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A U.S. STRATEGY TOWARD TRADE WITH JAPAN THAT WILL WORK

INTRODUCTION

Behind President Bill Clinton's confrontational approach toward trade with Japan are two controversial ideas: a government industrial policy that subsidizes U.S. emerging technologies and government management of the flow of U.S. exports and imports. Inspired by these two ideas, known generally as managed trade, Clinton is using trade negotiations with Japan to secure guaranteed shares of the Japanese market for U.S. exporters, possibly at the expense of other American businesses which are already successful in Japan. Moreover, Clinton has renewed congressionally mandated "Super 301" trade authority that allows the U.S. to impose sanctions against foreign trading partners accused of unfair trading practices. By September 30, the Clinton Administration will name those countries whose trade practices it feels unfairly restrict U.S. exports and will threaten them with Super 301 trade sanctions.

Key Clinton economic advisers, including United States Trade Representative (USTR) Mickey Kantor and Assistant USTR Charlene Barshefsky, are threatening to retaliate against U.S. trading partners unless they agree to increase American imports. Specifically, the Administration wants the Japanese government to agree to specified increases in imports of U.S. goods and services.

The Administration contends that this approach has worked before and points to the 1991 U.S.-Japan Semiconductor Agreement as a successful example of "managed trade," arguing that it established "numerical targets" by which U.S. semiconductor producers received a guaranteed share of the Japanese market. Moreover, the Administration argues that Japan agreed to these terms because of the threat of retaliation by the U.S. The Administration is wrong. Although U.S. semiconductor market share did in fact increase in Japan, this increase had little to do with numerical targets established in the Semiconductor Agreement. Instead, the agreement inspired U.S. firms to negotiate their own entry into the Japanese market without relying on government help. If the agreement can be called a success, in other words, it is not because of "numerical targets" but because it fostered private sector solutions undertaken because of business'

frustration with the results of years of failed government attempts to manage the trade in semiconductors.

Because it has learned the wrong lesson from the 1991 Semiconductor Agreement, the Clinton Administration has based its trade policy with Japan on the Agreement's anti-market principles of guaranteed markets, threats of retaliation through tariffs and quotas, and subsidies for U.S. industry. Rather than basing U.S. trade policy on such self-defeating protectionism, the Administration should help open markets overseas. Specifically, it should:

- ✔ **Seek rapid congressional approval of the General Agreement on Tariffs and Trade (GATT).** This wide-ranging trade agreement between the U.S. and 123 other nations should be approved by Congress as soon as possible. Based on seven years of multilateral negotiations, the current GATT agreement will reduce tariffs by as much as 40 percent worldwide and expand international trade by $235 billion annually.

- ✔ **Extend free trade agreements to other countries in Latin America, Asia, and Europe.** The North American Free Trade Agreement (NAFTA) expanded the U.S.-Canada Free Trade Agreement to include Mexico. That agreement, or separate free trade treaties, now should be expanded to other countries, including Chile and Argentina. Moreover, the President should raise the free trade ante by offering to negotiate free trade agreements with Hong Kong, Japan, Singapore, and emerging market economies in Central and Eastern Europe.

- ✔ **Pursue a pact liberalizing trade among the members of the Asia-Pacific Economic Cooperation (APEC) forum.**[1] The 17-member trade forum is a good foundation from which to launch a program of liberalized trade. The U.S. exports over $150 billion in goods and services to the Pacific Rim each year.[2] An APEC-based free trade area inevitably will expand that trade.

- ✔ **Foster private sector strategic alliances between U.S. and foreign firms.** The best way for American companies to gain a share of the Japanese market is to form private joint ventures with Japanese companies. These joint ventures should be encouraged and made part of any bilateral trade agreements with Japan or any other U.S. trading partner.

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1 APEC members include Australia, Brunei, Canada, China, Hong Kong, Indonesia, Japan, South Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, the Philippines, Singapore, Taiwan, Thailand, and the United States.

2 *U.S. Merchandise Trade: December 1993* (hereafter cited as USMT:12/93), U.S. Department of Commerce, February 17, 1994.

WHAT IS MANAGED TRADE?

Managed trade is government regulation of trade and international investments to achieve specific levels of imports and exports. Among the tools used by governments to manage trade are: quotas and other limits on imports, demands for guaranteed shares of sales in another country's market, demands that other countries adopt economic policies that favor imports, subsidies for selected industries or government-business "partnerships," subsidies for export industries, and some form of national industrial and trade planning.

Clinton's approach to trade with Japan reflects this philosophy. The Administration is pursuing a two-pronged approach: **1)** protecting U.S. industries at home through trade barriers and subsidies while **2)** negotiating numerical targets and guaranteed market shares in Japan for specific U.S. industries.

An example of the first approach is the Administration's decision to subsidize domestic development of flat panel displays used in laptop and notebook computers and related products. Under President George Bush, the U.S. imposed a tariff on the import of these displays in an attempt to give the infant American industry a chance to establish itself. The tariff was removed in 1993 after it was discovered that the U.S. industry was incapable of supplying quality displays to the U.S. computer industry.[3] Now, however, the Clinton Administration plans to spend over $1 billion in the next decade to help U.S. businesses develop the most advanced flat panel displays in the world.[4]

As an example of the second approach, the Clinton Administration, through the U.S.-Japan Framework negotiations begun in April 1993, is pressuring the Japanese government to accept "qualitative and quantitative" numerical targets for U.S. exports to Japan.[5] The Administration is asking the Japanese to guarantee a portion of their domestic market to U.S. automobiles, auto parts, telecommunication services, and insurance policies. The Administration, moreover, is seeking to increase these guaranteed shares by a predetermined percentage each year.

GOVERNMENT BUREAUCRATS AS INVESTORS

These approaches are doomed to fail. Managed trade policies require that the government decide which industry will perform best in foreign markets. Government determines which products and services receive government assistance, while other products and services not seen as worthy are left to market forces. The assumption is that government knows better than private investors which products to develop and bring to market.

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3 See "Certain High-Information Content Flat Panel Displays and Display Glass From Japan," U.S. International Trade Commission, USITC Publication 2413, August 1991, and Bryan T. Johnson, "A Guide to Antidumping Laws: America's Unfair Trade Practice," Heritage Foundation *Backgrounder* No. 906, July 21, 1992.

4 Jonathon Rauch, "The Visible Hand," *National Journal*, July 7, 1994, p. 1614.

5 From "Joint Statement on the United States-Japan Framework for a New Economic Partnership," press statement issued by USTR, April 1993.

If this assumption were true, managed trade would have a successful track record of picking winners and losers. But this is not the case. In fact, governments are more apt to pick losers than winners. The reason: government bureaucrats have a short-sighted view of profitable products and technologies. Bureaucrats in charge of picking which industries receive government subsidies or guaranteed shares of foreign markets usually choose existing technologies, not the more promising ones that may be profitable in the future.

There are numerous examples of failed industrial policy, including:

In the U.S.

Sematech. One of the most successful examples of industrial policy in the United States is supposed to be Sematech, a jointly funded government-business partnership aimed at developing advanced semiconductors.[6] However, after seven years and nearly $1.5 billion spent, Sematech has produced few marketable products; some of its biggest projects are failures. For example, Sematech funded attempts by some companies to produce advanced lithography equipment which etches the electrical circuit patterns into electronic components. The project collapsed after consuming tens of millions of dollars of Sematech's taxpayer-subsidized budget.[7]

Meanwhile, though remaining committed to Sematech's basic mission, Sematech partners like American Telephone and Telegraph (AT&T) and others have entered joint ventures with Japanese semiconductor firms to gain access to advanced products and production. AT&T has two joint ventures, one with Mitsubishi Electric Ltd. begun in 1990, and three different arrangements with Nippon Electric Company, also begun in 1990. While the jury is still out on just how successful these ventures will be for AT&T, they demonstrate how the company has chosen avenues other than government subsidies to enter the semiconductor market.

To be sure, Sematech may have helped some companies pay for new research and development projects. However, those "successes" came at the expense of diverting capital from companies that lacked government funding to others that received such funding. In fact, some of the companies denied government funding achieved equal or greater success. For example, California-based Cypress Semiconductor corporation is not a member of Sematech, yet it produces one of the world's fastest static random access memory (SRAM) chips, used in supercomputers to store and retrieve data. It developed this product without help from the government. Cypress Semiconductor CEO T.J. Rodgers says: "Sematech has waged a public relations campaign to claim credit for the [U.S. semiconductor industry] comeback. It is a preposterous claim. It is true that Washington spent or will spend $1 billion of taxpayer money on the Sematech boondoggle. It is true that the U.S. semiconductor industry has experienced a resurgence. It is not true that one had much to do with the other."[8]

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6 Robert S. Williams and George C. Lodge, *Sematech*, Harvard Business School Case Study, 1988.

7 "Govt High-Tech Boondoggles: Clinton Computer-Screen Next Failure?," *Investor's Business Daily*, May 6, 1994, p. 1.

8 Dr. T. J. Rodgers, statement given in testimony before the House Committee on Science, Space, and Technology, Subcommittee on Technology, Environment, and Aviation, March 25, 1993.

Very High Speed Integrated Circuits (VHSIC). Another U.S. industrial policy failure was the attempt to develop advanced electrical circuits needed for military computers and hardware such as shipboard computer systems, mobile computer products, and a host of other products. From 1979 to 1990, the U.S. government spent over $1 billion to support the building of advanced circuits to meet the needs of future electronic equipment. What it got was computer chips for existing equipment, despite market trends toward production of computer chips that were far more advanced. The result: $1 billion for no lasting marketable product.[9]

In Japan

High Definition Television (HDTV). HDTVs are next-generation TVs with better resolution, movie screen dimensions, and compact disc-quality sound. Japan's HDTV project was begun in the early 1980s and by 1985 was being funded directly by the Japanese government. By the late 1980s, President Bush was considering adopting a U.S. industrial policy for an HDTV project, but he rejected it while Japan's project went forward. In the meantime, some U.S. companies joined forces to build a system with an emerging technology based on digital transmissions, an advanced way to transmit data in large quantities very quickly. Japan's government-funded project used older technology based on analog transmissions, which is a slower way to transmit data. Thus, while Japan had the first HDTV, the U.S. product is far more advanced and will become the standard for HDTV systems elsewhere. Japan's industrial policy failed where the U.S. market succeeded.

These examples show a common problem with industrial policy: it tends to favor existing technology over emerging, often more promising technology. While the market cannot always foresee future emerging technology, private investors are better able to determine how much a potential project may be worth by spending their own money than are government bureaucrats spending someone else's money.

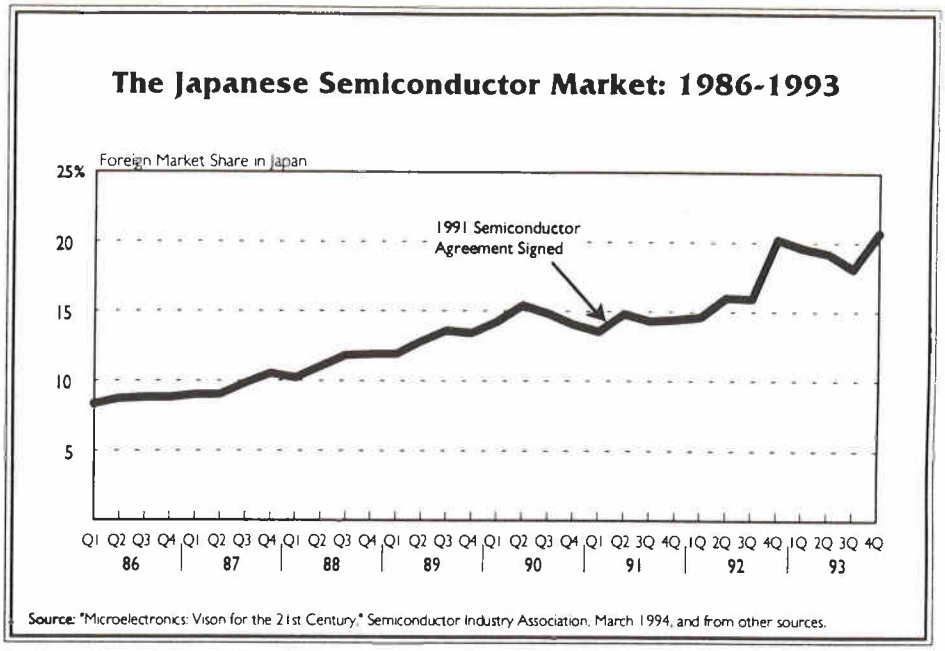
THE U.S.-JAPAN SEMICONDUCTOR AGREEMENT

Industrial policies fail because governments lack the knowledge, incentives, and expertise to influence markets successfully. But industrial policy is only one part of the President's managed trade agenda. The other is the pursuit of guaranteed shares of foreign markets. To justify such policies, the Clinton Administration is relying on the 1991 U.S.-Japan Semiconductor Agreement as a model of effective managed trade policy. A closer analysis of this arrangement reveals that it has not done what the Administration claims.

In 1991, President Bush signed a trade agreement with Japan seeking to increase the U.S. share of the Japanese semiconductor market. The Clinton Administration maintains that this agreement guaranteed a 20 percent portion of the Japanese market to foreign-made semiconductors, mainly U.S. products, and argues that this guarantee, together with threats of U.S. trade retaliation, has forced the Japanese to buy more U.S. semicon-

9 "Govt High-Tech Boondoggles," *op. cit.* See also Katie Hafner, "Does Industrial Policy Work? Lessons from Sematech," *The New York Times*, November 7, 1993, p. 5.

ductors. The Administration is wrong.



The Clinton Administration's argument actually is based on Ronald Reagan's 1986 U.S.-Japan Semiconductor Agreement. This agreement, among other things, called for incremental increases in Japanese purchases of foreign-made semiconductors and for U.S. trade retaliation if these targets were not met—retaliation that was applied in 1988 in the form of tariffs. The Clinton Administration points to the general rise in the share of the Japanese market captured by U.S. producers as proof of this approach's effectiveness.

But what the Administration ignores is that in the 1991 agreement, Bush eliminated all references to "guaranteed market shares" and scrapped the Reagan tariffs imposed on Japan. As the chart above shows, U.S. market share in Japan rose generally through the last half of the 1980s. But it was not until well after these changes were made that U.S. companies really gained market share in Japan. The 1991 Agreement makes no reference to guarantees, simply stating that:

> The Government of Japan recognizes that the U.S. semiconductor industry expects that the foreign market share will grow to more than 20 percent of the Japanese market by the end of 1992 and considers that this can be realized. The Government of Japan welcomes the realization of this expectation. The two Governments agree that the above statements constitute neither a guarantee, a ceiling nor a floor on the foreign market share.

If numerical targets and trade retaliation did not increase foreign market share in the Japanese semiconductor market after 1991, what did? A closer look at the 1991 agreement shows that market forces, sound business planning, and other aspects propelled U.S. firms into the Japanese market.[10]

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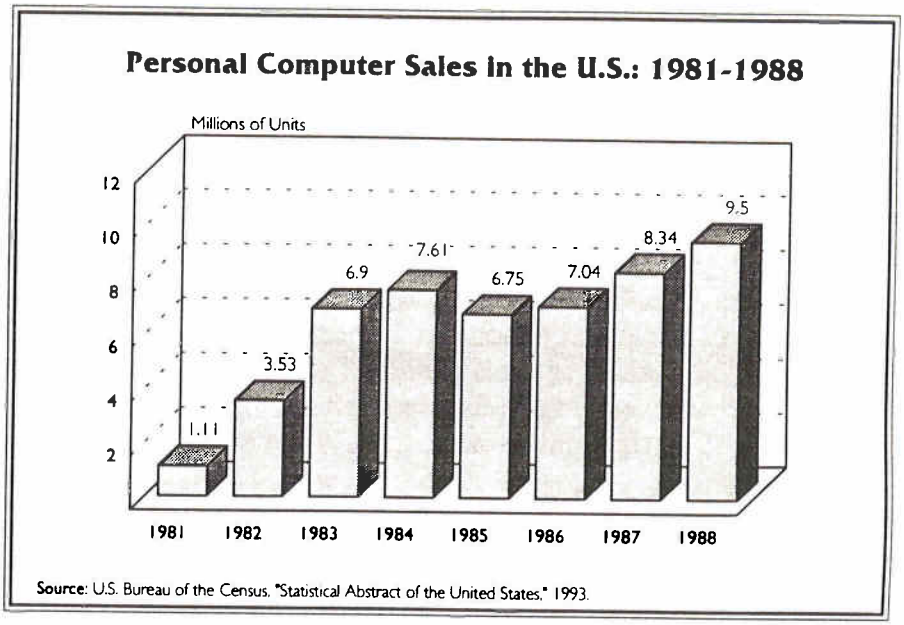
10 *Industry and Trade Summary: Semiconductors* [hereafter cited as I&TS:S], United States International Trade Commission, USITC Publication 2708, December 1993, p. 7.

HOW THE U.S. IS SELLING JAPAN MORE SEMICONDUCTORS

The fact that U.S. semiconductor sales in Japan increased so dramatically about a year after the 1991 agreement had much to do with sound business decisions made by U.S. companies in the mid-1980s and bad business decisions made by their Japanese counterparts. Consider the following chronology of events:



☞ **As the demand for personal computers increased during the early to mid-1980s, so did demand for components used in these computers.** In the United States alone, sales of computers increased nearly 1,000 percent from 1981 to 1988 (see chart). The main components of these computers are semiconductors, used in the form of dynamic random access memory (DRAM) chips and microprocessors.

☞ **Because the Japanese government and private semiconductor producers believed demand would increase throughout the 1980s, Japanese companies initiated a massive production schedule for DRAMs.** Many of these Japanese companies saw the expected increase in demand and their newly developed DRAM production techniques as reason enough to increase production in this crucial product area.

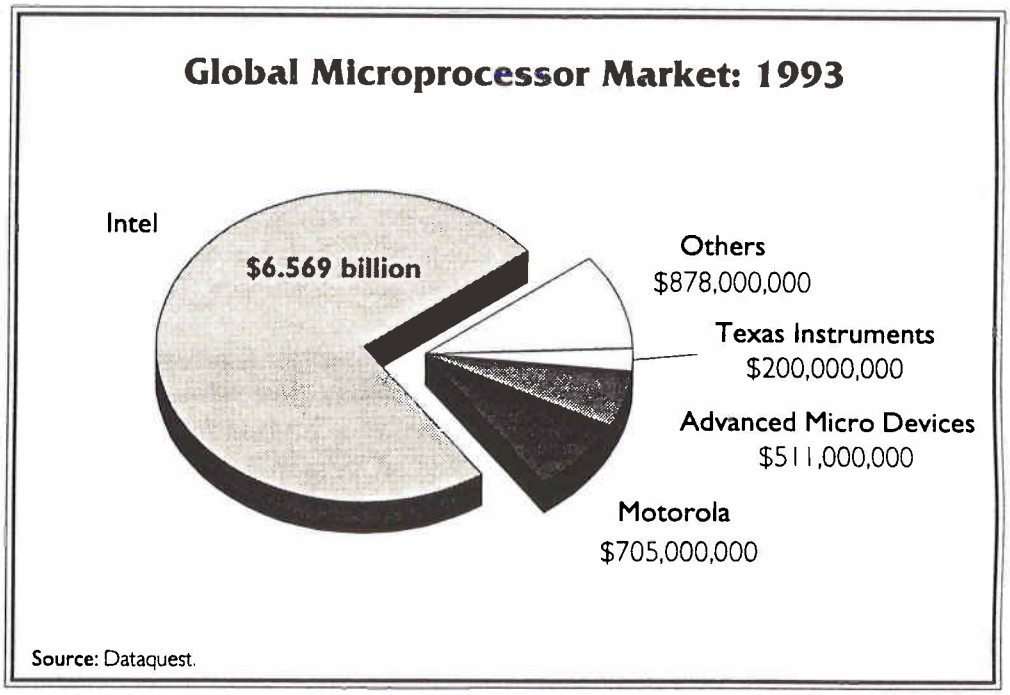
☞ **Meanwhile, U.S. companies like Motorola Incorporated and Intel Corporation saw an opportunity to increase production in an area being neglected by the Japanese: microprocessors.** Japanese efforts to enter this market were stifled in part because Japanese firms were busy trying to out-produce one another in DRAMs. Faced with this increased competition and dwindling profits, U.S. firms walked away from DRAMs and spent their money producing microprocessors. According to Cypress Semiconductor CEO Rodgers: "Gordon Moore, the chairman of Intel, admitted that Intel deliberately walked out of the DRAM business to make more profit. Two years later they made a profit of $600 million in microprocessors, which is where they squirreled their money instead of DRAMs."[11]

11 Virginia I. and Steven R. Postrel, "The New Mr. Chips, Speaking for Silicon Valley's Upstarts," *Reason*, July 1990, p. 31.

☞ **By 1985, the Japanese had overproduced DRAMs, and prices began to fall.** To cut their losses, Japanese companies began to sell their massive inventories at cut-rate prices, prompting U.S. semiconductor companies and the U.S. government to charge the Japanese with dumping, or selling them at below market value.[12] This led to the 1986 U.S.-Japan Semiconductor Agreement in which the Japanese agreed, among other things, to stop dumping DRAMs. The resultant cutback in DRAM production led to an eventual price increase and to higher Japanese profits, which in the end may have been all that kept some of these businesses from going bankrupt.

☞ **While many Japanese consumer electronics companies were losing money in DRAMs, companies like Intel and Motorola went on to become the world's largest producers of microprocessors, making billions in profits.** In fact, Intel alone controls almost all of the world's supply of high-end microprocessors and nearly three-fourths of all microprocessors, truly a tribute to the company's foresight, investment strategy, and business planning (see chart below).

In short, one reason the U.S. began gaining more market share in Japan is that some U.S. semiconductor firms walked away from the cut-throat competition in DRAMs and invested in microprocessors. By 1991, Japan was virtually dependent on the U.S. for microprocessors, which they had neglected. For example, the foreign share of the Japa-



12 *Four Years of Experience Under the U.S.-Japan Semiconductor Agreement: A Deal is a Deal,* Semiconductor Industry Association, San Jose, California, November 1990, p. 59. It must be said that the Japanese were selling their DRAMs at prices below their costs of production, which did injure U.S. companies still engaged in DRAM production. However, these lower prices were the result of cut-throat competition between Japanese DRAM producers who were trying to unload their bloated inventories after the demand for DRAMs collapsed. U.S. antidumping provisions do not take these issues into account. For a full description of U.S. antidumping laws, see Bryan T. Johnson, "A Guide to U.S. Antidumping Laws: America's Unfair Trade Practice," Heritage Foundation *Backgrounder* No. 906, July 21, 1992.

nese microprocessor market is 76.6 percent, and most of this is U.S. market share. This compares to a 23.2 percent share of Japan's DRAM market.

THE KEY TO OPEN MARKETS IN JAPAN: STRATEGIC ALLIANCES

Another reason the U.S. gained market share in Japan is that U.S. firms took advantage of language in the 1991 agreement which called for an increase in joint ventures between U.S. and Japanese firms. These strategic alliances are private sector arrangements between two or more companies seeking to increase production by taking on a partner. They can take many forms, including direct acquisition of one company by another, a joint venture partnership between two companies, and the merger of two companies to form a single entity for the desired production. These alliances are key to opening the Japanese market because they give U.S. firms unique access to Japanese partners. Moreover, these alliances provide U.S. firms with immediate access to Japanese technologies —and vice versa—that it would take years for them to develop on their own.[13]

The real success of the 1991 Semiconductor Agreement lies in the degree to which it encouraged these strategic alliances between U.S. and Japanese semiconductor firms, leading the U.S. to ease its antitrust laws to facilitate joint production arrangements between two or more companies.[14] The 1991 Agreement specifically states: "The Government of the United States of America will provide support for expanded sales of foreign-based semiconductors in Japan through the promotion of long-term relationships between Japanese producers, including joint product development with Japanese customers, and other actions the two Governments consider appropriate."[15] The Bush Department of Commerce worked closely with American businesses, giving them information on partnership and market opportunities in Japan. Partially as a result of these and other efforts, U.S. semiconductor companies today are engaged in hundreds of partnerships, alliances, joint ventures, licensing agreements, and research and development projects with Japanese firms.[16]

These alliances are the result of private U.S. businesses seeking increased market opportunities in Japan, not just of the 1991 agreement, but they demonstrate that many American companies need little prodding from government to seize an overseas opportunity. The 1991 agreement created an atmosphere in which U.S. businesses could begin to consider joint ventures with Japanese firms as a realistic way to break into the Japanese semiconductor market. American companies sought new alliances or broadened ex-

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13 Not all strategic alliances will be successful. Even some of those mentioned in this study may end up as failures. The significance of these alliances is that U.S. companies have sought private sector means to address their desire for increased market share in Japan and access to advanced technologies.

14 The National Cooperative Research Act of 1984 allowed two or more companies to enter joint research projects without the threat of extreme antitrust penalties. The law was aimed mainly at U.S. companies. Later, in 1993, President Clinton expanded the Act to include joint production ventures, but it was still aimed mainly at U.S. firms; foreign firms are allowed to participate, but only as minority members.

15 1991 Semiconductor Agreement, USTR.

16 I&TS:S, p. 7.

isting ones. AT&T, for example, established an alliance with Mitsubishi Electric in October 1991; National Semiconductor Corporation started two relationships with Toshiba Corporation in May and December 1992; and Intel established a joint venture with Sharp Corporation in February 1992.[17] All of these occurred after implementation of the 1991 agreement.[18]

These and hundreds of other alliances have helped U.S. companies to reduce research and development costs while gaining access to Japanese customers, manufacturing and marketing techniques, and technologies that they may not have been able to develop on their own. U.S. companies' sales in the Japanese market tripled between 1986 and 1992, rising from 7.7 percent of their world sales in 1986 to over 10 percent in 1992.[19] Thus, in contrast to President Clinton's call for numerical targets, some U.S. semiconductor companies want more, not fewer, U.S.-Japan alliances.

For example, William Weber, Vice President of Texas Instruments Incorporated, told the Japanese newspaper *Asahi Shimbun* that "We won't urge the [U.S.] government to set market share goals. The government's intervention should be held to a minimum."[20] Weber added, "Confrontation existed between the U.S. and Japan a year ago, but the present U.S.-Japan relationship is best characterized by trust. Foreign semiconductor suppliers are now integral parts of the Japanese users' *Keiretsu*."[21] (The *Keiretsu* system in Japan is an inter-linked group of businesses, banks, producers, and suppliers that have agreed to work together to reduce costs and maximize profits.)

In the same vein, Gilbert Amelio, President of National Semiconductor, told the Japanese press that "There is no need to set market share goals. The relationship between U.S. and Japanese companies has dramatically improved. Strong trust has been established and problems can be worked out quickly through communication. It is necessary to strengthen our business relationships further."[22]

Examples of these private sector relationships include:

Advanced Micro Devices Inc.— Sony Corporation. In 1990, the U.S. company Advanced Micro Devices (AMD) announced a strategic alliance with Japan's Sony Corporation, which promised to help AMD reopen a dormant semiconductor manufacturing site in San Antonio, Texas. When the agreement was announced, AMD Chairman W.J. Sanders III noted that "access to [SONY's] manufacturing know-how will significantly enhance AMD's global competitiveness."[23] As a result of this strategic alliance, Sony gave AMD valuable technology needed to enter the advanced computer memory chip business. Using this technology, AMD has done more business and become more profit-

17 Dave Webb, "Intel Pulls Plug on Flash Fab," *Electronic's Buyer's News*, July 11, 1994.
18 "Progress and Achievements Under the Semiconductor Agreement," Anderson, Hibey, & Blair and Powell Tate, Washington, D.C., February 23, 1994.
19 *Ibid.*, data quoted from Dataquest.
20 *Asahi Shimbun*, June 5, 1993.
21 *Denpa*, June 5, 1993.
22 *Nikkei Sangyo*, August 30, 1993.
23 AMD News Release, February 20, 1990, p. 1.

able, selling $1.05 billion worth of semiconductors in 1990 and $1.64 billion worth by the end of 1993. Overall, AMD's earnings grew from a $35.9 million loss in 1990 to a $228 million profit in 1993.[24]

Advanced Micro Devices, Inc. — Fujitsu Ltd. Newer computers need faster, higher memory, but smaller chips. Developments in notebook and laptop computer technology have put pressure on semiconductor manufacturers to produce more advanced components for these computers. To meet this demand, AMD and Fujitsu have teamed up to develop a new "flash" memory chip, which is smaller and faster than similar components found in desktop machines and represents one of "the fastest-growing segments of the semiconductor market."[25] These memory chips have the ability to retain information even when the power is off. According to Gene Conner, AMD's Vice President for Operations, such "collaboration between premier players on a global scale is the wave of the future" for the semiconductor industry.[26]

American Telephone and Telegraph (AT&T) — Nippon Electric Company (NEC). Many U.S. companies are breaking into new markets, especially in Japan, yet research and development costs for new technologies are extremely high. By emphasizing joint venture partnerships, these cost can be shared. AT&T, for example, teamed up with NEC of Japan in January 1992 to manufacture advanced static random access memory (SRAM) chips for computers and other products. NEC has provided AT&T with access to advanced SRAM technology, allowing it to introduce a new product line more quickly than it could have on its own because of the shared research and development costs.

LSI Logic Corporation — Sanyo Corporation. Digital high definition television promises to be a profitable new technology. HDTV has better resolution, digital sound, and a wider screen; but few companies, Japanese or American, have a competitive advantage in the many components necessary for this new technology. In August 1991, LSI and Sanyo announced a strategic alliance in which the two companies would manufacture semiconductors jointly for HDTV. LSI specializes in semiconductors tailored to its partners' needs, while Sanyo has designed some of the most advanced semiconductors available. Thus, LSI can take advantage of its sophisticated production techniques and develop Sanyo's advanced semiconductor designs, making both companies more competitive. LSI also has entered similar alliances with Nippon Electric Company, Mitsubishi, and Japan Victor Corporation (JVC).

Sun Microsystems Inc. — Fujitsu, Ltd. In the mid-1980s, Sun Microsystems had designed an advanced microprocessor called Sparc, but was unable to develop the chip on its own because its production techniques were not sufficiently advanced. Sun Microsystems eventually turned to Fujitsu, one of Japan's largest computer makers, for design and manufacturing assistance. Fujitsu soon be-

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24 The Value Line Investment Survey, January 28, 1994.
25 AMD News Release, April 14, 1993, p. 1.
26 *Ibid.*, p. 3.

came the largest Japanese supplier of Sparc microprocessors for sale in Japan and elsewhere. Today, Fujitsu sells computers built by Sun Microsytems in Japan under the Fujitsu label. Not only has this alliance helped an American company bring to market a product stuck in its design stages; according to Sun Microsytems, it also is helping the company sell more computers in Japan than it could have sold on its own. The joint venture has provided the U.S. firm with access and expertise on how to market and sell products in Japan. The alliance also has provided Sun with advanced components made by Fujitsu, which in turn have made Sun's workstations more competitive. Fujitsu now accounts for about 25 percent of Sun's Japanese sales of $700 million a year.

Because U.S. firms have joined hands with Japan's largest semiconductor manufacturers, access to Japan's market continues to grow, and U.S. market share continues to increase. Thus, the success of the U.S.-Japan Semiconductor Agreement is not due to a guaranteed 20 percent of the Japanese market, but to the fact that private companies have reached across international borders to develop business relationships on their own without government threats of trade retaliation.

Instead of trying to manage trade with Japan and other partners, the Clinton Administration should expand access to foreign markets for U.S. businesses. Specifically, it should:

✔ **Seek rapid congressional approval of the General Agreement on Tariffs and Trade (GATT).** After seven years of multilateral negotiations, this wide-ranging agreement between the U.S. and 123 other nations should be implemented as soon as possible. The current GATT agreement will reduce tariffs by as much as 40 percent worldwide and expand international trade by $235 billion a year by the year 2005.

There already is some debate in Congress that the current GATT round will sacrifice U.S. sovereignty and that lower tariffs will drain government revenues, causing higher taxes or spending cuts. Accusations of lost sovereignty, however, are unfounded. No international trade rule, whether emanating from GATT or from some other multilateral institution like the proposed World Trade Organization, can be binding on the U.S. Any such rule would have to be written into law and signed by the President to be binding on U.S. citizens.[27]

In order to maintain the momentum resulting from the conclusion of seven years of debate and negotiations, the Clinton Administration should press for quick passage of GATT implementing legislation this year.

✔ **Extend free trade agreements to other countries in Latin America, Asia, and Europe.** The North American Free Trade Agreement expanded the U.S.-Canada Free Trade Agreement to include Mexico. It now should be expanded to include other countries like Chile and opened up to countries in Asia, such as Hong

27 See Joe Cobb, "A Guide to the New GATT Agreement," Heritage Foundation *Backgrounder* No. 985, May 5, 1994. See also Joe Cobb, "The Real Threat to U.S. Sovereignty," *Heritage Lecture* No. 497, August 1, 1994.

Kong, Japan, and Singapore, and to the new democracies of Central and Eastern Europe. As an alternative, the U.S. could offer free trade agreements to these countries separately. This would allow for the global expansion of free trade while avoiding the diversion of trade between blocs that occurs when regional agreements such as the NAFTA and the European Union erect trade barriers to outsiders.

The Clinton Administration has promised that Chile will be the next candidate for a free trade agreement. Chile has earned this opportunity because of economic reforms, begun in the mid-1970s, which have made it one of the fastest-growing economies in the Western Hemisphere. Since the mid-1980s, for example, the Chilean economy has grown at a rate of 5.7 percent a year. With inflation rates stabilized at around 11 percent, unemployment near 4 percent, and average salaries rising, Chile makes a good candidate for free trade with the U.S.[28]

The Clinton Administration should not stop with Chile. It should begin to prepare for negotiations with other Latin American countries once negotiations with Chile are complete. The next likely candidates are Argentina, Colombia, and Costa Rica. The Administration also should consider offering free trade agreements to the Czech Republic, Poland, Hungary, and even Russia. Clinton's fiscal year 1995 foreign aid budget request for Eastern and Central Europe and the newly independent states of the former Soviet Union is over $1 billion,[29] but the U.S. does almost $10 billion in trade with that region each year.[30] Bringing these countries into free trade areas could expand that trade significantly. The economic growth created by more foreign trade would improve the lives of Czechs, Hungarians, and Russians far more than foreign aid. Moreover, such a move would provide many Eastern European and Eurasian countries with the economic foundation necessary for continued and sustained growth.

✔ **Pursue a pact liberalizing trade among the members of the Asia-Pacific Economic Cooperation (APEC) forum.** If liberalizing trade with Latin America and Eastern Europe is a good idea, it is a great idea for Asia. The 17-member forum for Asia-Pacific Economic Cooperation is a good foundation on which to build a free trade area in Asia. While offering FTAs to specific Asian countries, the U.S. should work within APEC to reduce trade barriers on a regional basis, while seeking to expand the APEC from an informal forum to a free trade region between the U.S. and APEC's members. Specifically, President Clinton should use the forum to pursue an aggressive strategy of reduced tariffs and non-tariff barriers.

In this forum, Clinton could urge countries like Japan to work harder to integrate their economies into the international economy. Pursuing such a multilateral ap-

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28 See Michael G. Wilson, "Building on the NAFTA: Forging A Free Trade Agreement With Chile," Heritage Foundation *Backgrounder* No. 991, June 27, 1994.

29 *Congressional Presentation Fiscal Year 1995*, U.S. Agency for International Development, 1994.

30 USMT:12/93.

proach among APEC members could result in real trade liberalization. Moreover, President Clinton should seek bilateral free trade areas with specific APEC members with the eventual goal of including all its members in a free trade area with the U.S. Clinton should start the process by pursuing a free trade area with Japan. Such a move would allow both U.S. and Japanese trade negotiators to eliminate tariff and non-tariff barriers to trade, much like the U.S. and Mexico have done through the NAFTA. Through this process, both countries would benefit. For example, U.S. automobile and auto parts companies could seek reforms in Japan's safety and inspection laws which restrict the import of American motor vehicles into Japan by making it difficult for them to get through the inspection process and into the showroom. Likewise, Japanese automobile companies could lobby for an end to the American Automobile Labeling Act and tariff reclassification of minivans, which raise the cost of Japanese automobiles sold in the U.S. The American Automobile Labeling Act requires all automobiles sold in the U.S. to specify the amount of domestic and foreign content of the automobile. The information must appear next to the sticker price information. This Act is a protectionist move by the domestic auto industry to portray automobiles with foreign names as "un-American" products even though many are built in the U.S.

Similarly, the tariff reclassification of minivans will raise the price of imported minivans sold in the U.S. by several thousand dollars. Both of these policies are protectionist maneuvers by U.S. industry to keep out imports. They would be targets for Japanese negotiators in free trade negotiations.

✔ **Foster private sector strategic alliances between U.S. and foreign firms.** Joint ventures, or "strategic alliances," between U.S. and foreign firms are far more successful in opening foreign markets than are such managed trade practices as guaranteeing a fixed share of a foreign market. They also introduce U.S. companies to technologies far more advanced than any that have been developed by government-sponsored industrial policies. These initiatives should be encouraged and made part of any bilateral trade agreements with U.S. trading partners.

As demonstrated by the 1991 Semiconductor Agreement, strategic alliances expand U.S. business's access to foreign markets, technology, marketing, management techniques, and capital. With these assets, American companies can become more competitive. The Clinton Administration should use the current U.S.-Japan Framework negotiations to develop language in any forthcoming agreement that encourages U.S. and Japanese companies to work together when they find it profitable and useful. For example, a new framework agreement should incorporate language similar to that found in the 1991 Agreement, which states that "long-term relationships between Japanese semiconductor purchasers and foreign-affiliated producers, including joint product development with Japanese customers," should be promoted.[31] While strategic alliances may not always be successful, they remain America's best hope for breaking into closed foreign markets.

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31 1991 Semiconductor Agreement, USTR.

CONCLUSION

President Clinton has brought the U.S. down a dangerous path. By pursuing managed trade policies whereby the U.S. tries to strong-arm foreign governments into guaranteeing a fixed share of their market, Clinton not only raises the risk of a trade war with Japan and other trading partners, but also misses the boat on how best to open foreign markets to U.S. goods.

Much of Clinton's confusion on managed trade stems from a misreading of the 1991 Semiconductor Agreement. The President believes this agreement was successful because it guaranteed foreign firms 20 percent of the Japanese semiconductor market. He is mistaken. The real reason the agreement was a success is that U.S. companies took advantage of provisions which encouraged the growth of strategic alliances between private U.S. and Japanese companies.

Clinton would do well to re-examine the impact of this agreement. He will discover that successful U.S. companies gained access to overseas markets on their own, with no help from the U.S. government.

Instead of trying to manage trade, Clinton should try to remove barriers to it. He should seek implementation of the General Agreement on Tariffs and Trade as quickly as possible and follow up on the North American Free Trade Agreement by negotiating other agreements with countries in Latin America, Eastern Europe, and Asia. These would do far more to open foreign markets to U.S. goods than would any threat of trade retaliation or guaranteed shares for foreign markets. Free trade will benefit U.S. businesses and consumers while expanding economic growth to all corners of the globe.

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APPENDIX

Examples of U.S.-Japan Joint Ventures in Semiconductors Past and Present

COMPANIES	COOPERATIVE ACTIVITY
AMD-Sony	Joint operation of semiconductor plant in San Antonio, Texas, for the purpose of technology transfer and advanced semiconductor manufacturing techniques (February 1990).
AMD-Fujitsu	Joint design, production, and sales of flash memory chips (July 1992).
AT&T-Mitsubishi Electric	Joint development, licensing, and production of SRAMs and integrated circuits (February 1990 and October 1991).
AT&T-NEC	Joint design and development of advanced SRAM memory chips (Four different ventures beginning in 1990)
IBM-Toshiba	Joint development of advanced memory chips (July 1992).
IBM-Toshiba-Siemans	Joint development of 256M DRAM (July 1992).
Intel-Matsushita	Joint development of advanced DRAM manufacturing technologies (November 1988).
Intel-Sharp	Joint development of flash memory chips (February 1992).
LSI Logic-Kawasaki Steel	Established a joint venture called Nihon Semiconductor, Inc., to produce advanced semiconductors (September 1985).
LSI-Sharp	Technology transfer from Sharp to LSI to build SRAMs (March 1990).
LSI-Sanyo	Joint development of advanced semiconductors for HDTV (August 1991).
LSI Logic-VLSI Tech.-NEC-Mitsubishi-JVC-Sharp-Pioneer-NEC Home Electronics	Joint development of advanced semiconductors for HDTV (November 1991).
Micron Technology-Sanyo	Joint semiconductor distribution agreement (October 1989).

Micron Technology-NEC	Mutual sales of 4M and 16M DRAMs (June 1992).
Motorola-National Semiconductor-Toshiba	Joint development of advanced semiconductors (July 1993).
Motorola-Toshiba	Established a joint production company, Tohoku Semiconductor Co., Inc., in May 1988 which sells DRAMs and microprocessors.
National Semiconductor-Toshiba	Joint development of advanced semiconductors (May and December 1992).
Texas Instruments-Hitachi	Joint development of 16M, 64M, and 256M DRAMS (1988, 1991, 1992).
Texas Instruments-Kobe Steel	Joint venture company, KTI Semiconductor, Ltd., to manufacture semiconductors (May 1990).
Texas Instruments-Fujitsu-Sony-Hitachi	Joint development of HDTV components (August 1991).
VLSI-Hitachi	Technical cooperation and joint R&D on advanced semiconductors.