

A Heritage Foundation Forum

Opening Japan: The Construction Market

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Opening Japan: The Construction Market

Margo Carlisle: Good morning. I am Margo Carlisle, Vice President for Government Relations at The Heritage Foundation. I would like to take this opportunity to welcome all of you to Heritage and to this forum that will examine the barriers facing American construction firms in Japan, American efforts to gain access to the Japanese construction market, and the current state of United States-Japan negotiations on this important subject.

We here at Heritage consider the relationship between the U.S. and Japan to pose one of the most pressing policy challenges for the Executive Branch and Congress in the months and years ahead. In this regard, it is a particular pleasure to be able to welcome Senator Frank Murkowski from Alaska as our keynote speaker this morning.

Senator Murkowski is a good and much respected friend of The Heritage Foundation. He was elected to the Senate in 1980 and reelected in 1986, and has been a wonderful addition to the U.S. Senate.

Several years ago, he learned that foreign construction firms were not allowed to compete on Japanese contracts without a license, but that a license could not be obtained from the Japanese licensing authority without previous construction experience in Japan. So with his practical and business-savvy common sense, Senator Murkowski played an instrumental role in promoting the U.S.-Japan fourteen Major Projects agreement, which was concluded in May of 1988. This agreement came up for its two-year review in May of this year.

We should also mention that Senator Murkowski is the author of the Brooks-Murkowski reciprocity amendment that bans construction firms from countries that discriminate against the U.S. from bidding on all federally funded public work projects. It is a great pleasure indeed to welcome Senator Murkowski.

Senator Frank Murkowski: Thank you for that warm introduction. I would like to review a theme or concept that we have supported, which I think is appropriate and sometimes is lost in all the fuss of doing business with Japan. The theme is relatively simple: we welcome in the U.S. foreign investment, and have for an extended period of time. However, what we are asking for is the opportunity to invest in other countries to the same degree that companies and private individuals from those countries invest here. Since we have so much trade with Japan, Japan is the focal point in this concept. Indeed, we have observed that the Japanese consistently invest heavily in the U.S., and why shouldn't they?

Money is attracted to those places where the highest rate of return is offered at the least amount of risk. The United States offers this kind of an opportunity, so it is appropriate that we should get investments from Japan. Other friends and allies, such as Great Britain, also have invested in the United States and I believe that Britain is still the leader in this regard.

In many respects, we are concerned less about the pattern of Japanese investment in the U.S. than we are about our own access to markets in Japan and in other countries. Sometimes Americans have the feeling that perhaps we are not welcome in those countries, despite the openness of the American economy.

I would like to focus for a moment on a narrow example which illustrates how part of the debate we have with Japan got started, that is over access to the Japanese construction market. It got started in about 1987 with a project in Osaka called the Kansai International Airport. When this is completed, it will be one of the construction wonders of the free

world. The task of building an airport in the middle of Osaka Bay in water depths of up to sixty to eighty feet, truly is an enormous undertaking.

When I first became interested in Kansai, I went to Japan to discuss the issues surrounding the project. At that time, the Japanese officials explained to me that this really was not a federal government operation but was being handled by the local prefectures. I said this implied that it was not a government or public sector project, and that the prefectural support for the project meant that it was, in effect, a private sector project. The Japanese officials admitted that the way the Kansai organization was set up had the connotation of a private sector project. This also meant, they said, that the Japanese government really did not control the access to the construction bidding process for the project. We asked whether that meant that all aspects of the project, including services, landing fees, etc. would be amortized as any other non-government sector project would be. In answer to our question, we received just a polite grin.

It was clear to us at that time that we really were pioneers trying to open the road for American firms in this market. Japan's Kansai International Airport project was significant because it represented a major construction project where Americans were not allowed the kind of access that we expected. Clearly, we had *and have* a good deal of expertise in construction. American firms build projects throughout the world; we have major corporations, such as Bechtel, which have built some of the major projects in North America. We also have projects like the Alaska pipeline that was the largest construction project in the free world and which was valued at around seven to eight billion dollars.

Since that initial trip to Kansai in 1987 we have started to make progress in the field of Japanese construction, but clearly we have a long way to go. I refer you to the current disparity in the amount of business that Japanese construction firms do in the U.S. versus what American companies do in Japan. Japanese construction firms do some \$2 to \$2.5 billion worth of construction work annually in the United States. We welcome that. But American firms have only about \$200 million worth of contracts in Japan, in total. Clearly, we do not have an equitable relationship with the Japanese in the construction sector.

As we began to knock on the door of the Japanese construction market some three years ago, we also went into the Yokosuka Naval Base, a U.S. facility where we found there was a major construction project underway. The Japanese told us that our firms could obtain a license if they had experience in Japan, but it was clear that we could not get any experience until we got a license, so this was a veritable "catch-22."

It took some time to get over that hump, and we were able to generate some interest among American construction firms for getting into the Japanese construction market. Clearly, some of these companies were interested in getting into the Japanese market, but did not want to spend a lot of time and effort only to find out they were not going to win any contracts. They wanted to spend their time and effort where they knew they were going to get some return on their investment.

So in 1988 we signed a U.S.-Japan Major Projects agreement for fourteen public works projects, which included such things as airports and bridges and which were intended to give U.S. firms experience in Japan. The fourteen projects' value was estimated at about \$16 billion. Coupled with that agreement was an American policy to get a little tougher with Japan. In November 1989 the Congress produced the Section 301 on Japanese construction markets. And after the investigation, U.S. Trade Representative Carla Hills found that Japan had erected unfair barriers to trade in the construction sector. She, however, because of our limited progress, decided against applying sanctions against Japan.

In this current year, we have the *1990 Foreign Trade Barriers Report* in which the Japanese construction industry was again found to have unfair barriers to trade. Furthermore, the Major Projects agreement in the construction sector is now under a two-year review. Our leverage in this agreement is that the Executive Branch can go back and institute legislative actions that are still pending against Japan in this area, including 301 action, and the Airport and Airways Safety Expansion Act. In the Congress we can institute another "Brooks-Murkowski" type legislation. This legislation basically would mean that if Japanese projects are not open to American firms, then the American public sector market will be closed to Japanese firms.

I also have begun a series of industry meetings that have brought industries from both the U.S. and Japan together into a "discussion mode." I think it is necessary for us to begin to address some of the Japanese concerns and to listen to what the Japanese have to say. And it is important for the Japanese to hear what we have to say. If you do not talk to one another directly, you end up misreading each other.

In cooperation with Hajime Sako, Chairman of the Japanese Federation of Construction Contractors, we had a meeting in Washington, D.C., in January this year. That was after I had met in Japan with Chairman Sako, the Minister of Construction, and the Minister of Transportation. We had some fairly spirited discussions in Japan over the issue of American access to Japanese markets. This meeting brought together a large sector of the American construction contractors.

We had another meeting in April in Tokyo, which my assistant Jennifer Brick attended. We have included industry specialists in these meetings, who have begun to speak on specific problems such as the role of subcontractors, the nature of the joint venture relationship, etc. We are not home free by any means, but we have made some progress, and the Major Projects agreement is one vehicle for promoting progress.

In the fourteen Major Projects agreement we have a total projects value of about \$16 billion. Of that, \$3 billion already has been awarded. About \$100 million of that is awarded to U.S. firms. We maintain, however, in the Major Projects agreement that we want equal access to all construction projects in Japan, and this is the position that Under Secretary of Commerce Mike Farren has reiterated again and again. This should be the case where we are clearly competitive. There are, of course, no restrictions on foreign firms participating in the U.S. market.

Another problem I have encountered on this issue is that Japan maintains a "designated bidder" system that places limitations on competitiveness. We find this system to be grossly unfair. We also have attempted to fix the *dango*, or bid-rigging system, in Japan. Under this system, Japanese firms have taken turns in getting the contract for certain projects, and there is no real competition. In our efforts to undo *dango* in Japan, we found the Japan Fair Trade Association fairly responsive. They brought about 114 charges of bid rigging against Japanese firms on various U.S. bases where we had contracts with those firms. They prosecuted about half of them. And the Japanese public has found that this type of protectionism and the practice of *dango* are unsatisfactory for them, and are costing them money. Furthermore, *dango* is a part of the Structural Impediments Initiative (SII). The Japanese have agreed to impose stiffer penalties on those caught engaging in *dango*, and require those firms accepting bids on contracts to warn of these penalties when announcing bids. These are the limited areas of progress we have seen to date.

I think that it would be safe to say that what we want at the end of the day in Japan is a free and open construction market. And we hope the day will come when both U.S. and

Japanese government intervention in the market are unnecessary. But until the Japanese market is deemed open by our own firms and by the U.S. Trade Representative, we clearly need a role by the American government in which it can work with the U.S. private sector to try to break into the construction industry market in Japan.

Roger A. Brooks: I am Roger Brooks, Director of The Heritage Foundation's Asian Studies Center. I would like to repeat the welcome that was extended to you by our Vice President for Government Relations, Margo Carlisle. Our forum today seeks to examine the barriers facing American construction firms in gaining access to the Japanese construction market and the current state of negotiations between the U.S. and Japan in this particular area.

We are particularly grateful to Senator Murkowski for coming to speak to us this morning and for giving us an insightful presentation on the subject of American efforts to gain access to the Japanese construction market and why that is important to our overall relationship with Japan.

We also are grateful to today's panel participants for agreeing to come to Heritage — some from quite far away — also to speak on this issue from their own perspectives. Before I introduce the panel, I would like to say a few words about the importance we attach to the construction market issue in Japan and why we believe it is an appropriate topic for an intensive discussion today.

It would be no news to anyone here today to hear that during the last several months, U.S.-Japan trade relations have been at an extremely difficult stage, and that the difficulties in our trade relationship have had an enormous impact on the larger relationship between America and Japan, upon our views of each other.

Our negotiations with the Japanese in sectors such as satellites, super computers, and wood products, as well as in the areas identified in the SII talks, indeed appear to have produced some important and potentially significant results.

Yet, as reports in the last few weeks have evidenced, there may be a real limit as to what America can expect from Japan in terms of commitments to structural changes in Japanese society and in the Japanese economy. And as America's previous experience with Japan in trade negotiations has shown, commitments to carry out market openings may only be seen as such — that is, only as verbal commitments — until there is palpable proof that markets are truly open and access achieved.

Americans have sought to achieve this access in many markets in Japan, including the construction market, because they believe that given the opportunity to compete in a fair and honest environment, American companies can compete successfully with the best Japan can offer.

They also believe that if Japan is given the opportunity to compete in open and fair competition on U.S. soil, American companies and entrepreneurs should be provided comparable opportunities in Japan. This is particularly true, I believe, in the construction sector.

The U.S. architectural, engineering, and construction (AEC) industry is enormous. In current dollars the AEC sector represented almost 10 per cent of America's GNP of \$4 trillion in 1988. These American companies also have proved their ability to compete in the international marketplace.

Between 1980 and 1985, for example, the U.S. AEC sector achieved around \$225 billion in total sales and contracts abroad. This figure probably will grow when measured in the following five-year period, extending through the end of this year.

Before the U.S.-Japan construction agreement was entered into in May 1988, the significant imbalance in construction services performed by U.S. companies in Japan versus that performed by Japanese companies in the U.S. brought construction to a head as a trade issue.

In 1987, this was approximately \$2.5 billion per annum by the Japanese in the U.S. versus practically nothing by the U.S. in Japan. This imbalance and the difficulties in entering the Japanese market resulted in the 1988 construction agreement between Japan and the U.S. to facilitate access by U.S. companies to the market. I think Senator Murkowski has ably described the purposes and goals of this agreement in his presentation this morning.

Prior the agreement a small number of U.S. companies had established offices in Japan. These included Bechtel, Fluor Daniel, The Austin Company, PAE International, and a number of smaller design firms primarily performing work for U.S. military bases at Okinawa.

Subsequent to the agreement, over eighteen business tie-ups or joint ventures were announced between U.S. and Japanese design and construction companies, resulting in their obtaining numerous construction licenses in Japan. There also has been SOME progress on the fourteen designated projects:

- ◆ For construction work on the Haneda Airport and Minato Mirai projects;
- ◆ For consulting work for the Minato Mirai, Tokyo Teleport, and Osaka Technoport projects;
- ◆ And for the supply of U.S. goods to Japanese clients or contractors.

While Japan claims that U.S. companies have obtained \$174 million worth of work on these fourteen projects, some in the U.S. claim that the "equivalent amount," or actual billings generated by U.S. designers and contractors in Japan on these projects is only approximately \$6.5 million.

Those U.S. voices also point out that most of the U.S. companies which have established offices for over fifteen years in Japan have not experienced any significant expansion of their business there. My colleagues on this panel will present their views as to the importance and validity of these figures.

But I believe we also should try to examine why we are concentrating on this seemingly esoteric issue that comprises only one element of our overall trade relationship with Japan — an element that has been receiving a lot less attention of late than the incredibly intriguing SII negotiations.

I will offer a few reasons for this, to which I hope my colleagues here this morning will add some of their own wisdom:

- ◆ ◆ First of all, American construction firms are very competitive in the world market, and we believe that there is little reason why they should not be equally competitive in Japan. Likewise, if U.S. policy is to provide markets for Japanese firms seeking construction service contracts in the U.S., we believe that it will be enormously difficult for U.S. policy makers to maintain that policy if reciprocal opportunities are not available to American firms in Japan. This is both a practical matter and one of principle.

◆ ◆ Secondly, one of the Japanese business practices that has hindered American ability to compete effectively in the Japanese construction service sector has been identified as collusive bidding on construction contracts or what is known as *dango* in Japan. *Dango* also has become the focus for U.S. targeting of "structural impediments" to free trade in services, and has been identified by the U.S. side during the recent SII negotiations.

The U.S. approach to this problem thus seems to be at least twofold: to open the construction market in Japan for American companies AND to seek an end to "exclusionary business practice" in Japan, which hinders competition and adds distortions to the market in this particular sector.

As S. Linn Williams, Deputy U.S. Trade Representative, told a meeting of the Asian Studies Center's Japan Working Group last week, "For us, the issue is not 'Is Japan different?' but 'Can Japan adapt its trade and economic policies to conform to the rules of conduct under which most of the world's free industrialized nations perform?'"

* Finally, as one of my colleagues on this panel told me several weeks ago when we were planning this forum, when U.S. negotiators and companies try to open the Japanese market in the construction service sector, they are in some ways operating on and uncovering the very nerve center in the intimate relationship between government and industry in Japan.

Few can debate the fact that Japan's ruling Liberal Democratic Party depends significantly on the support of the construction sector in that country for its political viability. Opening Japan in this particular sector could upset that relationship and could cause some problems for the U.S. in ways that are yet unforeseen or at least underestimated.

American efforts to open the construction market in Japan also could make Japan's government and private sector realize that the significant producer-orientation in the Japanese economy may be increasingly difficult to maintain, especially in light of the increasingly vocal dissatisfaction voiced by Japanese consumers over high prices and other distortions in their nation's economy.

To examine these and the more specific issues of the debate over the opening of the Japanese construction market, we have gathered an esteemed and expert group of panelists this morning.

Franco Eleuteri is Director of Advanced Facility Projects and Asia Operations for the Austin Company in Dallas, Texas. Mr. Eleuteri has developed his expertise over fifteen years with major U.S., European, and South African corporations. This has involved him in the fields of management consulting, engineering and construction, with particular emphasis on high technology and industrial modernization projects.

Donn Smith is Vice President and Director of Project Finance for the MK International Group of Morrison-Knudsen Corporation, and is based in Washington, D.C. In this capacity, Mr. Smith works on developing financing packages for Morrison-Knudsen's projects around the world.

Yasumasa Nagamine is First Secretary in charge of the Economic Section of the Embassy of Japan here in Washington, a position he has held since July 1987. He is a recognized authority in Washington on the construction industry in Japan and on the current negotiations between Japan and the U.S. over this issue.

Maureen Smith is Deputy Assistant Secretary of Commerce for Japan in the Department's International Trade Administration (ITA). Since 1981, Maureen Smith has been director of the Department's activities relating to U.S. trade with Japan. She recently