carrier classification created
 U.S. surrenders right to U.S. surrenders second carrier to operate internationally. All Nippon Airlines (ANA) begins development of Asian hub.
 Japan designates second carrier to new U.S. Japan points only on frequency controlled point-to-point routes.
 Opening of Osaka's Kansai Airport. Japan announces freeze on future U.S. carrier rights
 Japan refuses to honor its obligation with respect to beyond rights of '52 carrier.
 Japan again threatens to withdraw U.S. cargo rights beyond Japan.



Asia - Pacific Markets

(Millions Passengers)

1993	COUNTRY	2010
35	Japan	91
24	Hong Kong	72
8	China	62
19	Singapore	60
14	Taiwan	57
13	Thailand	54
11	Australia	43
11	South Korea	43
6	Indonesia	26
8	Malaysia	25
6	Philippines	22
7	India	21
4	New Zealand	10
3	Pakistan	7

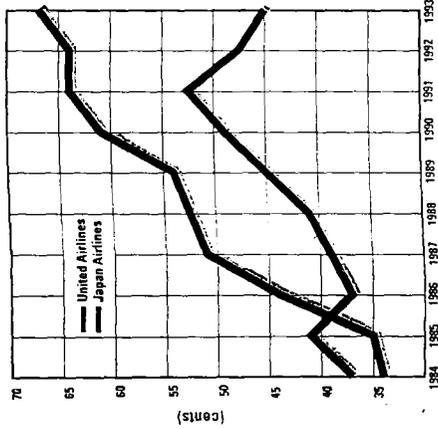
By 2010
10 Asian markets will match or surpass the two
largest '93 markets – Tokyo and Hong Kong

Source: IATA

U.S. Marketshare Correlates Directly with Cost Efficiency of U.S. Carriers

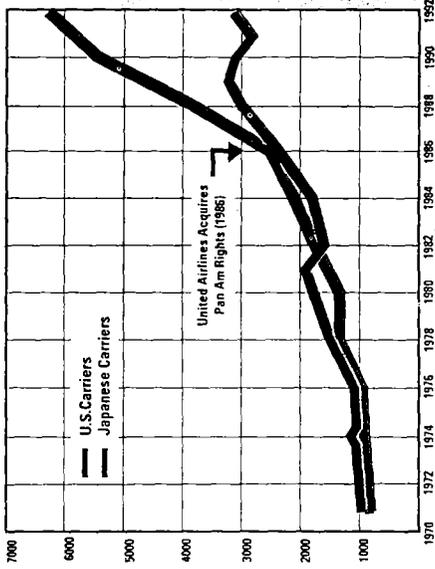
Airline Unit Cost

(Total Operating Expense per Available Ton Kilometer)



Source: ICAO Financial Data

Scheduled Airline Passengers Between U.S. - Japan
(in thousands)

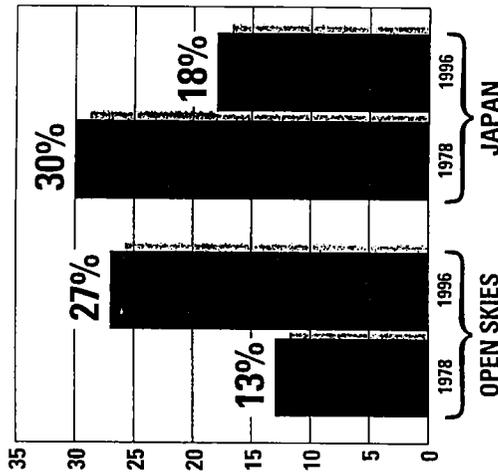


Source: Japan Economic Institute

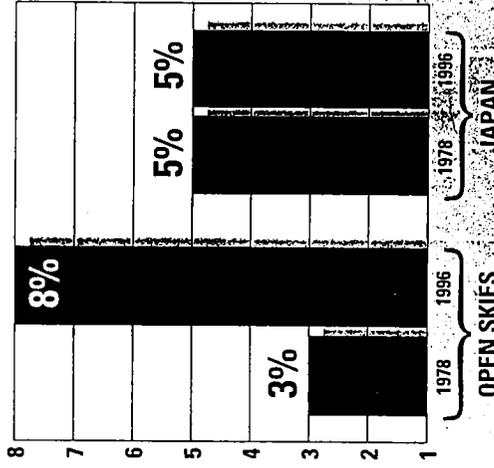
Chart 5

Asian Open Skies Carriers Marketshare Expanding More Rapidly than Japanese

U.S. - Asia Markets



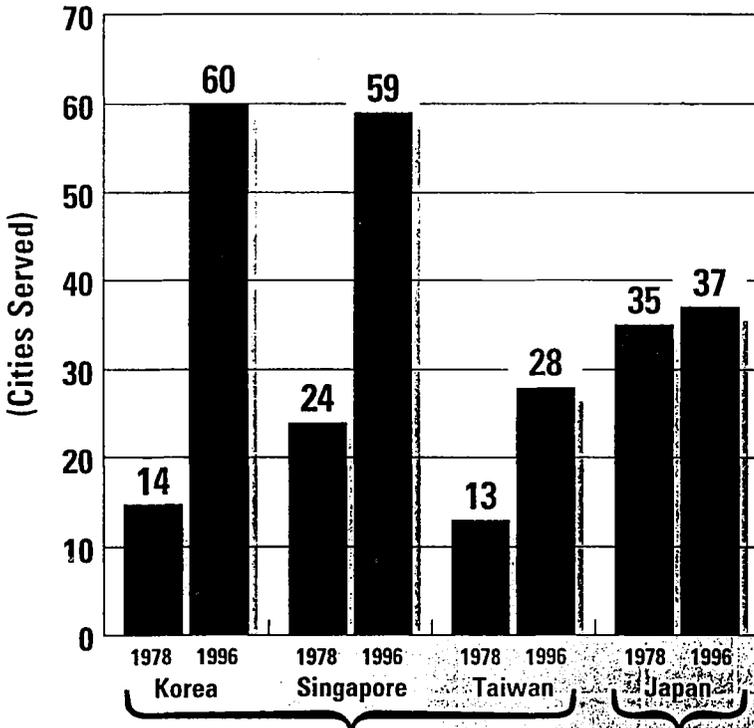
All Global Markets



Source: OAG Schedule Tables

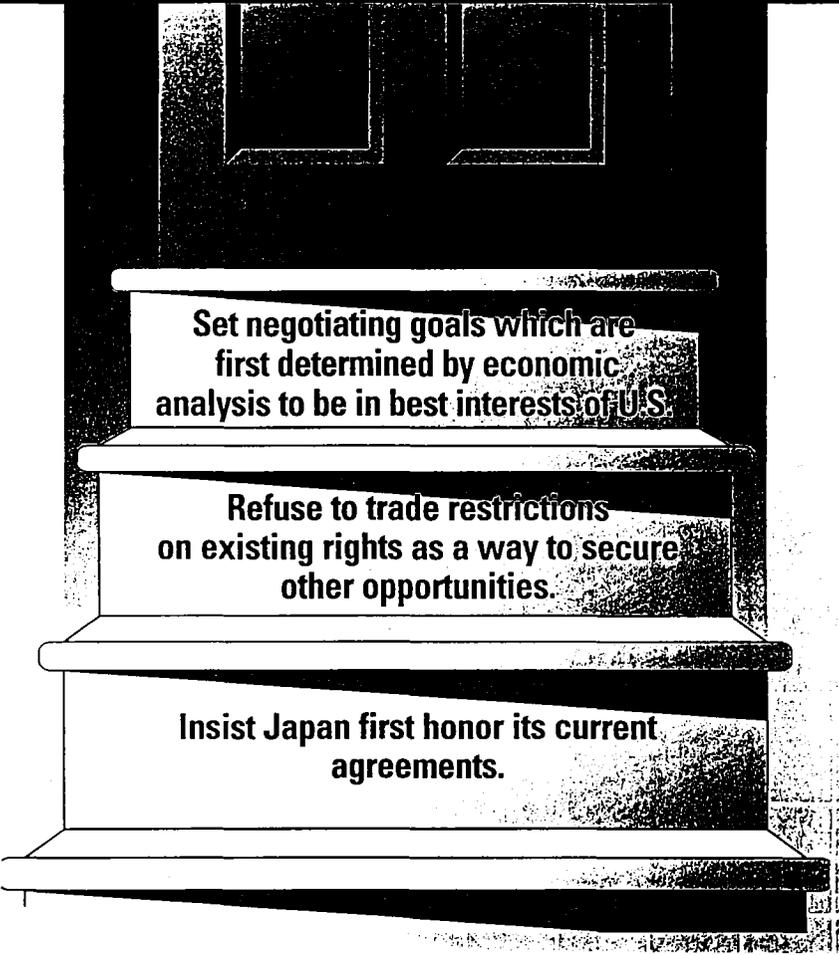
Asian Open Skies Carriers Expanding More Rapidly than Japanese Carriers

All Global Markets



Source: OAG Schedule Tables

A Framework for Successful U.S.-Japan Negotiations

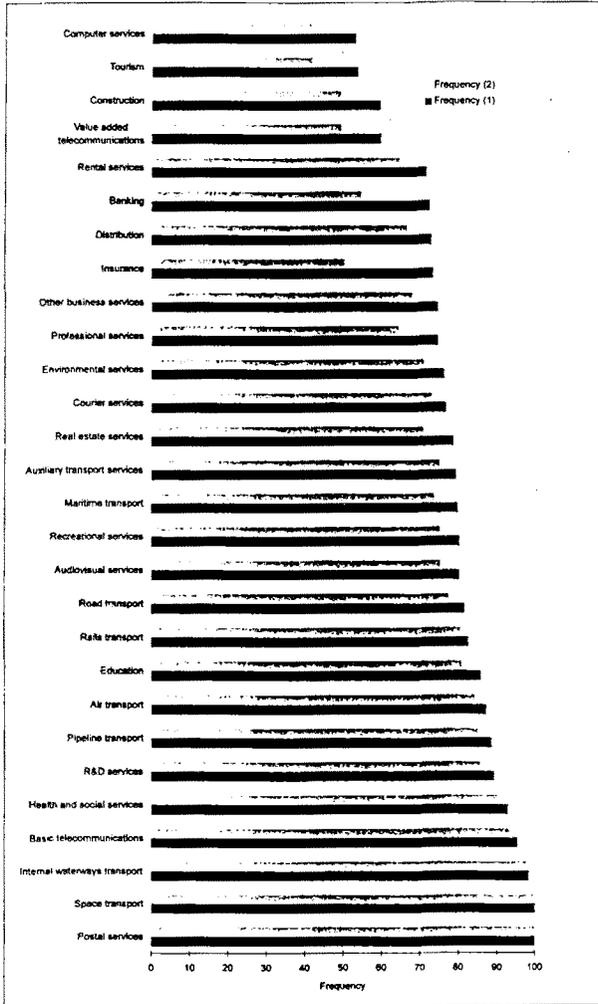


Set negotiating goals which are first determined by economic analysis to be in best interests of U.S.

Refuse to trade restrictions on existing rights as a way to secure other opportunities.

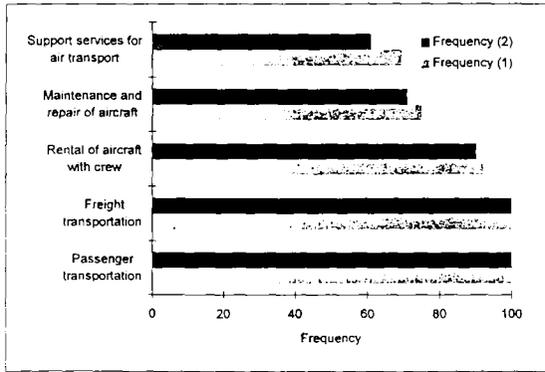
Insist Japan first honor its current agreements.

Frequency measures for selected 1- and 2-digit service industries for 16 APEC economies



Source: Constructed from the CATS schedules.

Frequency measures for the air transport industry for 16 APEC economies



Source: Constructed from the GATS schedule.

Chairman CRANE. Thank you.
Dr. Hilty.

**STATEMENT OF DONALD P. HILTY, SENIOR FELLOW,
ECONOMIC STRATEGY INSTITUTE**

Mr. HILTY. Thank you, Chairman Crane, I will briefly summarize my written comments.

Air transport is a leading global industry. Some people comment that telecommunications is the nerve system of the global economy. If that is true, air transport is the bloodstream. It transports nutrients to the global community, that is, documents, people and goods. It is a very large industry in the United States. The direct output of the airline industry is \$54 billion. That is 1 percent of private sector GDP. It employs 1 million people. It ranks just behind motor vehicles and is ahead of the petroleum and textile industries in size.

U.S. carriers have become the lowest cost operators in the world, mainly because of deregulation in the United States in 1978. The average cost structure of U.S. airlines now is one-fourth the cost of the Japanese airlines, one-half the cost of the Europeans and two-thirds the cost of other Asian airlines. So it is not surprising that U.S. airlines are the number one carrier in the world. They have a 20-percent share of the international air traffic business; this is double the share of second-ranked Britain, which in turn, is double the share of third-ranked Japan.

So airlines have become one of the United States' most competitive international industries. The potential, therefore, is enormous.

In this context, the new round of aviation negotiations between the United States and Japan are very important. As Mr. Murphy mentioned, Asia-Pacific is the fastest-growing market in the world. Forecasters in the industry expect United States-Japan traffic to double in 15 years and the intra-Asian market to triple during that time. One big problem is that Japan is one of the world's great bottlenecks. It is the number two economy in the world and the only practical hub for air service between the United States and the rest of Asia. Yet its major business center, Tokyo, has only one runway for international traffic. The Japanese people have fewer international flights available per million people than any of the developed nations and fewer than most of the developing nations in Asia. Recently, Japan has been giving very bureaucratic interpretation to the bilateral 1952 civil air agreement that the United States has with Japan. So with inefficient carriers but a crucial hub location, Japan is using regulations to protect its airlines by giving them the immense leverage entailed in the control of this key hub.

To assist U.S. negotiators, the Economic Strategy Institute studied the economic impact on overall U.S. welfare of various potential settlements. We studied three main scenarios. The open skies scenario is by far the most favorable. I will not go through the numbers; our results are in my written comments, and I have given copies of our complete report to your staff members. An extension of the 1952 agreement is second best; that is, if all our carriers are allowed to grow with the market, as it is now structured.

Some have suggested that we should trade the ability to fly beyond Japan for more flights between the United States and Japan.

We studied that scenario and it comes out a poor third. One of the fundamentals of beyond air service is that about half of the traffic on Japan-beyond flights is flowthrough traffic on United States-Japan flights. Thus, the loss of two direct Japan-beyond flights causes the loss of one United States-Japan flight. This is a fundamental that argues against any capping of beyond flights or any trading of beyond flights for more United States-Japan frequencies.

So the following strategy for U.S. negotiators is recommended: One, we feel that they should insist on open skies for both cargo and passenger carriers. Two, at a minimum, they should insist that current rights under the 1952 agreement are not subject to negotiation. Three, declare that if Japan restricts fifth freedom rights of U.S. carriers, the United States will restrict Japan's sixth freedom operations. For example, if they will not allow us to fly from the United States to Japan and beyond to Bangkok, we will restrict their Bangkok-Japan-United States flights. And four, seek affirmation of the APEC agreement on free trade in aviation services in the Asia-Pacific area. The Japanese did agree to free trade in the Asian market; further restrictions do not seem to be the way to move toward a freer market.

To conclude, Mr. Chairman, the United States, we feel, has not put air transport services in the appropriate global context or to assign them proper priority. The United States has been the primary moving force in efforts to expand trade in the world. As a result, we have lost many jobs in sectors where other countries had the competitive advantage. We have lost many jobs in consumer electronics, textiles, apparel manufacturing industries. Yet, the United States does not aggressively promote airline services where the United States has a major competitive advantage.

Thank you for this opportunity to present my views.

[The prepared statement follows:]

**STATEMENT OF DONALD P. HILTY
SENIOR FELLOW
ECONOMIC STRATEGY INSTITUTE**

A new round of aviation negotiations is currently underway between the United States and Japan. These talks are extremely important because of the large impact the U.S. airline industry has on the health and growth of the American economy, and because aviation has become one of the United States' most competitive international industries.

I. Importance of the Aviation Industry

The aviation services industry has become so large and so linked to all other industries that it must be considered one of the fundamental industries of any economy. As shown below, its direct output of \$54 billion constitutes about one percent of U.S. GDP and generates one million jobs.

GDP for Selected Industries
In billion dollars

	1993
Food and kindred products	\$106
Motor vehicles and equipment	\$68
Transportation by air	\$54
Petroleum and coal products	\$48
Textile mill products	\$25

Source: U.S. Department of Commerce

Beyond the direct impact of its own spending and employment, the aviation industry also contributes significantly to the creation of earnings and jobs in virtually all major sectors of the U.S. economy. Through the indirect impact of the off-airport activities of passengers and shippers (such as spending at hotels, restaurants, and tourist attractions) and the induced impact of successive rounds of spending, generated on everything from new cars to groceries, by those who receive direct or indirect payments (the so-called multiplier effect), the U.S. aviation industry, according to one estimate, generated nearly six percent of U.S. GDP in 1993, as shown below.

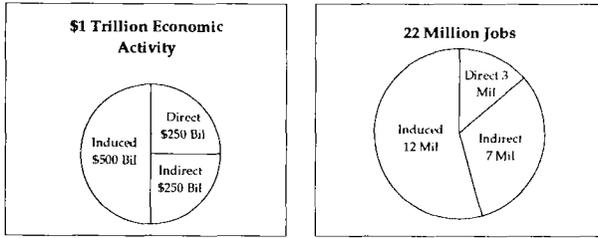
Air Transport Contribution to the U.S. Economy
Summary

	1993
Economic Impact	
Aviation spending, plus ripple effect	\$771 Billion
Earnings of affected industries	\$230 Billion
Employment effect	8.8 Million Jobs
Contribution to GDP	5.9 Percent
Impact on Trade Balance	
Passenger air fares	\$5.3 Billion

Source: Wilbur Smith Associates, U.S. Department of Commerce

On a global basis, the industry generates over \$1 trillion in economic activity and more than 22 million jobs.

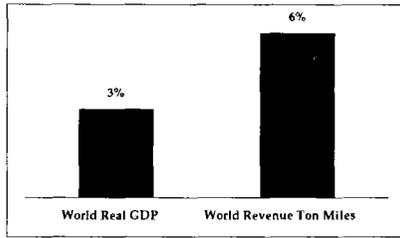
Estimates of Worldwide Air Transport Benefits, 1992



Source: ATAG, IATA

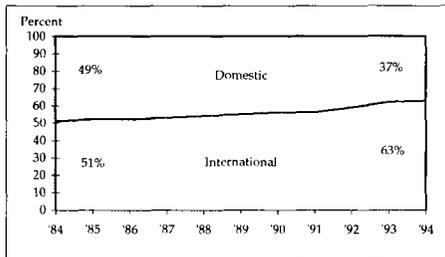
Even more important than the size of the aviation industry is its growth rate and, in particular, the location of most of the growth. As shown below, the volume of passengers and freight carried by the world's airlines has risen at twice the rate of real growth in the world economy over the past ten years and is expected to continue growing at about a six-percent annual rate over the next fifteen years.

**Growth Rate Comparison
Past Ten Years**



Of great significance for the future shape of the industry is the fact that the bulk of the growth has been, and will continue to be, in international skies, particularly the skies over the Asia-Pacific region. In the ten years between 1984 and 1994, world scheduled airline traffic shifted from being about half domestic and half international to being nearly two-thirds international. This trend is expected to continue, largely because of the explosive growth in Asia-Pacific skies (see exhibits below).

World Scheduled Airline Traffic



Source: Ton Miles Performed, ICAO

International Scheduled Passenger Traffic Annual Rates of Growth

	Actual 1985-1993	Estimates	
		1993-2000	2000-2010
Rest-of-World	5%	4%	3%
Asia-Pacific	10	9	7
World Total	7%	6%	5%

Source: IATA

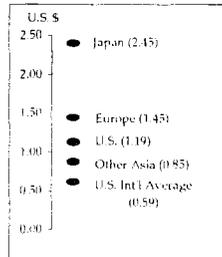
Thus, it seems clear that a strong and growing U.S. airline industry is necessary for the U.S. economy to grow at an acceptable rate in the future, and anything that would hurt the U.S. airline industry would be a major impediment to overall U.S. economic growth.

II. The United States is Competitive

As a result of having a large domestic airline services market, and of having faced the competitive pressures created by airline deregulation, U.S. carriers now enjoy a strong comparative advantage in airline services, as shown in the figure below.

Relative Cost Structures

Average Operating Expenses per Revenue Ton Mile, 1993



Source: ICAO¹

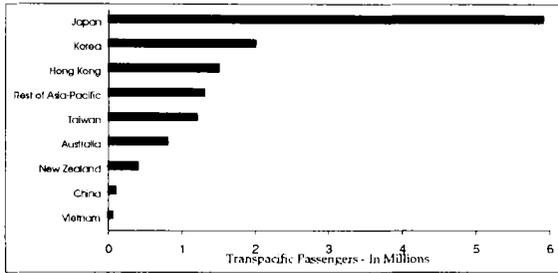
The implications of this superior competitiveness are enormous. When the Japanese consumer-electronics industry gained a similar, competitive superiority it was able to use that advantage to gain absolute dominance of most world markets. Indeed, the U.S. consumer-electronics industry was virtually driven out of business. U.S. airlines are in a position to do the same thing in the world's aviation markets. Aviation service, even under today's restricted conditions, is one of the few industries in which the United States has a trade surplus. Based on U.S. carrier experience in key international markets when restrictions were relatively few, American carriers could easily achieve two-thirds of total market share, with a gain of billions of dollars in airline revenue and profits, as well as thousands of new jobs for U.S. residents.

III. Liberalization Efforts

The U.S. government has been negotiating to liberalize international skies and has, in fact, concluded "open skies" deals with a number of European countries, including, most recently, Germany, Europe's largest economy. Progress in the Pacific has been much slower, largely reflecting Japan's reluctance to liberalize.

As shown below, Japan is by far the largest transpacific air traffic market in the region. This, in addition to its location as the gateway to Asia, make it the only practical hub for aviation service between North America and the Asia-Pacific region.

Transpacific Traffic, 1993



Source: IATA

Just as the hub-and-spoke system of air service has proven to be most efficient domestically, so it is proving to be internationally, and the world's carriers are racing to establish strong footholds at key hubs around the globe. With inefficient carriers, but a crucial hub location, Japan's Ministry of Transportation has used regulation to protect its airlines and has attempted to give them the immense leverage entailed in the control of Asia's key hub. This has led to significant constriction of traffic through Tokyo. While transpacific service has been maintained at a level comparable to that over the Atlantic, intra-Asian load factors and fares are sky high. This constriction, and Japan's manipulation of the agreement, has led to clashes with U.S. carriers and difficult U.S.-Japan negotiations.

Comparison of Retail Air Fares
Between the United States and International Locations

(Lowest advertised fares, first calendar quarter)

		Round-Trip Fares		Nonstop Miles	Fares per Mile		Fares per Mile Index: Tokyo City Pairs = 100	
		1987	1996		1987	1996	1987	1996
Chicago -	Tokyo	\$525	\$550	6,273	\$0.0418	\$0.0438	100	100
	Paris	449	509	4,152	0.0541	0.0613	129	140
	Frankfurt	430	519	4,343	0.0495	0.0598	118	137
	London	439	469	3,953	0.0555	0.0593	133	135
Los Angeles -	Tokyo	\$529	\$530	5,450	\$0.0485	\$0.0486	100	100
	Hong Kong	599	569	7,247	0.0413	0.0393	85	81
	Taipei	599	569	6,799	0.0441	0.0418	91	86
	Frankfurt	469	549	5,805	0.0404	0.0473	83	97
	Paris	459	549	5,668	0.0405	0.0484	84	100
	London	569	499	5,455	0.0522	0.0457	108	94
Seattle -	Tokyo	\$549	\$570	4,768	\$0.0576	\$0.0598	100	100
	Taipei	579	549	6,073	0.0477	0.0452	83	76
	Hong Kong	579	569	6,488	0.0446	0.0439	77	73
	London	469	499	4,799	0.0489	0.0520	85	87

Source: 1987 fares: American Airlines Exhibit AA-R-235-237, U.S. DOT Docket 44380, Seattle/Portland-Japan Service Review Case

1996 fares: Haywood Travel, Hayward, California

**Comparison of Retail Air Fares
Between Japan and the United States
and Japan and Beyond Locations**

(Lowest advertised fares, March 1996)

	Round-Trip Fare	Nonstop Miles	Fares Per Mile	Index: Tokyo-Seattle=100
Japan-U.S.				
Tokyo- Chicago	\$550	6,273	\$0.0438	73
Los Angeles	530	5,450	0.0486	81
Seattle	570	4,768	0.0598	100
Japan-Beyond				
Tokyo- Bangkok	\$800	2,886	\$0.1386	232
Hong Kong	700	1,826	0.1917	321

Source: Hayward Travel, Hayward California

**Load Factor Comparison
Atlantic versus Pacific Operations**

	Atlantic	Pacific	Memo: Atlantic vs. Pacific
	(In Percent)		(Percentage Points)
Northwest	78%	72%	+6
United	77	74	+3
American	74	72	+2
Delta	73	67	+6
USAir	70	-	na
Continental	67	67	0
TWA	66	-	na
Industry	73%	72%	+1

Source: BACK Associates

Current operating authority in the U.S.-Japan market is governed by the U.S.-Japan Civil Air Services Agreement of 1952, and by numerous memorandums, consultations, minutes, and amendments negotiated since that time. These permit the designated, so-called "1952 carriers" to provide service from the United States to-and-from Tokyo, Osaka, Okinawa, and beyond, and permit the so-called "MOU carriers" to fly to-and-from Japan, but with more frequency, capacity and gateway limitations, and with no beyond rights. All traffic moves within this governing framework, which over the years has become increasingly ambiguous and subject to the whim of bureaucratic interpretation. Disputes have multiplied and risen in intensity.

IV. Scenarios

To assist U.S. negotiators, the Economic Strategy Institute projected total U.S. carrier revenues, as well as the impact of the Asia-Pacific operations of U.S. carriers on U.S. trade receipts, frequency and cost of aviation service, and total

spending and total employment in the United States, for several scenarios that, in one form or another, are being considered in the negotiating process. These scenarios are (a) completely open skies, in which all airlines are free to establish whatever frequencies, routes, and prices they wish, in response to market forces; (b) an extension of the 1952 Agreement; (c) a capped beyond rights scenario in which the 1952 Carriers continue to fly the same number of beyond flights as they do now, and MOU frequencies to and from Japan are increased; and (d) a capped beyond rights scenario in which substantial attrition of current beyond flights is assumed.

Summary Impact of the Scenarios: All U.S. Carriers
In 1995 Dollars

Scenarios	Impact in the United States			
	Revenue of U.S. Carriers (\$ Bil)	Economic Activity (\$ Bil)	Employment (Thous)	U.S. Trade Receipts (\$ Bil)
TOTAL IMPACT				
Impact in 1995	\$8.3	\$29.3	647	\$7.6
Impact in 2010				
Open Skies	\$21.0	\$97.8	2,150	\$18.4
1952 Extension	19.8	68.3	1,502	17.4
Capped Beyonds	16.6	64.4	1,391	14.6
Capped Beyonds with Attrition	14.6	59.8	1,289	12.3
DIFFERENCE FROM 1952 EXTENSION				
Impact in 2010				
Open Skies	\$1.2	\$29.5	648	\$1.0
Capped Beyonds	-3.2	-3.9	-111	-2.9
Capped Beyonds with Attrition	-5.4	-8.5	-213	-5.1

Summary Impact of the Scenarios: Passenger Carriers
In 1995 Dollars

Scenarios	Impact in the United States			
	Revenue of U.S. Carriers (\$ Bil)	Economic Activity (\$ Bil)	Employment (Thous)	U.S. Trade Receipts (\$ Bil)
TOTAL IMPACT				
Impact in 1995	\$7.4	\$27.3	602	\$6.8
Impact in 2010				
Open Skies	\$17.7	\$90.0	1,980	\$15.5
1952 Extension	17.0	62.2	1,369	14.9
Capped Beyonds	14.9	59.8	1,291	13.0
Capped Beyonds with Attrition	13.1	55.8	1,201	11.2
DIFFERENCE FROM 1952 EXTENSION				
Impact in 2010				
Open Skies	\$0.7	\$27.8	611	\$0.6
Capped Beyonds	-2.1	-2.4	-78	-1.9
Capped Beyonds with Attrition	-3.9	-6.4	-168	-3.7

Summary Impact of the Scenarios: All-Cargo Carriers
In 1995 Dollars

Scenarios	Impact in the United States			
	Revenue of U.S. Carriers (\$ Bil)	Economic Activity (\$ Bil)	Employment (Thous)	U.S. Trade Receipts (\$ Bil)
TOTAL IMPACT				
Impact in 1995	\$0.9	\$2.0	45	\$0.8
Impact in 2010				
Open Skies	53.3	\$7.8	170	\$2.9
1952 Extension	2.8	6.1	133	2.5
Capped Beyonds	1.7	4.6	100	1.5
Capped Beyonds with Attrition	1.3	4.0	88	1.1
DIFFERENCE FROM 1952 EXTENSION				
Impact in 2010				
Open Skies	\$0.5	\$1.7	37	\$0.4
Capped Beyonds	-1.1	-1.5	-33	-1.0
Capped Beyonds with Attrition	-1.5	-2.1	-45	-1.4

Summary Impact of the Scenarios: Flight Availability

	B747-400 Equivalents				Implied Actual			
	U.S.-Japan	Direct	Code-Share	U.S.- Other Asia	U.S.-Japan	Direct	Code-Share	U.S.- Other Asia
1952 Carriers								
Available in 1995	169	80	-	62	217	103	-	62
Available in 2010								
Open Skies	473	312	-	298	609	398	-	298
1952 Extension	326	216	-	206	419	275	-	206
Capped Beyonds	228	80	-	206	299	102	-	206
Capped Beyonds with Attrition	212	8	-	206	279	10	-	206
MOU Carriers								
Available in 1995	78	-	-	14	126	-	-	27
Available in 2010								
Open Skies	224	-	-	67	363	-	-	129
1952 Extension	156	-	-	46	252	-	-	89
Capped Beyonds	211	-	136	46	333	-	173	89
Capped Beyonds with Attrition	172	-	104	46	290	-	132	89
Total All U.S. Carriers								
Available in 1995	247	80	-	76	343	102	-	89
Available in 2010								
Open Skies	697	312	-	365	972	398	-	427
1952 Extension	482	216	-	252	671	275	-	295
Capped Beyonds	439	80	136	252	632	102	173	295
Capped Beyonds with Attrition	394	8	104	252	569	10	132	295

As the summary charts make clear, this analysis indicates that the open-skies scenario is by far the most favorable for the United States, on all measures of performance. Such a conclusion is not surprising, because an open-skies arrangement would enable U.S. carriers fully to exploit their competitive strength in both the U.S.-Japan market and the beyond-Japan market.

The analysis indicates that extension of the 1952 Agreement is the second-best scenario. By maintaining market share across the board, it allows all U.S. carriers to benefit from the rapid growth in Asia-Pacific air traffic while keeping a U.S. carrier presence in all segments of the market. Although it does not add additional U.S. gateways, this scenario actually provides more U.S.-Japan frequencies than all except the Open Skies Scenario.

Surprisingly, the best case of the Capped Beyonds Plus More MOU Frequencies Scenario, comes in only third best. This is striking because the assumptions are unrealistically favorable for the Capped Beyonds Case. For example, it is most unlikely that any U.S.-Japan agreement would result in eight new U.S. gateway cities. It is also extremely unlikely that the 1952 Carriers would be able to maintain current levels of beyond service in a market in which they were rapidly losing share. Nor is it probable that the Japanese will code-share as many of their own flights in the beyond markets as were lost by the 1952 Carriers under this scenario.

There are several reasons, however, why the best capped beyonds scenario would not result in a net gain for the United States.

- First, capping beyond-rights for the 1952 carriers not only would cause their loss of participation in the explosive growth of the intra-Asian market, but, because almost one-half of beyond passengers and cargo travel to and from the United States, would also cause a reduction in their U.S.-Japan service. Furthermore, by sacrificing fifth freedom rights, American carriers would be prevented from establishing networks in the Asia-Pacific market, while unimpeded carriers would be free to build strategic route structures.
- Second, future direct service to Japan from even eight new U.S. cities would generate 15 percent net new traffic from these cities, but this is a relatively small increment for the U.S. system as a whole after substitution is taken into account. This gain is not enough to offset the impact, on the U.S. airline industry and the U.S. economy, of the loss of beyond-Japan traffic.
- Third, while code sharing arrangements may prevent some leakage of beyond passengers from U.S. carriers on the U.S.-Japan leg of their journey, this, too, will offset only a small portion of the 1952 carriers' losses.

That Japan is attempting to constrain U.S. beyond flights is easily understandable. A cap on U.S. rights would transfer more than 200 weekly high-fare, intra-Asia flights from U.S. to Japanese airlines over the next several years and, at the same time, divert a large number of beyond passengers from U.S. to Japanese carriers in the U.S.-Japan leg of their flights. This would be good for the Japanese carriers, but it would not be good for the United States. Ironically, it would not be good for Japan either, because it leaves Japan with less service, higher fares, and lower economic growth.

Capping the current beyond rights for U.S. all-cargo and express-package carriers would also result in a sizable revenue loss, amounting to \$1.1 to \$1.5 billion, in 1995 prices, in the year 2010. This would translate into a \$1.5 to \$2.1 billion loss of total spending in the United States in 2010. Furthermore, it would jeopardize the very existence of the express-cargo business, an industry first developed in the United States and not existing anywhere else in its current form.

Recent U.S. aviation policy has been marked by some serious shortcomings. The United States has simply failed to put airline services in their appropriate global context, or to assign them sufficient priority. Over the last five decades the United States has been the primary moving force behind global efforts to expand trade and commerce, and the United States has lost hundreds of thousands of jobs in sectors where other countries had the comparative advantage, such as the textile-and-apparel industry. Yet, in airline services, a sector where the United States has a major competitive advantage, U.S. negotiators have pursued U.S. interests in a less than aggressive manner.

Above all else, the situation calls for a significant change in mindset and priorities. The United States should be aggressive about seeking free trade in airline services, even if that means ruffling the feathers of trading partners.

The Economic Strategy Institute therefore recommends the following strategy for U.S. negotiators:

Recommendation 1: Insist on open skies for both cargo and passenger carriers. A transitional arrangement like those with Canada and Germany should be possible.

As noted earlier, U.S. carriers now enjoy a strong comparative advantage in airline services as a result of having a large domestic airline-services market and having faced the competitive pressures created by airline deregulation.¹ Two other sectors where the United States enjoys a substantial comparative advantage -- agriculture and intellectual property -- have been made priorities of the U.S. government in international trade negotiations. It was sensible to do so. Similarly, it is also sensible to make open skies for the U.S. airline industry a top priority in U.S. trade negotiations. If necessary, the United States can make transitional arrangements, as it did in the case of Canada and Germany, but there should be an agreement on open skies by a time certain.

Recommendation 2: At a minimum, insist that the access and expansion of third, fourth, and fifth freedom rights for both cargo and passenger operations be guaranteed as set forth in the 1952 Agreement and that additional frequencies, gateways, and code-share opportunities be added for both 1952 and MOU Carriers, including All Nippon Airways and Nippon Cargo Airlines.

The United States must make it clear that current rights under the 1952 Agreement are not subject to negotiation. It is important that an agenda be established prior to any negotiations, making clear what is to be discussed and what is off the table. At the same time, it is entirely understandable that the MOU Carriers are anxious to play a larger role in the market and it is imperative that they do so. The United States cannot fully capitalize on its competitiveness in aviation without obtaining greater access for its airlines. Trading beyond rights to gain increased access for MOU Carriers is not in the interest of the United States, but there is no reason why additional access for MOU Carriers cannot be negotiated.

There is no good, economic rationale for the United States to agree with Japan's MOT and accept the position that the only way to add new services is to trade beyond-rights. When the United States seeks market access for semiconductors or auto parts in Japan, it does not do so by offering to give away its market access in grain. Why shouldn't the United States act in aviation precisely as it does in other areas and demand open markets without some *quid pro quo*?

Recommendation 3: U.S. officials should make it clear that Japan's sixth freedom operations to the United States will be restricted if the Japanese MOT attempts to restrict the fifth freedom rights of U.S. carriers.

¹ See also Clyde V. Prestowitz, Jr., Scott C. Gibson, Paul Willen, and Saul Goldstein, *The Future of the Airline Industry* (Washington, D.C.: Economic Strategy Institute, 1993).

In the event of restrictions on U.S. beyond rights, the United States, of course, would also have to study the U.S.-bound operations of other Asian carriers who might cooperate with MOT's protectionist schemes.

Recommendation 4. The United States should seek clear reaffirmation of the APEC (Asia Pacific Economic Cooperation Forum) agreement with regard to achieving free trade in aviation services in Asia-Pacific skies and should add no new restrictions on aviation services.

Chairman CRANE. Thank you. I have a question I would like to direct it to Mr. Murphy and to you in this regard. Are there any carrier rights that the United States should be offering in exchange for expanded opportunities to fly cargo in and passengers in to Tokyo that could then go on to different Asian destinations?

Mr. Murphy, you might respond first.

Mr. MURPHY. Frankly, we think there are huge opportunities here for carriers of both sides. We have the fastest growing market in the world. By 2010, our international trade association predicts that the Asia-Pacific region will represent over 50 percent of the world's scheduled passengers flowing in this marketplace. The Japanese essentially have two carriers in this marketplace; the United States has two carriers that have network opportunities in the Pacific. There is plenty of traffic in this marketplace for everybody.

Our biggest challenge in the coming years is probably going to be supplying enough capacity to meet the demand. And yet, in spite of that, we have this continued resistance from the Japanese to opening up these markets, and that is primarily because the Japanese carriers, much like the French carriers, have failed to get their costs under control and are not competitive. If Japanese costs were under control, the opportunity for expansion of opportunities for both sides would be there, and we could do very well in this market.

Chairman CRANE. Dr. Hilty.

Mr. HILTY. Yes; I agree. Fares in the rest of the world and especially in Japan are running about 28 percent higher than the deregulated domestic fares in the United States. If we had open skies, we think the rates would drop about 28 percent; traffic would blossom. There is plenty of room for the growth of Japanese airlines and U.S. airlines.

Chairman CRANE. Very good.

Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman. Mr. Chairman, I would like to direct this question if I may, please, to Mr. Murphy.

Mr. Murphy, I have heard from a number of industry analysts that there is a group, an industry group, which in an effort to increase access to Japan is willing to surrender the rights of American companies to operate connecting hubs in Japan to serve United States-Asia passengers. To the best of your knowledge, is this accurate?

Mr. MURPHY. There is a group that has been formed by essentially two carriers, American and Delta, and they put together a coalition of a number of civic parties essentially from their hub cities, and they advocated initially surrendering U.S. rights to fly beyond Japan in return for getting more rights to Japan. In other words, in our terms, they advocated surrendering Asia to get access to Japan. And frankly, I think those proposals have met with such resistance that I think they have largely now moved away from those proposals. I think that the next step, though, that they have to do is to recognize that it is not the U.S. Government that is the problem in this area. The U.S. Government is the leading advocate of open skies and free trade in this area. If we need to lobby anybody or convince anybody, it is the Japanese bureaucracy, not the U.S. bureaucrats.

Mr. RAMSTAD. Just a followup question: What would be the effect of losing these rights for passengers to Asia or for U.S. exporters who rely on the Asian market and for U.S. carriers as well?

Mr. MURPHY. That is a very good question, because I think people tend to lose sight of the fact that when we talk about these things, we talk about them in terms of carrier rights. But a beyond right for a United Airlines is also a beyond right for the city from which we operate. And if we lose access beyond Japan to the rest of Asia, so do the cities from which we operate. So we had Booz, Allen & Hamilton last fall do an analysis of what it would cost the U.S. economy over the next 20 years if we were to lose beyond rights. The result was a \$100 billion loss for the U.S. economy, most of which would transfer to the Japanese economy.

Mr. RAMSTAD. Just a final question, Mr. Murphy. In terms of the almost \$5 billion trade surplus that air transportation currently generates with Japan, how deleterious would it be on that surplus?

Mr. MURPHY. We also looked at that issue. In 20 years, it would virtually eliminate that surplus. And this is, I think, the second-largest surplus area that we have in our trade with Japan.

Mr. RAMSTAD. It is indeed. Thank you very much. That is very helpful, Mr. Murphy.

Thank you, Mr. Chairman. I yield back.

Chairman CRANE. Let me again apologize to all of the panelists for the interruptions and the delays. This has been a long and trying day I am sure for you folks, too. And we appreciate your input profoundly, and all of your written statements will be made a part of the permanent record.

With that, the Subcommittee stands adjourned.

[Whereupon, at 6:48 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

**STATEMENT OF ROBERT F. KELLEY
AND CHARLES P. HEETER, JR.
ANDERSEN WORLDWIDE**

As partners of Andersen Worldwide, which is the coordinating entity for Arthur Andersen and Andersen Consulting member firms around the world, we appreciate very much the opportunity to submit a statement to the Subcommittee as it begins its oversight hearings on the World Trade Organization (WTO) and implementation of the Uruguay Round agreements. Our Firm believes that the Uruguay Round was a great success and that continued work on professional services in the WTO will provide even further benefits.

Andersen Worldwide

Andersen Worldwide is the world's largest professional services firm, employing 82,000 persons in more than 360 offices in 76 countries. The Arthur Andersen business unit provides accounting, audit, tax, business advisory, and specialty consulting services to clients. The Andersen Consulting business unit provides global management and technology consulting services.

Last year our revenue topped the \$8.0 billion mark, a doubling in the last five years, and we expect similar strong results in the next five years. Our growth is in part attributable to our increased involvement in markets overseas, with roughly half of our revenue now coming from outside the United States. Continued liberalization of trade and investment in professional services is vitally important to our continued success, and an effective WTO is vital to that continued liberalization.

In fact, for a worldwide professional services firm such as ours there is no efficient alternative to an effective, rules-based global trading system. Our organization transfers capital, personnel, data, and technology not only between the U.S. and other countries, but also between many nations outside the U.S. Bilateral and multilateral free trade initiatives, while positive and useful, can never adequately replace a well-functioning multilateral system. In short, for our firm, the World Trade Organization has been and continues to be the best forum for securing further liberalization of trade and investment in the services we provide.

Our commitment to the multilateral process is nothing new. We have been involved since the launch of the Uruguay Round a decade ago. In 1985, we completed the first survey and analysis of government impediments affecting the operations of international accounting and consulting organizations. This information was updated in 1990.

Both the 1985 and 1990 results were shared with government negotiators. Based on this information, we provided detailed comments to U.S. and other countries' negotiators during their work on the draft services framework and initial commitments. Andersen Worldwide partners in over twenty of our largest markets contacted their governments to push for liberalization in our sectors.

We believe our active involvement had an important impact on the successful conclusion of the Uruguay Round. Also important to our effort was the openness and professionalism of the officials with which we worked in the U.S. Trade Representative's office. They are to be commended.

The Uruguay Round Agreements

Andersen Worldwide had two main goals that guided our work during the Uruguay Round:

1. to eliminate unnecessary government impediments to marshaling the financial resources, professional talent and technology of our global organization in order to serve the needs of clients anywhere in the world; and
2. to advance the globalization of professional services - through the international recognition of qualifications and the use of International Accounting Standards - to better serve the modern global marketplace.

When we measure the Uruguay Round agreements against these criteria, we find great strides have been made, and a mechanism has been created to complete the job.

Removing Impediments to Our Worldwide Operations

There are three principal types of impediments to our international operations:

1. restrictions on payments and financial transfers affecting inter-firm arrangements, the collection of fees in cross-border transactions, and investments in new operations;
2. restrictions on the movement of professional, managerial and technical personnel for short- and long-term assignment in other countries; and
3. problems affecting our intellectual capital, including inadequate protection against piracy of software, training materials and publications, as well as restrictions on transborder data flows and telecommunications.

These issues are addressed in the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), the two most significant new agreements to come out of the Uruguay Round.

The GATS sets out a series of rules to discipline government intervention in international trade and investment transactions affecting service industries and professions. The broad intent of these rules is twofold: to ensure that foreign service firms or firms with international affiliations enjoy the same privileges as domestic competitors with respect to government regulation (national treatment) and to remove obstacles to trade and investment in services (market access).

For the most part, these rules apply only if individual countries commit to apply them to specific service industries as indicated in schedules attached to the agreement. More than 62 countries, constituting more than 90 percent of Arthur Andersen's global market, have agreed to apply the rules to accounting, audit and tax services. More than 60 countries - more than 95 percent of Andersen Consulting's global market - have agreed to apply them to information systems, management consulting and software development. This scheduling is important even for countries where we do not face problems or where our practices are not heavily regulated because it prevents governments from imposing new restrictions.

The TRIPS agreement sets minimum standards of legal protection for intellectual property and provides for enforcement through domestic and international procedures. All 117 countries participating in the negotiations agreed to abide by the TRIPS rules, although some receive an extended grace period for implementing their obligations. In addition, any other nations seeking to join WTO must accept these rules.

Payments and Transfers: Article XI of the new services agreement prohibits countries from applying restrictions to payments and transfers in sectors covered by their schedules of commitments. This prohibition applies to all current transactions as defined by the International Monetary Fund (IMF), including virtually every type of payment made by our worldwide organization.

The one exception to this rule is in cases where a country is authorized by the IMF to impose restrictions to safeguard its balance of payments against serious difficulty. However, stricter rules and international surveillance now apply to balance-of-payments measures to prevent their abuse.

Movement of Personnel: The services agreement addresses the issue of restrictions on the transfer of managerial, professional and technical personnel, but not as clearly as it speaks to the problem of payments and transfers. Once again, the freedom to move personnel is related to the commitments a country makes in its schedule.

For the most part, these commitments permit the free movement of "intra-company transferees," marketing personnel or business visitors in sectors covered by the schedule. Governments may employ measures necessary to protect the integrity of their immigration laws and their borders, however, only if these measures do not negate the commitment they have made to national treatment and market access.

The agreement provided for negotiations to further liberalize movement of personnel, but these talks proved disappointing. This is an area of unfinished business left over from the Uruguay Round that must be addressed. The U.S. and other nations must recommit themselves to reaching agreement on additional liberalization, and need not wait for a new overarching "Round" of talks.

Protection of Intellectual Property: The TRIPS agreement requires all GATT member countries to recognize computer programs and software as literary works and databases as compilations protected by copyright. The agreement provides two levels of protection against infringement and piracy. First, countries must give full protection in domestic law as prescribed by the Berne Convention. They must put into place enforcement measures against infringement, deterrents to infringement, and criminal penalties for willful piracy.

Second, the agreement allows foreigners to challenge ineffective domestic protection through GATT dispute settlement procedures, and reforms the dispute settlement process to assure resolution of complaints in a 12 to 18-month period, including all appeals. Developing countries are permitted a five-year transition to full implementation of the rules. The recent

decision of Japan to lengthen its copyright protection for recorded music to the WTO standard is evidence that the TRIPS agreement is bearing early fruit.

In sum, the Uruguay Round agreements make substantial progress on each of the three types of impediments faced by our firm.

Advancing the Globalization of Professional Services

Although accountancy is probably the most international of the professions, true globalization has been impeded by the lack of accepted international standards and of cross-border recognition of national qualifications and credentials. Our Firm has been a leader in addressing these issues through the International Accounting Standards Committee (IASC) and work at the regional level through support for the European Union's (EU) mutual recognition directive and the North American Free Trade Agreement's (NAFTA) professional services provisions. We are pursuing further opportunities in the Asia Pacific Economic Cooperation (APEC) forum and the Free Trade Area of the Americas (FTAA) talks.

Consulting has not traveled the same road to internationalization as accounting, but some governments already set standards and qualifications for consultants and there are indications that other countries wish to follow that course.

The GATS agreement provides an opportunity to address the problem of regulation and the issue of international standards in a truly global initiative with the participation of all WTO member countries. First, Articles VI and VII establish certain standards in the areas of domestic regulation and recognition of qualifications and standards. And second, a separate ministerial-level "Decision on Professional Services" is designed to ensure that those principles will be applied specifically to the professions.

Domestic Regulation and Recognition: The services agreement contains important new principles on domestic regulation and recognition of qualifications. Article VI on domestic regulation contains three relevant features:

1. governments shall apply regulations to service industries in a reasonable, objective and impartial manner so that they do not act as arbitrary barriers to trade;
2. qualifications requirements and procedures, technical standards and licensing requirements in the professions shall be based on objective and transparent criteria and not be more burdensome than necessary to ensure the quality of the service; international standards shall be taken into account in determining compliance with these principles; and
3. all countries must have adequate procedures to verify the qualifications of professionals from other countries.

Likewise, Article VII on recognition of qualifications and standards has three relevant features:

1. countries may choose their own approach to recognizing qualifications and standards, through unilateral recognition, bilateral reciprocal arrangements or international harmonization;
2. whatever approach is chosen must be applied in a consistent, objective and fair manner to all other countries seeking recognition of their professionals; and
3. countries shall cooperate with intergovernmental and non-governmental international organizations towards the establishment and adoption of common international qualifications and standards of practice.

Decision on Professional Services: A separate decision establishes a Working Party on Professional Services (WPPS) to carry out Articles VI and VII with respect to the professions and assigns the first priority to accountancy. In conducting its program, the working party must involve the profession's international organizations and respect the role of self-regulation where this is the norm.

The decision identifies three specific objectives in accounting:

1. to encourage the use of international standards in the accounting profession through cooperation with international professional organizations such as the IASC and the International Federation of Accountants (IFAC);
2. to establish guidelines for the reciprocal recognition of accounting qualifications across borders; and
3. to make sure that domestic regulation of the accounting profession serves legitimate public policy objectives, while not acting as an unnecessary barrier to trade and investment.

The mandate of the WPPS, however, extends beyond accounting to other professions. It is anticipated that once concrete progress has been made on accountancy, the working party will begin work on another profession -- perhaps engineering, consultancy, architectural or legal services.

Continued Work in the WTO

While professional services fared quite well in the Uruguay Round, the work is not complete. The Working Party on Professional Services is the primary forum for the continue effort, but liberalization in accountancy, consultancy and other services should be advanced wherever possible.

Working Party on Professional Services

The WPPS meets next week for the fourth time. The chair is Ambassador Leonora Saurel of El Salvador, a dynamic and highly respected figure in Geneva. She has asked participating governments to make suggestions for priorities within the Working Party's mandate, and for proposals for achieving success in those priorities.

While the United States and some other parties have been active in pursuing the WPPS's goals, the participation of other nations has lagged. It is crucial to the credibility and effectiveness of the Working Party that its efforts on accountancy not fall by the wayside. For this reason, we are calling for significant steps to be taken on professional services in anticipation of the WTO Ministerial Meeting to take place in December 1996 in Singapore. This "Action Program" – which we have shared with the U.S. Trade Representative's office – contemplates movement on several fronts.

Continuing Liberalization of Trade in Accountancy Services

All WTO members that have not yet scheduled the accountancy sector (accounting, auditing, bookkeeping, at a minimum) under the GATS should agree to do so at Singapore. The content of the scheduling should be the *status quo* or better. This would be a significant sign of confidence in the WTO/GATS and of support for the liberalization of professional services.

All WTO members that require citizenship as a condition for an individual to obtain professional qualification or licensing within their jurisdictions should agree to eliminate this requirement at Singapore. This is a small but highly symbolic initiative in support of liberalization of professional services.

Initial Conclusions of the Working Party on Professional Services

With respect to arrangements for the mutual recognition of qualifications between WTO members, the Working Party on Professional Services should complete work on disciplines for uniform, open, transparent and objective procedures for the negotiation of such arrangements. These disciplines should be endorsed by Ministers at Singapore.

With respect to residency requirements for individual professionals and professional firms, the WPPS should complete work on disciplines to end such requirements that are more burdensome than necessary to achieve legitimate policy objectives. These disciplines also should be endorsed by Ministers at Singapore.

With respect to requirements that owners of professional firms must be locally licensed professionals, the WPPS should complete work on disciplines that would open ownership to foreigners in a way which would still protect professional objectivity and independence. Again, these disciplines should be endorsed by Ministers at Singapore.

With respect to encouraging the development and use of international standards, the WPPS should develop disciplines on appropriate procedures and due process in professional standards setting at the international level. These disciplines should be endorsed by Ministers at Singapore.

Finally, Ministers should agree at Singapore that the Working Party on Professional Services will complete work on accountancy, including recommendations on international standards, no later than December 1997. If concrete first steps on accountancy are made in Singapore, work on other professions should begin, using the progress made in accountancy as a model.

Any support that the Subcommittee could provide for our Action Program or that otherwise reinforces and spurs the efforts of the Working Party could be of great value in achieving a successful completion of the WPPS agenda.

Conclusion

We have been a consistent advocate of freer trade across the board, because expanded trade is in our enlightened self-interest. The Uruguay Round trade package will encourage world economic growth, which will be good for our clients and increase the demand for our services. And, as we have outlined, the agreements contain numerous provisions liberalizing trade and investment in professional services, creating new opportunities to provide our services. In addition to the services and intellectual property agreements, the package includes tariff cuts on thousands of industrial and agricultural products, a reduction of trade-distorting agricultural subsidies, liberalization of non-tariff barriers such as textile and apparel quotas, and significant institutional reforms to back up the new rules.

That having been said, much work remains to ensure that professional services may enjoy the full range of benefits promised by the Uruguay Round, and we urge your support for this work. Our firm will continue to be intimately involved in the process, and we stand ready to offer assistance to Congress, the Administration, and all other parties interested in promoting liberalization in trade and investment in professional services.

STATEMENT OF MR. RALPH J. GERSON
 PRESIDENT AND CEO, GUARDIAN INTERNATIONAL CORP.
 before the
 Subcommittee on Trade
 Committee on Ways and Means
 United States House of Representatives
 March 28, 1996

**IMPLEMENTATION OF THE U.S.-JAPAN
 AGREEMENT ON FLAT GLASS**

Introduction and Summary

I am Ralph J. Gerson, President and Chief Executive Officer of Guardian International Corp., of Auburn Hills, Michigan. Over the past three decades, Guardian International and its parent company, Guardian Industries Corp., have built a worldwide network for flat glass manufacturing, distribution, and sales. Today, we manufacture flat glass products in 14 plants in eight countries in North and South America (the United States, Canada, and Venezuela), Europe (Luxembourg, Spain and Hungary), and Asia (Thailand and India). Five additional production facilities are currently under construction, one each in the United States, Germany, Brazil, Saudi Arabia and Thailand. Operations in several other countries are planned over the next five years. Guardian also has built highly successful sales and distribution operations in more than 80 countries.

Guardian has strongly supported an active U.S. government role in opening Japan's market for flat glass. After years of effort, we had concluded that official help was required to change the closed, cartel-like structure of that market. For that reason, we were extremely pleased in December 1994 when Ambassador Kantor announced that agreement had been reached on steps to open the flat glass market. Based on experience during the first year of the agreement, conditions have begun to change, but much more progress must be made for Japan to enjoy an open and competitive glass market. Imports have increased significantly in percentage terms, but import levels remain unusually low in absolute terms. Moreover, there are indications that we are starting to reach the limits of the willingness of Japanese distributors to handle foreign glass products.

Officials of the U.S. and Japanese governments will meet in Tokyo on April 22nd and 23rd for the first annual review of the flat glass agreement. Prior to that meeting, President Clinton will be traveling to Tokyo. It is essential that President Clinton and other U.S. officials make it clear to their Japanese counterparts that continued efforts to implement the flat glass agreement are important to the bilateral trade relationship.

The remainder of my statement reviews the efforts that led to the agreement on flat glass, the principal terms of the agreement, implementation to date, and the efforts of the U.S. private sector.

Initial Efforts in Japan

During the late 1980's, Guardian concluded that, for two key reasons, it was vital to our global competitiveness to become a significant player in the Japanese market. First, the \$4.5 billion Japanese market was the second largest country market in the world. Second, our Japanese competitors, whom we faced in virtually every market around the world, were financing their worldwide expansion with excess profits earned in the high-priced Japanese market.

Our initial market-entry strategy in Japan was one that had been successful throughout North America, Europe, and Asia. We set out to win customers by providing high-quality glass

products at very competitive prices. Throughout the world, Guardian has been able to offer competitive prices that are made possible in part through production efficiencies and in part through shortening and simplifying the distribution chain.

From the outset, Guardian met a stone wall in Japan. With very minor exceptions, neither glass distributors nor glass fabricators would handle our products, even though we were able to provide prices at least 30% to 50% below domestic prices. On the surface, two reasons were most frequently given for our lack of success: low quality and slow delivery time. Both reasons were demonstrably bogus. Our glass was the same product that competed successfully with Japanese glass in the U.S., Europe, and other markets around the world. Moreover, we kept our delivery time short by developing a network of warehouses in the major Japanese cities. We soon discovered the real problem: the Japanese flat glass market was a cartel, tightly controlled by the three domestic manufacturers -- Asahi Glass Company, Ltd., Nippon Sheet Glass, and Central Glass Company. Since the 1950's, these three companies had maintained fixed market shares in a 5/3/2 ratio. Each maintained an exclusive network of distributors and each had extensive ties throughout the construction sector due to keiretsu relationships. Any distributors tempted to purchase imported glass were threatened with the cutoff of supply from their domestic sources. In all other markets in developed countries, glass distributors are free to handle the products of any manufacturer. In Japan, not only are distributors blocked from the purchase of glass from foreign producers, but there is no competition between Japanese producers, as distributors are exclusive to each producer.

U.S. Government Support

Faced with enormous barriers to entry, Guardian turned to the U.S. Government for help. In the 1992 Bush-Miyazawa Action Plan, the Japanese government acknowledged the problem in the flat glass sector, and undertook to "substantially increase market access for competitive foreign firms." Unfortunately, there was little follow-up to the Action Plan, and the Japanese Government failed to implement key elements of the agreement.

In June 1993, the Japan Fair Trade Commission (JFTC) released a survey of the Japanese flat glass market. The survey is remarkable in two respects. First, it confirmed in great detail the anticompetitive practices prevalent in the flat glass sector. Second, in the face of substantial documentation of these practices, it concluded that there is no evidence of violation of law. It was clear that outside pressure was critical if attitudes in Japan were to change.

In July 1993, the Clinton Administration renewed pressure on the Japanese Government to open the flat glass market. At U.S. insistence, the flat glass sector was included in the so-called "compliance basket" in the Clinton-Hosokawa Agreement on Framework Negotiations. That triggered 18-months of negotiations that culminated in the U.S.-Japan Agreement on Flat Glass, which was signed on January 25, 1995.

The U.S.-Japan Agreement on Flat Glass

The U.S.-Japan Agreement on Flat Glass is unusual because it was negotiated during a period of confrontation in U.S.-Japanese trade relations. The most divisive issue at the time concerned autos and auto parts. Because of failures to implement past agreements, the Clinton Administration insisted on obtaining measurable indicators of success in new agreements. In turn, the Japanese Government accused the U.S. of favoring managed trade and vowed to resist any steps in that direction. In the flat glass agreement, both sides managed to preserve their core positions while incorporating terms strong enough to reassure the U.S. flat glass industry that genuine market-opening could result from the agreement.

Through the extraordinary efforts of Ambassador Mickey Kantor and his dedicated team, an agreement was reached in December 1994 setting out responsibilities for all involved. For their part, the Japanese glass manufacturers and distributors released voluntary public statements recognizing the need for open and non-discriminatory procurement in the flat glass sector, and acknowledging that distributors are free to purchase from any supplier, including foreign flat

glass manufacturers. In turn, the Government of Japan praised the industry statements and undertook to:

- Brief the domestic industry on the contents of the agreement and facilitate contacts between the U.S. and Japanese industries;
- Promote wider use of specialty glass for safety and energy conservation purposes;
- Promote increased competition in large-scale construction projects, both public and private;
- Support steps by Japanese glass distributors to diversify their sources of supply; and
- Conduct an annual survey of the industry to assess implementation of the measures.

Finally, the U.S. government agreed to ensure that U.S. manufacturers are appropriately working to take advantage of the openings created by the agreement.

The key to the agreement, in our view, is the Japanese government's commitment to conduct an annual survey to collect clearly defined sets of data. In addition to data on imports by country, the surveys will generate data on:

- The extent to which Japanese distributors and glaziers begin using market forces to determine their glass suppliers, which should lead to substantial quantities of imported glass;
- Perceived material differences between foreign and domestic glass;
- Sales activities by foreign-owned glass firms; and
- Participation by foreign-owned firms in publicly financed large-scale construction projects.

The agreement spells out the objective criteria -- both qualitative and quantitative -- to be used in assessing implementation of the agreement. The qualitative criteria are based on levels of effort by the two governments. The quantitative criteria are based on the survey results. In our view, the most significant quantitative criterion is "the change in the extent to which Japanese distributors and glaziers deal in or use imported flat glass..." This measures the extent of real opening in the distribution system. If distributors and glaziers source their glass from more than one Japanese or foreign supplier, they are much less vulnerable to pressure to maintain traditional sole-source buying patterns. While the Japanese were careful to include a statement in the agreement that the criteria do not constitute numerical targets, it is clear that success would be judged in large part by whether imports of flat glass increased substantially. The Japanese also understand that it is not sufficient that import increases only occur from Japanese-owned glass plants located abroad.

The agreement runs for five years, until the end of 1999, and consultations are to be held at least annually.

Implementation of the Agreement

The Clinton Administration made it clear from the outset that successful implementation is crucial, that it did not intend to forget about the flat glass issue now that agreement had been reached. Both Ambassador Kantor and Ambassador Mondale have been consistent on this point.

No doubt this clarity had an effect on the Japanese, because several early steps were taken. The Japanese government promptly briefed the industry on the contents of the agreement. The Japanese distributors and manufacturers promptly issued their voluntary statements endorsing

competition and openness. Japan's Ministry of Construction promptly staged a trade fair to promote the use of foreign building materials, including flat glass. Also, Japan's Ministry of Trade and Industry promptly began designing its survey questionnaire. Finally, there are signs that the JFTC is becoming more active in the fight against anticompetitive practices. In January of this year, the JFTC began studying the records of 18 large glazier on suspicion that prices were being fixed in the industry. The U.S. government should encourage this JFTC initiative.

However, other implementation steps have been taken more slowly or not at all. Some areas where actions have fallen short of commitments are indicated below.

- The government of Japan has been slow in compiling the results of the first annual survey. The survey was to have been completed in January, but was only finished in March.
- Japan's Ministry of Construction has been slow to provide access to publicly financed large-scale building projects, and only one foreign bid was accepted on any such project since the agreement was signed.
- In the private construction market, the MOC has not yet clearly designated "contact points" among local general contractors, glaziers, and architectural design firms, as it committed to do in the agreement.
- The Government of Japan has yet to adopt measures to promote increased use of safety and energy-saving glass, despite substantial technical support from both the U.S. and Japanese glass industries.
- Plans are still in their infancy to build publicly funded "model projects" to showcase the benefits of advanced glass products -- most of which are commonplace in the U.S. and European markets, but are little known in Japan.

The status of implementation is to be reviewed by U.S. and Japanese government officials in a meeting later this month in Tokyo, on April 22nd and 23rd.

Private Sector Efforts

The U.S. and Japanese private sectors have worked together in an effort to make the flat glass agreement a success. Even before agreement was reached, the U.S.-Japan Business Council and its counterpart, the Japan-U.S. Business Council, created a Joint Subgroup on Flat Glass. The two Councils, which meet together annually, consist of top executives of some 150 leading U.S. and Japanese companies.

The members of the Flat Glass Subgroup include representatives of all companies involved in implementing the agreement: Asahi Glass, Nippon Sheet Glass, and Central Glass on the Japanese side; and Guardian, PPG Industries, Inc., and Monsanto Company for the U.S. side. A representative of Weyerhaeuser Japan also participates for the United States because experience gained in the flat glass issue may be helpful in opening the wood products market, which is also dominated by cartel-like keiretsu relationships. The Subgroup is co-chaired for the Japanese side by Yasuhiko Furukawa, Executive Vice President of Asahi Glass Company. I serve as co-chair for the U.S. side.

The Flat Glass Subgroup has served as a useful forum for communication on implementation of the agreement. Since the results of the MITI survey of the first year's implementation will soon be made available, I expect that the Subgroup will become even more valuable in identifying and helping to resolve problems that may emerge. The Subgroup has been especially active over the past year in pressing the government of Japan to act promptly to strengthen regulations on the use of insulating and safety glass. Japan is far behind North America and Europe in both areas.

Regarding energy conservation, in August 1995, Guardian and PPG sent a team of technical experts to Tokyo to present a series of briefings to Japanese government and private sector officials on the U.S. experience in using energy-saving glass products, and the implications if similar standards were adopted in Japan. I am attaching for the record a copy of the English version of the presentation made by that team.

With respect to safety glass, on March 21, my Japanese counterpart and I, along with representatives of all companies on the subgroup, called on and presented a joint letter to several key officials in MITI and the Ministry of Construction urging that safety glass regulations be strengthened quickly.

While U.S. companies continue to compete strongly with each other in the Japanese market as elsewhere, we have also worked together through the U.S.-Japan Business Council to encourage market-opening in Japan. PPG supports the conclusions and recommendations of this statement.

Conclusions and Recommendations

Guardian is cautiously optimistic that the flat glass agreement will produce some genuine and sustained opening of the Japanese market. We are informed that the MITI survey indicates that imports of flat glass increased 90 percent by volume in the first six months of 1995 compared with the same period in 1994. At the same time, there are three reasons why it is far too early to conclude that the agreement is a success.

- First, sales levels that generate impressive year-over-year growth statistics in percentage terms are still minuscule in absolute terms. Even if Guardian were to double its sales in 1995 over 1994, we still would account for at most only 2 percent of the Japanese market. Based on our performance in comparable markets around the world, we could reasonably expect a market share in the range of 10 to 15 percent.
- Second, strong keiretsu bonds still exist, making it extremely difficult for us to participate in privately-funded construction projects.
- Third, there are strong signs that distributors and glaziers have only set aside a small token portion of their business to be allocated to imported products. Once that portion has been filled, foreign suppliers may find it impossible to win increased market share, no matter how competitive we become.

It is essential, in my view, that the U.S. government continue to assign high priority to the implementation of the U.S.-Japan Agreement on Flat Glass. For reasons already given, it is far from clear that the agreement is producing meaningful results. Failure would have repercussions far beyond the flat glass sector by intensifying the sense of distrust that already exists between our two countries on trade issues. The only way to dissipate that distrust is to demonstrate one agreement at a time that each country is as good as its word.

The bilateral agreement on flat glass offers a tremendous opportunity to open a Japanese market that has been tightly closed to American manufacturers. It deserves praise, as do President Clinton and Ambassador Kantor for securing the agreement. Yet without effective implementation, the goal of fair access to Japan's flat glass market will continue to elude us. And if questions are raised about the U.S. commitment to implementation in one sector -- in this case, flat glass -- every other sector in the U.S.-Japan trade relationship will suffer as well. The effort expended to achieve an agreement with strong terms warrants an equally strong effort to ensure Japanese compliance. Prompt disclosure of survey data, regularly scheduled government-to-government meetings, private sector involvement, and close monitoring of designated quantitative criteria all are necessary.

Attachment retained in Committee files.

COMMENTS IN LIEU OF PERSONAL APPEARANCE
BY STEVEN J. KEOUGH, INTELLECTUAL PROPERTY ATTORNEY
United States-Japan Trade Relations Hearing
Thursday, March 28, 1996

In lieu of a personal appearance, Steven J. Keough, intellectual property attorney, Patterson & Keough, P.A., 1100 Rand Tower, 527 Marquette Ave. S., Minneapolis, Minnesota 55402 respectfully submits the following written statement for the printed record of the United States-Japan Trade Relations hearing held on Thursday, March 28, 1996 at 2:30 p.m.

In a technology-driven worldwide marketplace, exclusive rights to its hard-earned breakthrough technology give a U.S. company a competitive advantage. The Japanese practice of patent application flooding essentially strips U.S. companies of this advantage, and deprives them of fair and equitable access to Japanese markets. This anti-competitive conduct, which is supported by the Japanese Government, results in damage to U.S. companies' markets worldwide, including in the United States. This conduct damages the United States economically, and reduces its competitiveness worldwide.

The practice of "patent flooding" in Japan, as detailed below, has injured the trade relationship between the U.S. and Japan and has significantly contributed to the trade deficit and the macro-economic imbalances that have caused deep friction between the two countries. The ongoing nature of this practice sheds serious doubt on the degree of good faith with which the Government of Japan has entered into recent negotiations and TRIPS Agreements with the United States. Critically, Japan's structural barriers to adequate and effective protection and enforcement of patent rights deprives U.S. companies of the worldwide competitive value merited by the breakthrough technology they invent.

The Commenter is a patent attorney who has practiced extensively in the area of international patent protection. This submission is based on the experience and knowledge the Commenter has acquired through his private practice, in which he has represented numerous United States and Japanese companies having worldwide intellectual property interests, including in Japan. These comments express the personal views and opinions of the Commenter.

I. The Government of Japan denies U.S. companies adequate and effective means to secure, exercise and enforce patent rights.

The Government of Japan has structured its patent system to deny U.S. companies adequate and effective means to secure, exercise, and enforce patent rights. 19 U.S.C. §2242(a)(1)(A). The Government of Japan has put in place a number of structural barriers to adequate and effective patent protection for U.S. companies in Japan. These structural barriers include: the lack of any duty of disclosure on the part of Japanese applicants; the lack of any speedy remedy for failure to correctly identify inventors; the ability of applicants to wait seven years before requesting examination of patent applications; toleration of patent application flooding; delays in completing examination once requested; severe under-staffing in the Japan Patent Office (JPO); the differences between the official fees charged for filing an application and for requesting examination; the differences between the fees that Japanese patent attorneys (Benrishi) charge their foreign and their domestic clients.

These structural barriers relate to pre-issuance conduct, and have not, apparently, been the focus of negotiations between the United States and Japan. The discussions and agreements between the United States and Japan have not addressed the root cause of the problems described herein — pre-issuance conduct, including patent application flooding, by which the Japanese companies, with the encouragement and assistance of the Government of Japan, deprive U.S. companies of rights to breakthrough technology. Prior negotiations have focused on increasing

the ability of U.S. companies to get patents issued in Japan, not on increasing the ability of U.S. companies to defend themselves from flooded patent applications. As part of the bilateral agreements, the ending of pre-grant oppositions in Japan has actually made it harder for U.S. companies to fight back against patent flooding. This likely effect was surely not lost on the Japanese negotiators to the talks. Now, a U.S. company seeking to challenge validity or inventorship must virtually wait until the flooded application matures into a patent — a delay of up to ten years or more; and all the while the U.S. company is subject to threats and harassment based on the flooded patent applications. It is well established that use of a U.S. company's patented technology is frequently deferred by potential customers in view of the existence of a flood of Kokai patent applications by a Japanese corporation. In the Commenter's view, the Government of Japan is not entering into good faith negotiations or making significant progress towards addressing the issues described in this comment or towards providing adequate and effective protection of intellectual property rights. See 19 U.S.C. §2242(b)(1)(C).

These structural barriers have a serious detrimental impact on U.S. companies seeking to protect their breakthrough technologies in Japan. However, when combined with Japan's publication of patent applications eighteen months after filing, and with the JPO's historic tendency to grant multiple, narrow patents rather than single, broad patents, the detrimental effect is compounded.

This pre-issuance conduct affects all U.S. companies but is more pronounced in its detrimental economic impact on small and medium sized U.S. companies. It is also these very companies which, in recent years, are the single most important source of job creation and breakthrough technologies in the United States.

These structural barriers have two general adverse effects on the patent protection process in Japan. First, they reduce the effectiveness and significance of the JPO as the grantor of enforceable patent rights and the initial arbiter of patentability. Due to deferred requests for examination, issues, such as patentability, which should, in the first instance, be decided by the JPO, are left unaddressed and unresolved for long periods of time. Without definitive, timely rulings from the JPO, companies are left to contest, debate and resolve these issues on their own. This marketplace horse trading is often conducted without the benefit of full information, and is often influenced by the superior bargaining power of large, well-funded Japanese companies.

The second effect of these barriers is to clearly encourage "patent application flooding." Patent application flooding is the practice by which a Japanese company files a flood of sham patent applications — or applications covering minor "improvements" in a U.S. company's breakthrough technology. Throughout most other jurisdictions such "improvements," or obvious uses of the technology, are not considered patentably distinct over the underlying innovation. A goal of a patent flooder is to target and surround the U.S. company's technology with a flood of trivial or frivolous patent applications, and then to use the Japanese applications as priority applications for entering foreign jurisdictions — including the United States. The Japanese company will then offer to license some of its "flood" of patent applications in return for a license to use the U.S. company's breakthrough technology or in return for another form of substantial business advantage.

As a result of these structural barriers, a U.S. company bringing or selling new technology to Japan cannot rely for patent protection on the workings of the JPO. Such practices are even employed by Japanese corporations when the U.S. company does not sell in Japan but the Japanese corporation intends to use the flooded patents as market entry tools in foreign jurisdictions — including the United States. A new U.S. corporate entrant to the Japanese market will quickly find its breakthrough technology surrounded by a flood of patent applications, from either Japanese customers or competitors. All too often, in view of the flooded patent applications, these U.S. companies are forced to surrender exclusive rights to their

new technology, or to indemnify the worldwide customers of the U.S. company, as the price of market access and a continued customer base.

A. Summary of Structural Barriers

1. No Duty of Disclosure and No Speedy Remedy for Failure to Disclose True Inventors

In filing an application with the JPO, the applicant has no duty to disclose prior art relating to the invention or to disclose any defect which could cause it to be invalidated. For this reason, even if the applicant knows that a technology he seeks to patent was previously invented by another, or is not patentably distinct from a prior technology disclosure, the applicant has no readily enforceable obligation to disclose this information to the JPO at the time of filing. As a result, important issues of prior inventorship or patentability might not even be eligible for presentation to the JPO until a post-grant opposition proceeding, nullity action, or trial of invalidity — years after the application was filed, and years after the conduct became known to other parties.

Addressing basic issues of inventorship and patentability so late in the process will be of little solace to a U.S. company that was forced to relinquish competitive advantages related to its breakthrough technology in response to one or more sham patent applications. The damage to the U.S. company is done long before the JPO is apprised, in a post-grant opposition, that there is an issue to be adjudicated. The damage to U.S. companies is done when the Japanese company extracts valuable business advantage on the basis of flooded patent applications, or even earlier when the Japanese company “advises” the U.S. company’s customers of the existence of one or more patent applications by the Japanese company.

Moreover, under the Japanese system, there is no speedy remedy for an applicant’s failure to name the true inventors of an invention. In the United States, a failure to name the true inventors on a patent application can result in the invalidation of any resulting patent, under 37 C.F.R. § 1.56. In addition, a practitioner who attempts to deceive the United States Patent and Trademark Office (PTO) with regard to inventorship or patentable subject matter could lose his or her license to practice before the PTO. In Japan, there is virtually no corresponding, swift, sure, and credible deterrent or punishment — notwithstanding this clear abuse of rights and principles of trust. For example, one can always file an application that fails to identify the true inventors; let it publish as a Kokai (unexamined) application and remain in that status for several years; and then never request examination. If examination is never requested, an application is never examined, a patent is never granted, and the false statement of inventorship or patentable distinctions on the application will never be addressed. The Japanese company is still able to “use” the published application as a coercive tool in the world marketplace without ever requesting examination. Moreover, by failing to request examination, the Japanese company can actually insulate its sham application from JPO scrutiny and from any challenge by third parties. Meanwhile, the market damage for a U.S. inventor or owner of the technology targeted for patent flooding accumulates. The damage occurs through loss of sales, requirements for indemnification, and the need to constantly persuade potential customers to ignore the flood of Kokai applications. Additional damage occurs when the market perceives that a U.S. company’s market advantage has been diluted, or that the U.S. company lacks resolve by not expending the resources necessary to directly attack the sham patent applications. Overall cost is clearly increased in both tangible and intangible ways.

A further twist in the Japanese system is that abandoned patent applications are destroyed after only four years. This means that information regarding false claims of inventorship, and sham patent applications is regularly covered up by the Japanese system. A Japanese company can file a sham patent application; let the Kokai hang as a threat over the head of U.S. companies for a number of years; fail to

request examination; and then, in due course, the evidence of the Japanese company's misconduct will be destroyed.

2. Ability to Defer Examination for up to Seven Years

Under the Japanese system, a patent application is not examined until the applicant requests examination. The applicant has seven years from the date of filing to request examination. The applicant is not, however, required to request examination. If, after seven years, there has been no request for examination, the application will become abandoned.

Patent applications in Japan are automatically published as Kokai publications eighteen months after filing, whether or not the applicant requests examination. Under Japanese law, an applicant may recover damages for infringement of these Kokai applications. After the patent is granted, the applicant can seek to recover damages for this "infringement." This longer period for damages to accrue is one of the reasons that the mere presence of Kokai applications can be used to threaten and intimidate competitors. Because damages potentially begin accruing at the time of Kokai publication, a U.S. company targeted for patent flooding cannot wait to address the problem until its competitor's (or customer's) flood of applications mature into issued patents.

A wave of Kokai applications directed at a U.S. company's critical technology is like a wave of incoming torpedoes. The U.S. company does not know whether any of the torpedoes will find their mark, but it does know that even a single strike can be fatal to either the U.S. company or to any of its customers which may also be targeted.

The U.S. company has no way of knowing which, if any, of the flooded applications will be pursued through examination, which of those examined applications will mature into issued patents, or which of those patents will cover the U.S. company's technology. In the face of a wave of threatening Kokai applications, the U.S. company can either buy a measure of peace by giving up valuable competitive advantages, or else cross its fingers, wait up to ten years or more to see what the issued patents look like, and hope the Kokai will not, in the interim, scare away all of its customers.

If the U.S. company is lucky, none of the issued patents from that wave of Kokai applications will hit its mark, and the U.S. company can hope that it will fare as well when the next wave comes. If, by some chance, the Japanese company can obtain a patent covering the U.S. company's critical technology, then the U.S. company knows that it has taken a direct hit below the water line — ten or more years of back damages are likely to be astronomical. To take a wait-and-see approach, a U.S. company must be extremely well-funded, and be run by people who have nerves of steel and who have a fondness for Russian roulette.

3. Delays in Examination and Understaffing in the JPO

Even after examination is requested, it may take three years or more for the JPO to complete examination. This delay is due, at least in part, to severe understaffing in the examiner ranks at the JPO. The JPO typically receives about twice as many applications as the U.S. Patent and Trademark Office receives. Yet the JPO has roughly half as many examiners as the PTO. See Intellectual Property Rights: U.S. Companies Patent Experiences in Japan, U.S. General Accounting Office (1993) ("GAO Report") at p. 45. Previous staffing increases by the JPO have not met agreed-upon outcomes. Moreover, these increases were, in effect, merely window dressing to cover the real issue of too many improperly filed patent applications. Once again, this is certainly a tactic that has been clearly understood by previous Japanese representatives to bi-lateral intellectual property talks with the United States.

4. Filing Fees and Benrishi Fees

The official fee for filing an application is about ¥21,000. Upon requesting examination, however, the applicant must pay an additional fee of at least ¥87,000, or more than four times the application fee. In addition to this, the applicant must pay Japanese patent counsel (Benrishi) fees for preparation of the patent application and for any subsequent examination or prosecution work. The GAO Report found that for prosecuting a twenty five page patent application, Japanese Benrishi charged about three times more than U.S. patent attorneys. Benrishi generally bill according to an industry standard fee schedule. Large Japanese companies can, however, negotiate special arrangements that exempt them from the standard fee schedule. See GAO Report at p. 34. For a U.S. company, Japan is one of the most expensive countries in the world in which to seek patent protection.

B. Structural Barriers Have Reduced the Importance of the Japanese Patent Office (JPO), and Have Permitted Patent Application Flooding.

Japanese patent statistics demonstrate that these structural barriers have reduced the importance of the JPO. The key to Japanese patent protection has become, not the issuance of patents by the JPO, but the accumulation of Kokai applications. The problem is that the JPO is not actively or properly policing pre-issuance patent rights in Japan. As a result of structural barriers, the JPO has been turned into a holding cell, into which legitimate and sham patent applications alike are dumped. Japanese companies use their sham applications to coerce business concessions from U.S. companies that have filed legitimate applications covering their critical technology. Patent flooding, delayed examination, coerced cross-licenses or other business concessions, and the creation of a Kokai application minefield greatly reduce the practical significance of JPO decisions.

In essence, the JPO has stopped policing the pre-issuance patent field, has stopped granting timely patent protection, and has abandoned the field to the Japanese corporate decision-makers. The Japanese companies are left to file whatever sham applications they want, and to use those sham applications to bring whatever concessions and cross-licenses they can coerce from U.S. companies.

Some major Japanese companies have filed 10,000 patent applications in one year! GAO Report at p. 48. In a high-activity year, a single Japanese company may file more than 20,000 patent applications. *Id.* Applicants in Japan often file applications without intending to request examination. GAO Report at p. 48. In 1989 and 1990 for example, about 40 percent of the applications filed at the JPO were abandoned (i.e., after the full 7-year deferral period had elapsed). *Id.*

Large Japanese companies demonstrate a very low ratio of requests for examinations to patent application filings. Indeed, leading Japanese companies experience patent grant-to-patent application ratios of roughly 25% to 32%. Thorson & Fortkort, *An Analysis of Patent Protection*, Journal of the Patent and Trademark Office Society, Vol. 77, No. 4, April, 1995, at pp. 314-315 (Figure 2). This means that two-thirds to three-quarters of these companies' patent applications do not mature into patents. *Id.* During the same time period, however, IBM had a 79% grant-to-application ratio in the JPO. *Id.*

Indeed, recent data indicate that by sheer numbers alone, Japanese companies inundate the JPO with patent applications. Over the past 10 years, the leading Japanese companies filed more than twenty-five applications for each application filed by comparable United States companies.

<u>JAPANESE COMPANIES</u>		<u>UNITED STATES COMPANIES</u>	
<u>Firm name</u>	<u>No. of patent applications to the JPO</u>	<u>Firm name</u>	<u>No. of patent applications to the JPO</u>
Matsushita Electric	195,808	IBM	8,684
N.E.C.	171,345	General Electric	5,124
Mitsubishi Electric	116,726	Texas Instruments	2,314
Sanyo Electric	36,408	Hewlett Packard	2,627
Yamaha	11,825	Intel	325
TOTAL	532,112	TOTAL	19,074

The high volume of patent applications by Japanese companies combined with the previously noted high number of Japanese applications that do not mature into patents are a clear indication of extensive "patent flooding." (The data in this chart were collected in an online database search by Questel-Orbit in the INPADOC database for the time period covering 1985-1996.)

II. The practice of patent flooding, which is encouraged and supported by the Government of Japan through its central economic planning and intellectual property policies and practices, constitutes a discriminatory nontariff trade barrier that denies fair and equitable market access to U.S. companies that rely on intellectual property protection.

Patent application flooding is a common practice in Japan in which a Japanese company surrounds a competitor's breakthrough technology with a flood of sham patent applications, or applications covering, at best, minor "improvements" to the breakthrough technology. These "improvements" are often in the nature of obvious uses of the technology, the actual technology itself, or improvements so trivial as to constitute clearly non-patentable, insubstantial differences in most other worldwide jurisdictions. See GAO Report at pp. 49-50. The patent flooder then uses these flooded applications to exact business or market concessions from the U.S. company. One technique is to offer to license these sham applications in exchange for a license to the flood victim's breakthrough technology. GAO Report at p. 49.

The net result of the improper structural barriers and processes in the Japanese system, and the patent flooding that the Japanese government and Japanese corporations encourage, is that U.S. companies trying to gain access to Japanese high technology markets, are forced, as the price of market access, to license their critical technology to their Japanese competitors. A coerced license or other form of business compensation due to patent flooding in a technology field is especially damaging to small U.S. companies, whose primary assets are their technology. When a small company trying to gain and maintain a foothold in the world market is forced to either license its breakthrough technology, or acquiesce to coercive business concessions, to larger, more established Japanese competitors, the small company's prospects are bleak. (As noted previously, prior negotiations by Japanese representatives have actually strengthened the position of the Japanese patent flooders. The existence of an agreement eliminating compulsory cross-licenses on basic patents, while having merit for other reasons, has no practical effect on this pre-issuance conduct, and is actually a convenient negotiating red-herring for the JPO to use relating to patent flooding conduct.)

The procedures at the JPO encourage patent application flooding and are discriminatory, nontariff barriers that deny fair and equitable market access to U.S. companies that rely on intellectual property protection. 19 U.S.C. §2242(a)(1)(B). Because the applicant can begin accruing infringement damages based on Kokai applications, these published patent applications are a valuable commodity in Japan.

As a result, there are instances in which infringement notices, patent disputes, and cross-license agreements in Japan revolve around published applications rather than issued patents. The deferral of examination permits the applicant to maintain its valuable Kokai for several years at virtually no cost, but to simultaneously receive disproportionate benefits from the chilling effect on other companies who may defer use of breakthrough technology due to the existence of this flood of published applications. In effect, those Japanese companies with the largest Kokai generating capacity (not necessarily the most technically innovative) exert extraordinary competitive distortions in the world technology marketplace.

Additionally, the large official fees and Benrishi fees associated with the examination phase actually discourage applicants from seeking examination. The official fee schedule set by the Government of Japan subsidizes patent flooding. The Government of Japan benefits from the direct revenues of the patent applications, and the indirect benefits to the Japanese economy due to market advantages obtained by Japanese corporations using these tactics.

The Japanese system is discriminatory in that it encourages Japanese companies to use patent application flooding tactics to deprive U.S. companies of their rights to breakthrough, or other targeted, technology. The Japanese system is also discriminatory in that if U.S. companies attempted to engage in patent application flooding they would incur a much higher cost than would a Japanese company. The cost of seeking patent protection in Japan is higher for a U.S. company than for a Japanese company. A U.S. company would need to retain a full-time Benrishi, in addition to its U.S. patent counsel; the Benrishi would likely charge the U.S. company more than he would charge a Japanese company; the U.S. company would need to pay for translations; and the U.S. company would need to pay higher filing fees if its applications were initially filed in English. These are some of the added costs that the U.S. company would face on a single patent application; given the number of patent applications that are filed in a campaign of patent flooding, the added costs incurred by the U.S. company would be quite substantial.

III. Summary and Recommendations

In a technology-driven worldwide marketplace, exclusive rights to its hard-earned breakthrough technology give a U.S. company a competitive advantage. The Japanese practice of patent application flooding essentially strips U.S. companies of this advantage, and deprives them of fair and equitable access to Japanese markets. This anti-competitive conduct, which is supported by the Japanese Government, results in damage to U.S. companies' markets worldwide, including in the United States. This conduct damages the United States economically, and reduces its competitiveness worldwide.

This conduct of patent application flooding is in violation of U.S. patent and anti-competitive laws. Recommended remedies should, at a minimum, include the following:

- a) the Japanese Patent Office should establish a rule of practice having similar effect to that in the United States Patent and Trademark Office as described in 37 C.F.R. § 1.56;
- b) the Japanese Patent Office should establish an administrative office which enforces a new requirement of good faith and candor in all matters before the Japanese Patent Office;
- c) the Japanese Patent Office and Courts hearing patent cases should allow invalidity to be presented by a defendant as a defense to a charge of infringement, in the same proceeding;

d) the Japanese Patent Office should increase the period of time after abandonment or final rejection (including failure to request examination) from four years to ten (10) years before the files relating to the rejected/abandoned application are discarded;

e) the Japanese Fair Trade Commission should be directed and empowered to investigate corporations in Japan which engage in anti-competitive business practices defined by abusing the patent system, including by filing of patent applications having improper inventorship or non-patentable, insubstantial subject matter "improvements;"

f) the Japanese Government should actively discourage filing of sham patent applications having improper inventorship or non-patentable, insubstantial subject matter "improvements;"

g) the Subcommittee on Trade of the Committee on Ways and Means should encourage establishment of Japan as a Priority Country until the practices and procedures which allow patent application flooding are ceased, and objective evidence of a cessation of patent application flooding is well established, and procedures are in place in Japan to prevent resurgence of this practice;

h) the Subcommittee on Trade of the Committee on Ways and Means should establish patent application flooding as a priority interest agenda item on all future trade talks with the Japanese Government until the practices and procedures which allow patent application flooding are ceased, and objective evidence of a cessation of patent application flooding is well established, and procedures are in place in Japan to prevent resurgence of this practice;

i) President Clinton and the Subcommittee on Trade of the Committee on Ways and Means should request a review of prior agreements made with Japanese intellectual property negotiators to determine, in view of ongoing patent application flooding practices, whether the negotiations were conducted in good faith;

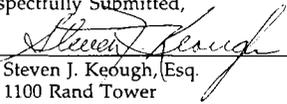
j) the Subcommittee on Trade of the Committee on Ways and Means should advise, and seek advice from, other Congressional Committees and agencies of the United States Government of the past and projected economic impact on U.S. companies and the loss of U.S. competitiveness in Science and Business due to patent application flooding by Japanese companies; and

k) the Subcommittee on Trade of the Committee on Ways and Means should request and/or lead an inter-agency investigation, in close cooperation with the Federal Trade Commission and the Department of Justice, into the ongoing violations of U.S. anti-competitive conduct and related consumer/business protection laws that the Japanese patent flooding practice constitutes.

Absent these actions, which might lead to adverse economic impact on a wide range of Japanese products and services, the trade distortions caused by abuse of the intellectual property system in Japan will continue unabated. Under such circumstances, the main loser is American inventors and consumers and, consequently, the United States economy.

Respectfully Submitted,

Dated: 11 APRIL 96

By 
 Steven J. Keough, Esq.
 1100 Rand Tower
 527 Marquette Avenue South
 Minneapolis, Minnesota 55402
 Telephone: (612) 349-5742
 Facsimile: (612) 349-9266

ISBN 0-16-054133-6



90000



9 780160 541339