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Economic Conflict and Cooperation over Trade and Investment between Japan and EC*)

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Introduction

The present paper is concerned with the acute problems of economic conflict and cooperation over trade and investment between Japan and EC. Recalling on the long-term economic development of Japanese economy after the war, Japan could not realize her marvelous performance of economic growth without free international trade within the framework of GATT. Japan has, therefore, now to play a major role in rebuilding and strengthening the free trade system and work even harder than other countries to open our domestic markets wider.[1]

Japanese colse relationship with US has been managed until recently to remain free in general terms, thanks to the overwhelming economic power of US. But the position of US in the world economy has significantly changed,[2] and we can no longer expect US to lead the movement to promote free trade, as suggested recent emergence of economic conflicts between Japan and US. EC, the other important trade partner for Japanese economy, has successfully tried to realize a biggest unified market in a widened European area. This activities of economic integration contribute also undoubtedly to encourage a broadrange of products and service exchanges, and to give a fruitful chances for direct investment and technology transfer between Japan and EC. However, easy recource to take bilateral measures such as voluntary export restraints, local content requirements and some regulatory measures cannot be denied, although we can understand that a sharp increase of Japanese exports of some particular items threatens to give severe damages to several strategically important industry sectors in the EC member countries.

In order to resolve such complicated international trade problems before they worsen and turn into political issues, it should be required that on Japanese side individual firms must take care that their exports are orderly so as not to upset European markets, and that their direct investment contributes to reduce technology gap and trade imbalances over the long run. On the European side the importing countries should take steps for industrial adjustments purposefully.

The prospects for colser economic relationship between Japan and EC would, therefore, depend on the future development of inter-industry trade and mutual direct investment activities. Since both economic structures do not differ widely in terms of relative factor endowments, the necessary conditions for intensifying intra-industry trade is the open-door policy especially for manufactured goods and the reform of trade-related regulatory procedures.

This paper is organaized as follows: Section 1 reviews firstly some basic features of intra-industry trade between Japan and EC. Section 2 is devoted to a detailed analysis for external commercial policy of EC, characterized by reciprocity, antidumping and anticircumvention measures, local content requirements and voluntary export restraints. Section 3 and 4 present the main implications of Japanese industrial policy and some important opening measures of Japanese markets. Section 5 reports and discusses the important role of direct investment for avoiding conflicts and encouraging cooperation between Japanese and EC industry. Section 6 provides my conclusion.

Before proceeding to Section 1, it would be useful to give a shortremarks on the meanings of structure. Structure is an elusive concept with different meanings in different contexts. While commonly used, the concept is rarely defined. In what follows, I would like to take into account of three closely related and interdependent concepts of structure: market, institutional and regulatory. Main reason making an economic analysis of international relations difficult may come from these interdependent concepts of structure. For instance, the regulatory structure imposes various regulatory constraints on economic activities. While the regulatory constraints influence the institutional structure, the market structure is fully dependent on this given or (more importantly) changing institutional structure.

1. Intra-industry trade

Study of international trade of today must incorporate imperfect competition, scale economies and intra-industry trade. The new trade theory, developed by Helpman and Krugman[6,7] and others, emphasizes the effects of scale economies on trade, whereas traditional analysis (Heckscher-Ohlin Theorem) describs international trade by comparative advantage coming from the difference of factor endowments in a competitive market. According to the new trade theory, scale economies realize effictively the gains by trade even for both trade partners who have the same factor ecdowments. In other words, scale economies make possible to emerge intra-industry trade which is, as well known, main stream of trade between advanced countries.

Some empirical studies on Japanese intra-industry trade show that her intra-industry trade coefficients[3] are relatively small, compared to those of main European countries. For instance, Japanese coefficient for 1985 is only 12.9, whereas France 37.8, Germany 39.9, United Kingdom 34.6 for the same year. From these empirical results it may be inclined to conclude straightforwardly the colsedness of Japanese markets, as Tyson[23] gave comments on the elaborate empirical work of Saxonhouse[21]. One point needs, however, to be noted about this small coefficient of Japan. Helpman-Krugman Theorem clarifies the following interesting proposition concerning factor endowments and composition of trade items: given the relative economic scale between trade partners, the larger the difference of factor endowments (capital, labor, land and energy) ratios between trade partners is, the smaller becomes the weight of intra-industry trade. In the opposite extreme case, in which factor endowment ratios for both countries are exactly the same (i.e. no difference of this ratio), there is no intra-industry trade, as shows traditional analysis. Trade in this case composes all in all of inter-industry trade. On the ground of this proposition and of the above mentioned empirical results of Saxonhouse[21], the small coefficient of Japanese intra-industry trade is mainly due to the Japan's distinctive national endowments (i.e. scarce and little endowment of energy), and not directly due to the market-closedness. Relatively poor and scarce arable land and energy endowments, compared to plentiful capital and skilled labor endowments determin such a small coefficients.

In order to make this conclusion more credible and understandable, I refer in Table 1 to Japanese intra-industry trade coefficients for the year 1989 by regions and industry sectors.[4] We can easily insight that firstly Japanese intra-industry trade coefficients in Japan-EC trade are much higher than those in Japan-ASEAN trade, and that secondly total Japanese coefficient of intra-industry trade becomes small, because of her big weight of inter-industry trade with Asean countries.

Table 1 Japanese intra-indutry trade coefficients (1989)

SITIC	5	65	67	72	75	76	776	781	87	5-8
EC	46	31	28	47	8	3	21	60	63	31
ASEAN	18	33	15	2	73	32	22	0	6	14

where; SITC 5: chemical products, 65: textiles, 67: iron & steel, 72: industrial machines, 75: office machines(incl. computers), 76: telecom-instruments, 776: semi--conductors, 781: passenger-cars, 87: opticals, 5-8 total manufactured goods, respectively.

Source: Housen, M. , "Japanese Market is not closed"(in Japanese), No. 265, Mar. 15., 1992, Japan Center for Economic Research.

Aside from concern over the distinctive pattern of Japanese intra-industry trade coefficients, Japn's import share of manufactured goods as defined by SITC categories 5, 6, 7, 8, and 9 has remained remarkably low still in the year 1990, compared to the levels of selected advanced countries (Table 2). This facts suggest to foreign competitors the existence of barriers to Japanese market access --some formal, but mostly informal structural barriers. Many of the formal barriers to trade such as tariffs, quotas and discriminatory standards and certification requirements have been eliminated through bilateral and multilateral negotiations. Indeed, Japanese tariffs today remain quite low (3.4%, calculated as a ratio of total duty income to total volume of imports) by world standars (for instance, US 3.8% and EC 3.9%). Moreover, most

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Japanese import quotas have been eliminated, even the ristrictions on agricultural products[5] will be in April 1992 reduced from 22 products to only 13. Consequently, a significant determinants of barriers to trade and investment into Japan are today informal and structural.[6]

Table 2 Import of manufactured goods in advanced countries

(1980-90) (%)

	1980	1985	1990
Japan	22.8	31.0	50.9
USA	54.0	74.7	78.6
Canada	74.8	84.5	84.4
Germany	58.3	62.0	76.9
UK	67.2	70.6	79.4
France	57.7	62.0	78.4
Italy	49.7	51.2	71.0

Source: OECD, Statistics of Foreign Trade, for respective year.

2. EC external commercial policy and its implications

EC has, with some exceptions, proved a decisive force for the greater liberalization of world trade. It often causes, however, far-reaching changes in high-tech industry sectors of EC, in which the effects of external economy and economies of scale are in operation. These markets are, as well known, imperfectly competitive. The markets of passenger-cars, business-machines and electro-machines are today some of such typical examaples, where a number of bilateral arrangements between EC and Japan have been set.

2.1 Reciprocity

The institutional structure refers to the basic characteristics of market setup. It describes the fundamental willingness of policy organs considering an existing regulatory structure and if necessary, aiming to introduce a new set of regulatory constraints. Therefore, the institutional sturcture in a country or region gives present and future fundamental market conditions.

One of the most important institutional structure in EC is, in my view, the true interpretation of reciprocity for Japanese business circle, because there were and are still a lot of misunderstandings or malinterpretations on EC reciprocity in Japan. Someone has overestimated scope and effect of EC reciprocity, and another has simply accepted it as a form of European protectionism. It was alleged that there would be an EC offensive against Japanese export products as a whole, and so this would be an EC industrial and trade policy by the backdoor. The scale of expected policy measures with reciprocity has been in Japan greatly exaggerated. For instance, the EC Commission reserves the right to make access respective markets conditional on the context of reciprocity.[7] Possible results would be an easy recource to bilateral arrangements and the sectoral balance of trade between Japan and EC, aiming at avoiding the sustained imbalance of trade.

To deepen the understanding on this issue, it is worth considering as one example the institutional character of reciprocity shown in the articles of the Second Banking Directive directly. The Directive sets, in my view, the general aim of obtai-

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ning access for Community banks to the markets of third countries comparable to that it offers on its own. Although the Directive provides for negotiations on this which must be authorized by the Council, the Commission can only initiate negociations itself when it finds that a country does not offer national treatment and effective access to Community banks and only in these circumstances can request for authorizations be refused. Thus, it may conclude thta the Community's general aim is liberalization at the multilateral level.

The concepts of reciprocity in the scheme of international transaction are, in my veiw, policy-oriented, especially EC trade-policy oriented. That means reciprocity is a product of institutional structure, not of regulatory structure in EC. It is practically a means of negotiation with relevant third countries. Consequently, concepts of reciprocity are flexible in charater. The community does not expect third countries to copy the Community's legislation. The Community has also excluded the idea that reciprocity should apply retrospectively. Therefore, Japanese companies already established in any EC member countries will be treated like Community companies.

The major aim of reciprocity in EC is to create the same competitive conditions at multilateral level. So I judge the concepts of reciprocity are harmonious with GATT rules.[8] When no international rules like GATT for some industry sectors, for instance, service trade, intellectual properties and government procurement, exist, then any policy stance --in the EC case reciprocity --could be presented from any country or region for international negotiation with these new trade issues.[9] Without expressing the corresponding policy stance from Japanese side for the new trade issues, there would be no positive results in Japan.

2.2. EC antidumping and anticircumvention measures

While trade of various high-tech products has been a growing part of total world trade, high-tech industry sectors posess certain characteristics that provide opportunities for unilateral trade policy which could be harmful to all trade partners in the international competition, if practiced by all trade partners. In recent years, EC anti-dumping measures have grown increasingly trade restrictive. Some examples of EC practices.

Firstly, The GATT Antidumping Code[10] provides that investigation shall normally be initiated upon a written request by or on behalf the industry affected, and that --this is important condition --such a request must be supported by sufficient evidence". In practice, however, the EC has often initiated investigations where the petition did not establish a prima facie case of dumping and injury. Secondly, the introduction of the in 1987 extended anti-dumping legislation for imported product-parts, in order to prevent anti-dumping measures being circumvented by Japanese companies assembling like products in EC member countries on the basis of imported product-parts.

Because the cases of the photocopier[11] in 1968 are the typical example in which anti-dumping and anticircumvention procedures were combined, it is worth investigating what are the consequences of the inconsistent and discriminative decisions of EC Commission to Japanese manufacturers for European photocopier market? Under inconsistent" and discriminative" I mean the arbitrary use of criteria in the antidumping office for drawing a clear borderline between domestic firm as follows: the first is the criterion by production volume, the second one is defined in terms of ownership and lastly the third refers to the production relationship between the firms involved. If we consider the Article 2.6[12] of the GATT Antidumping Code, and at the same time investigate the factual situation in European photocopier industry including Japanese firms in terms of production, of ownership and of production relationships, it is easy to confirm that the identification procedure of domestic firms by EC antidumping office is inconsisitent with the GATT Antidumping Code. Concretely, the inconsisitency and unfairness to exclude Canon and other Japanese sourcing firms from the EC industry and to include Xerox in the Antidumping case was compounded by the unfairness to exclude Xerox from the anticircumvention cases.

Considering an industry sector with highly differenciated products --photocopier industry the case --we can often find networks of transactions between competitors. One example for them is a strategy of OEMs (Original Equipment Manufacturers). This is advantageous strategy for both side, because they can enjoy the benefit from large economies of scope. In today's borderless economy, in which products, parts, capital and technology beyond border freely move, almost every firm buys special products and parts from other competitive firms instead of producing them directly. If so, the above mentioned photocopier industry case combining antidumping and anticircumvention procedures would bring undoubtedly inefficient and costly result in European market. Nevertheless, the antidumping office has decided to choice the jour firms (Xerox, Olivetti, Oce· and Tetras) as constituting the EC industry". This decision seems to me to have led to anticompetitive barriers to entry. For instance, the antidumping office states that the investigation showed that, if no protective measures covering segment 1 and 2 copiers were taken, then the process actively engaged in by Rank Xerox of replacing key parts sourced from Japan with Community--produced supplies would be jeopardized". The statement sounds a targeting industrial policy of EC favored to the four firms.

2.3. Separated disposal of direct investment and of local content requirements

The regulatory structure is the total setup of legal institutions defining and enforcing the market rules. The regulatory structure shapes consequently fundamental economic conditions of respective markets. The regulatory structure in EC is embodied, except for GATT rules, in the Treaty of Rome(1958), the Single European Act (1986), and a lot of directives announced by EC Commission in every year. It is selfevident for Japanese firms to follow such regulatory structures, when they do busi-

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ness in integrated European market. What often headache for Japanese firms is, however, is the wide range of rules and regulations to which firms face. Although the Community aims to harmonize every regulation and to replace national legislation by uniform Community rules, the regulatory structure can be inconsistently shifted with manipulating it by polititians, bureaucrats and pressure groups in EC member countries. This is the case in which foreign direct investment and local content requirements are separatedly disposed between the Community and the member countries.

The separated disposal of foreign direct investment and of local content requirements[13] is reflected clearly in the legal actions of EC against Japanese business behavior in the 80s. What were formerly merely undertakings are after the second half of the 80s being made into duties on the ground of antidumping rules. In addition, the EC Council of Ministers adopted a new regulation on 11. July 1988 to extend this antidumping duties to assembly parts, as already mentioned. This is a duty to prevent the circumvention of antidumping measures. Under this legislation, the Community can define circumstances to levy duties clearly. One of these is that more than 60% of the parts used must come from the same country as the product originally found to be dumped. If 40% or more come from elswhere (not necessary the Community), it is not possible to apply this special duty.

This 40/60 split is certainly not a limitation on foreign direct investment nor a rule of origin. It is merely a condition for imposing this specific measures. However, a misuse of the rules of origin may being inevitably unfavorable effects for Japanese exporters, because these rules make in the context of antidumping measures easily possible to extend the coverage of antidumping duties to products manufactured in EC or in the third countries using imported parts. Furthermore, EC countries could use these rules of origin to expand the items of products manufactured in a third country toward quantitative restrictions applicable to Japan. Indeed, this specific measures and new rules of origin (for Japanese semiconductor on February 6. 1989 and for photocopier on July 11. 1989) have given a bad impression to Japanese business circle, because in practice these legal actions of EC treat Japanese producers discriminatively, as already sketched.

From these examples we have to acknowledge some intended change of legal actions of EC in the scheme of GATT. With paying respect on GATT rules, however, EC has occasionally an intent or, more concretly to say, a necessity to manage and conduct trade relations by diplomacy in a way of making her legal actions conform to the original economic policy goals of the Rome Treaty. This would be logical and political consequences from European regionalism.

2.4. Voluntary export restraints

Japan has been forced to enter into a number of voluntary export restraints, as a last resort in order to avoid unilateral import restrictions by US and EC. However, final results of voluntary export restraints until recently are, in general, disputable determinations of relevant trade volumes after bilateral negotiations.[14]

In January 1992, when US President Bush visited Japan, the two heads of state announced officially the action program in which Japanese car makers shall import about 19 bill. $ US-made car-parts in 1994 against 9 bill. $ imports of the same items in 1990. In March 1992, moreover, MITI has decided in the negotiation of voluntary car-export restraint to reduce the export volume to US (1.65 mill. units for the year 1992) by 5% of previous year. In the same way, MITI has recently reached a final conclusion of voluntary car-export restraint with EC, while the import quota of Japanese cars into EC is to abolish by the end of this year. These bilateral arrangements have long been recognized to function as a rent-seeking collaboration between exporters whose volume are restrained and importers, at the cost of consumers. If both exporters and importers (mostly competitors) could find a compromise for the resultant rent, both side has practically no incentive to complain. After all, such grey-zone measures" remain in the GATT negotiations untouched without dispute settlement panels.

Much yet remains to be discussed for the arbitrary function of voluntary export restraints. One of the most dangerous functions is that they provide a window for any uncompetitive industriy sector to press the government to bargain on its behalf with a foreign government. This induces easily to deal with foreign governments, showing off some risks of retaliation and possible use of unilateral enforcement measures. Krishna [14] gives a theoretical background for such unilateral trade policy: "It is now understood that to the extent that national interests do not include the well-being of foreigners, in particular of foreign firms, there may be a case for trying to draw away the profits of foreign firms. This can be done directly, or if this is illegal, indirectly, by altering the behavior of domestic firms in order to improve their strategic position. Attention has forcused on the use of taxes and subsidies for such purposes." Sir Brittan, Vice President of EC Commission, spoke about this topic with more political tone on October 6, 1989 at an occasion of EC/ Japan journalists' conference in Hakone, Japan, mentioning, "we must ensure that Europe's motor industory is fit to respond to world-wide competition. Europe's motor manufacturers have made great progress in this direction, and it is interesting to note that this year, the Commission introduced much stricter rules limiting state subsidies given for new motor industry investment in the Community. I would underline that these limits are without predudice to whether the investment concerned is by a European, an American or a Japanese company. It will be judged by the same criteria." Recent action of the EC Commission in 1992 against the case of subsidy by netherlandish government is consistent to this strict rules. Netherlandish government planned originally to give about 700 million guilder subsidy for joint production of Volvo and Mitsubishi motor Co.

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However, it is said in Japanese business circle that the strict application of such rules would make European companies shrink to decide to enter into a new market by joint production.

3. Japanese industrial policy

The unilateralism is not solely a EC phenomenon. Japan has also stamped the most serious of major unilateral players. Because of running trade surpluses to EC and US, closed domestic market structure and cultural differences, Japan has continuously given the impression of a conscious protectionism to EC and US. In addition, Japanese targeting policies for strategic industry sectors has been acknowledged as unfair"[15] on the grounds that they attempt to dominate world markets by utilizing unfair subsidies, implementing improper tax advantages, and sealing off domestic markets.

Both Japanese government and business circle know very well that the pressures toward unilateralism in advanced countries is a serious threat to the multilateral trade system. Therefore, the Ministry of International Trade and Industry (MITI) and Keidanren (Japan Federation of Economic Organization) have decided to discuss intensively on Japanese trade and market--opening with EC Commission and US government since the beginning of 80s, bearing special responsibilities as sustained surplus country when the total system has chronic imbalances. This is clearly the one of positive impacts of EC 1992 on Japanese economy. Industrial(targeting) policy and opening of domestic markets in the recent past can be sketched as follows:

The major purpose of industrial policy[16] by MITI consists of helping to set a future vision of relevant industry sectors and providing, if necessary, funding through government financial institutions that is in most cases limited to the area of basic indutrial technology. This measure is GATT-legal, because it has no intention to assist some product development. It supports only private initiatives collaterally. Interestingly, the financial scales of Japanese industrial policy do not diverge substantially from the practices of other advanced countries. Compared with percentage of national income as well as percentage financed by public fund, Japan showed figures of 3.43 and 17.1 in 1989 respectively, whereas Germany 3.70 and 33.2, France 2.65 and 49.3, United Kingdom 3.01 and 38.4, and lastly US 3.36 and 46.4 in the same year. Accordingly, the allegation that Japanese industry enjoys as unfair advantage over EC and US industry is simply the unfortunate result of misunderstandings on Japanese industrial policy.

4. Opening measures of Japanese markets

European countries have repeatedly demanded that Japan should open its markets to their products.[17] Since Japanese government anounced in May 1979 that it would cut tariff rates ahead of the schedule set at the Tokyo-round of multilateral trade negotiations with a view to opening Japanese markets, Japan is free trade country according to GATT legislation. However, Japanese markets are not open because of difficulties to market access. It would be sufficient as one example for it to refer to intricate import inspection and testing procedures. In the case of import inspection and testing procedures, conflicts of interest among government ministries and agencies have often prevented any action from being taken until EC Commission and US government have blamed Japanese delayed approvals as one of the most serious NTBs.

European newspapers and magazines charge that the inability of European producers to increase their Japanese market share is due, among other things, to control of respective markets by Japanese manufacturers. The existence of "keiretsu" and complicated distribution channels in Japanese markets is perceived to be detrimental in penetrating Japanese markets. "Keiretsu" is a general expression of various (physical, financial and personal) activities within corporate groups. It may be difficult to point out one or another actual case in which a particular company in a group would try to curb imports of competitive products to benefit another company of the same group, because on the one side these import barries have been developed within the corporate groups and on the other side foreign competitor does not belong to this corporate groups.

When US ambassador Armacost adressed the 27th Japan-US Business Conference in Osaka on July 9, 1990, he said, "relaxation of the Large Retail Store Law, and full implementation of a government plan for deregulation of six major sectors, including telecommunications, distribution and finance, are examples of measures which should greatly extend business opportunities for Japanese and foreign firms". The beneficial outcome from these deregulation measures should be applied in the same way to European producers. Otherwise Japan would be characterized as "a Fortress Japan", reflecting serious frustration business world. In order to avoid such bad name, the Japanese Fair Trade Commission should watch strong tie of corporate groups colsely and apply the Anti−Monopoly Law against actions that limit competition more strictly.

Let us review some of still existing NTBs which have traditionally been considered domestic matters, where foreign views have seldom been taken into account, and at the same time effective implementations to market access of foreign competitors.

4.1. Distribution

Usual perceptions of Japanese distribution system are a) the overall existence of small stores, b) the complexity of wholesale distribution chanels, c) the wide practice of resale price maintenance, liberal acceptance of returns and weak enforcement of Anti-monopoly Laws. The density and the average size of Japanese retailers are quite high and small. The wholesaler is also characterized by a high density. And a product will often pass through several wholesaling tiers before it reaches the retailer. These characters may impress that the Japanese distribution sector is economically backward, inefficient and intractable. M. Ito[12] and T. Ito and Murayama[13] have presented some quantitative evidences on efficiency of Japanese distribution system. Ito and Murayama[13]

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conclude as follows: "[I]ts performance, measured by value added, gross margin, operating expenses, and labor costs, is quite comparable with US performance. Hence, we do not have any evidence to conclude that the Japanese chatacterisitics are symptoms of inefficiency."

Japanese consumers prefer to buy fresh foods everyday. They visit neighborhood shops for small quantities of groceries. These customs appear to be very different from those of US and EC consumers. With detailed investigation of such consumers' behavior, however, we can also confirm that retailers correspond efficiently and rationally to cover consumers' demand by delivering pronptly ordered goods from wholesalers' storage, thereby they can at the same time reduce the inventory costs.

What is then main reason as to why US and EC attack institutions and business practice in the Japanese distribution system as a significant non-tariff barrier? They suspect that market imperfection would emerge some discriminative effect against their exports and the entry of newcomers in Japanese market. It is worth mentioning that the removal of the impediments would rectify the large differentials between domestic and overseas prices and so surely improve the Japanese consumers' welfare.

It is not easy for foreign exporters to establish their own distribution networks anywhere in the world in a relatively short period. It is also valid in Japanese market. Unfavourable business for foreign exporters would, however, emerge explicitly, if exclusive distributorships do not necessarily share the same interests as their foreign clients, with discriminatively heavy markups for Japanese distributors and lower sales for the foreign exporters. Such practices procuce inevitablely higher prices for a broad range of consumer and capital goods in Japan.[18] Today, many Japanese believe that reform of inefficient and costly distribution system is essential and urgent. Otherwise unfoutunate perception among Japanese of " rich Japan, poor Japanese " remains unchanged.

Recently, the liberalization of regulations and marked improvement of inefficient practices have proceeded apace. Japanese government has eased its restrictions on the opening of large retail stores, which tend to carry more imports than smaller outlets.

Large-Scale Retail Law was amended and streamlined approval procedures were put into pace. She has revised the distribution-related guidelines of its Fair Trade Commission. She has also adopted a number of import promotion measures involving tax incentives, low-interest loans, and lower tariffs.

4.2. Exclusionary business practices

Any exclusionary business practices distort competitive market structure. The US government has tried to negotiate intensively with Japanese government in the scheme of SII(Structural Impediments Initiative) for a effective and comprehensive approach for deterring private anticompetitive behavior in Japan. US government and American business circle have always judged that effectiveness of Japan's anti-

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monopoly low has been constrained by inadequate penalties,[19] less than vigorous enforcement and numerous exemptions. In order to enforce the Japanese Antimonopoly Law more strictly and rigorously, it is at the same time necessary to reexamine the individual industrial law and other legistrative measures that provide statutory waivers from the applicaiton of the Anti--monopoly Law. Generally speaking, competition policy should be reviewed by securing transparency in the management of the law. In addition, the close relationship in Japan between the government and the private sector would contain discriminative and exclusive distribution of some valuable informations for particular groups. Therefore, in case administarative guidance needs to be provided, it should be done in writing instead of verbally. Various guidance and distribution of relevant informations by the Fair Trade Commission must be also applied in a spirit of openness and not in any arbitrary manner.

According to the record as the joint text issued 18. March, 1992, Japanese government has acted to strengthen the enforcement arm of the Fair Trade Commission by increasing the investigative staff of the Japan Fair Trade Commission. The positive result from it is that in the first eleven months of 1991, the Fair Trade Commission took 26 formal actions against antimonopoly violators, quadruple the average number of actions taken in the six years prior to SII.

The Japanese government amended the Antimonopoly Law to increase the Fair Trade Commission's administrative fines automatically imposed on companies committing the most egregious antimonopoly violations. Thus, large manufacturers and service providers are assessed an administrative fines of 6% of the value of their sales involved in the violation. In addition, Japanese government committed to bring more criminal enforcement actions against antimonopoly violations such as price-fixing, bid rigging, market allocations and group boycotts. One example of this criminal antimonopoly action is the case of a price-fixing cartel in the plastic food wrap industry.

4.3. Keiretsu

In connection with exclusive business practices, various keiretsu forms and relationships of business organization in Japan may also bring possibly complicated distortions into respective markets. Keiretsu may promote "buy Japan" mentality that exists in the keiretsu-affiliated sectors. It is clear that some keiretsu practices have strong and extensive adverse effects both on the efficiency of the Japanese economy and on its openness to foreign suppliers and investors.

Among the perceived problematic features of Japanese distiribution system and industrial structure, the long-term transactions among members of keiretsu, consignment sales, and rebates have been thought to impede the entry of new imports. One example of distribution keiretsu: by developing their exclusive distribution system, manufacturers of consumer electronic products can carry a set of their own brands in this vertically semi-integrated

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retailers. In addition, the regulations like the Large-Scale Retail Store Law would block the construction of big retail outlets and so disturb to take advantage of scale economies.

These two questions (inefficiency and non-tariff barrier in Japanese distribution system) were, as well-known, important topics in the SII talks between Japanese and US government. Contrary to the judgements on keiretsu practices by US and European scholers,[20] however, Japanese academic studies appear to emphasize the practices as rational behavior to promote systemic innovation and to build golbal corporate networks.[21] Indeed, some empirical studies for Japanese distribution system show that its performance, measured by value added, gross margin, operating expense, and labor costs, is quite comparable with US performance.[22]

It is worth mentioning, however, that keiretsu leaves open a possibility as a barrier to potential new entrants from both domestic and foreign manufacturers, even if keiretsu and distiribution system in Japan are judged to be rational and efficient, in the true sense of long-term relationships. Therefore, it is reasonable that in the SII talks the US representatives have repeatedly referred to the importance of vigorous and effective enforcement of the antimonopoly elememt in the discussion of exclusionary business practices.

5. Foreign investment and technology transfer

There is an obvious, but important difference between trade flows and foreign investment. The former are dependent on economic growth trend and heavily influenced by market conditions and foreign exchange risks. The latter implies a longer term commitment to respective markets in order to respond to changing market conditions and to reduce trade risks.

Table 3 shows the direct investment in Japan by country and Table 4 its trends of total amount. Throughout four decades (1950-1990), US foreign investment in Japan represented about the half of the total, but by 1990 the US share has fallen to some extent. And we can confirm that European firms are increasing their investments in Japan. Because European multinationals continue to mature as international investors and be interested in the markets of Japan and East-Asian countries, this trend is likely to be reinforced.

Table 3 Foreign investment in Japan by country (mill.$)

	1990	1950—1990 (total)
US	664	8,573
Switzerland	142	1,157
Germany	259	950
UK	54	652
Netherlands	734	1,464
Hong Kong	62	515
France	74	301
Canada	142	329
Foreign affiliated companies in Japan	231	2,082
Others	415	2,408
total	2,778	18,432

Source : Ministry of Finance, Japan.

Table 4 Trends of foreign investment in Japan, 1982-1990 (mill.$)

1982	1983	1984	1985	1986	1987	1988	1989	1990
749	813	493	930	940	2,214	3,243	2,860	2,778

Source : Ministry of Finance, Japan.

As a whole, foreign investment of advanced countries has grown in 1980s very rapidly, induced by liberalisation measures of capital. US and UK recorded increase in this decade in real terms of 6-7% a year, while Japan and Germany, starting from much lower bases, increased their foreign investment at more than twice that rate.

There are remarkable differences among the G5 countries in their sectoral patterns of foreign investment. The US foreign investment is concentrated in the manufacturing sector. This reflects straightforwardly the shift of production bases from US to overseas, aiming to regain world market share in manufactured exports. Japanese firms have been drivingly investing overseas at a record pace in 80s(Table 5). This was partly due to the threat of protectionism in major export markets, partly due to the MITI-initiated stategy to internationalize Japanese business and partly due to yen

Table 5 Japan's foreign investment by Region and industry, 1991 (mill.$)

	North America	Latin America	Asia	Europe	Oceania	Others	Total
Iron & nonferrous metals	4,183	2,074	2,804	599	455	193	10,308
Chemicals	4,824	775	2,641	1,415	131	1,154	10,940
Electrical equipment	11,099	638	4,175	4,322	104	23	20,360
Transport equipment	5,030	1,284	1,699	1,899	947	21	10,880
Textiles	759	452	1,867	865	12	43	3,999
General machinery	3,973	424	1,649	1,794	80	12	7,932
Lumber & pulp	2,061	205	525	20	157	1	2,969
Manufacturing, total	40,322	6,281	18,659	12,540	2,302	1,508	81,613
Mining	2,089	1,605	7,357	1,559	2,947	983	16,539
Commerce	16,983	2,179	3,792	6,700	1,602	59	31,315
finance & insurance	19,393	14,651	4,231	25,129	1,755	160	65,319
Transportation	510	12,201	1,095	229	167	3,235	17,438
Total	136,185	40,483	47,519	59,265	18,098	9,257	310,808
ratio(%)	43,8	13,0	15,3	19,1	5,8	3,0	100

Source : Ministry of Finance, Japan.

Table 6 Japanese imbalance of foreign investment (mill. $)

	1984	1985	1986	1987	1988	1989	1990	total
outflow(A)	10,155	12,217	22,320	33,364	47,022	67,540	56,911	310,808
infolw(B)	493	930	940	2,214	3,243	2,860	2,778	18,432
ratio(A/B)	20.6	13.1	23.7	15.1	14.5	23.6	20.5	16.9

Source : Ministry of Finance, Japan.

appreciation. One remarkable point is that a big volume of investment outflow from Japan has brought calls for greater reciprocity for foreign-owned firms in Japan. Table 6 provides the Japanese imbalance of foreign investment between outflow and inflow. Comparing with the factual ratios of US, UK and Germany which are 1.0 for the year 1990, 1.7 for the year 1989 and 2.2 for the year 1990 respectively, the Japanese ratios are abnormally large, i.e. reflected a combination of massive outfolw from Japan and negligible infolw into Japan. It is convincing that there have been and, will continue to be, calls for investment reciprocity with Japan just as there have been in the sphere of trade. In parallel with this small volume of foreign investment, the activities of foreign-owned firms in Japan are limited in only energy-and resource-intensive sectors: oil, rubber, chemicals and nonferrous metals. In order to consider the future outcomes of economic conflict and cooperation between Japan and EC, it is worth investigating, firstly the role of local production and business activities by foreign investment, and secondly important role of technology transfer through mutual foreign investment.

5.1. Local production

Foreign production allows multinational enterprises to enjoy the status of a local company in each of its principal markets. This has the advantage of removing the threat of trade restrictions. Many Japanese world enterprises have openly claimed that the threat of US and EC trade restrictions against their exports has been one of the most important catalysts for their local production in US and EC. In spite of such advantage, there are anywhere in the world some limitations. Few foreign-owned firms could achieve fully comparable political status to that of local firms. In addition, foreign-owned firms are always under the risk of being accused of "screwdriver operations" designed to avoid tariffs by importing components for final assembly in the host country, even when local content ratios satisfy neessary requirements. As shown in Table 5, the Japanese presence in Europe is even in recent time relatively small: Europe represents about 19.1% of the total, running well behind North America(43.8% of the total).

Notwithstanding, the critical judgement of European countries on Japanese penetration in their markets is to be found in the rapid growth and sectoral concentration on this presence in recent years, as sketched by Micossi and Viesti[18], and in the remarkable imbalance between outflow and inflow with Japanese foreign investment, as already shown in Table 6. For solving such imbalance as soon as possible, MITI has announced in November 1991 the action-program of business global partnership to promote imports, to raise local content ratio and to accelerate joint-venture. Thus, MITI provided the followign five assistance measures for foreign-owned firms in Japan, aiming at (1)decreasing of initial costs with tax measures, including extended tax loss carry-forward provisions, (2)supplying of investment-necessary capital with favorable conditions offered by Japan Development Bank and other government entities, (3)accomodating of infra-stractures, (4)insuring of appropriate personnel and (5)presenting of investment-related informations by JETRO. These measures are expected to make atractive for investing directly, promoting imports and not lastly enlarging local prodution by foreign-owned firms.

In the high-tech industry sectors, in which the impotance of labor costs as a share of total costs has relatively decreased, and productivity can be realized by means of technology transfer in highly competitive level, there seems to have become more flexible for multinationals when deciding where to invest. This is main background to be expected to expand foreign investment and local production between Europe and Japan mutually.

5.2. Technology transfer

Although recently foreign production has become a viable alternative to exporting, we must not forget the important role of technology transfer in foreign investment process. As Krishna[14] correctly described, this thechnology transfer poses domestic firms often to decide "whether to make one's product compatible with a competitor's products."[23] In decision-making of compatibility choice, they are involved in externalities of transfered technology. It is of course very difficult to generalize that highly sophisticated technology of Japanese high-tech industries today superior to those of European industries. But in view of trade balance concerning electronics and transport machinery, i.e. mass-market consumer durables and office equipment, Japanese technology appeares to have gained a signficant competitive edge. In addition, the management system of such scale-intensive industries in Japan could be utilized in EC market more intensively through technology transfer. Micossi and Viesti[18] refer: "more extensive, flexible and integrated (system design) use of automation, shorter product cycles, just-in-time methods, tight quality control, ability to change production flexibilty to meet demand, great simplification of product design (fewer components), a pyramidal system of sub-contracting that is very important in ensuring tightly centralised decision-making."

Over the next five years we could expect to see a slower rate of foreign investment growth into the US and a higher growth of it into Europe, reflecting accomplishment of unified market in EC. However, Europearn countries don't become still concious of its position in the world economy as recipients of foreign investments and technological transfer from Japan and as investers of them into another countries as well. On the contrary, Japan is showing greater interest in Europe as part of a general broadening and rebalancing of her international interests as a big economic power away from heavy reliance on the US. Thus Japan has a full responsibility to harmonize the pace of foreign investment and technological transfer between advanced countries in coming years.

6. Concluding remarks: Toward more harmonized relationships between Japan and EC

In the age of conflict and cooperation,

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what are Japan and EC required to do? At the core of possible cooperation should lie such common values as leaders for maintaining and promoting a free world economy and environmental protection.

First, through positive action, Japan and EC should demonstrate a zeal for such values to make the world recognize that Japan and EC are striving on the common rules for what the world economy ought to be. Setting limits of international relations to those between Japan and EC only, I regret to say, Japan is apt to be too flexible in switching between "principles" and "true intentions", whenever negotiations progress. Indeed, Japan used often several contentions each in its proper way. While calling for a free trade and capital liberalization, Japan in 70s often said, and says still today for some sectors. "Our domestic situation is an exception."As long as it retains this way of "free rider", Japan could not gain the trust of the international community and display leadership in the age of cooperation. On the other side, EC should correctly acknowledge the merits of foreign invetsment and technology transfer from Japan. Several trade-related investment measures adopted now by EC would hinder to supply high-quality products that consumers are satisfied.

Second, in the case of the Uruguay Round, debate in Japan and EC focuses mainly on the issue of opening of agricultural product market. Debate from a broader perspective, i.e., concerning a new world order of international trade and new issues such as intellectual property, service trade and governmental procurement, is more essential to develop the world economy in coming years. Regarding unification of the European Community, Japan's fear is that its products may be shut out of Europe as a result of its fortification. In my view, this fear emerges partly from misunderstandings on Japanese side, but partly from protective measures and deficient adjustments on EC side. As long as Japan and EC responds to every international development from the viewpoint of its narrow national interest, cooperation between Japan and EC will be in today's global activities of worldenterprises more difficult. In dialogue and negotiation, each party should clarify its views and arguments, consider the other party's positions and circumstances. Spending a great effort to do so will ultimately benefit both sides, because no country can today hope to be a solitary victor.

Notes

*) This paper was prepared for presentation at the Florence Conference on Europe and Japan : cooperation and conflict, June 4−6, 1992

1) The issues as to how open is Japan have been extensively analysed and evaluated by both Japanese and foreign scholors. The overall investigations of Japanese market would continue to analyse which of Japanese trade policy and practices have the potential to act as unfair impediments to free trade. For a comprehensive study on the Japanese market with careful distinction bet-

ween markets that are open to products and markets that are open to firms, see Lawrence[15] and Saxonhouse[22].

2) A substantial amount of trade imbalance remain between Japan and US in the years ahead unchanged. After the second half of 80s economic frictions in terms of technology and investment emerge continuously, not much improvement of US competitiveness could not be expected. As near as one can guess that sustained imbalance and rapid increase of Japanese investment in US are regarded as a threat to America's ability to control its economy, it is feared to develop into serious political issues.

3) Intra-industry trade coefficients are defined conventionally for net trade as follows:

$$\text{Index}=\sum_{i=1}^{n}[(X_{ij}+M_{ij})-|X_{ij}-M_{ij}|]/\sum_{i=1}^{n}(X_{ij}+M_{ij})$$

where i denotes manufacturing category, j denotes country, and X and M are exports and imports, rspectively. Saxonhouse[21] has developed new measure for intra-industry trade coefficients, because "trade research that uses net trade as a dependent variable does ignore the possibility that Japanese policy may have worked to keep down both imports and exports." His coefficients are derived from intra-industry equation for gross import shares expressed as a percentage of GNP. This new coefficients of Saxonhouse takes relevant effect of factor endowments on trade structure into account. With his empirical study, he says that "it is difficult to argue that Japanese sectoral policies are yielding distinctive outcomes", recalling at the same time that this does not necessary mean that Japan has a liberal trade regime. Under the given factor endowments with relatively small amounts of arable land and little amount of energy, "the removal of the remaining distinctive formal and informal Jappanese sectoral barriers to the import of manufactures, ... may have little effect on Japanese trade structure". See especially his concluding remarks. It is worth noting in this connection that Lawrence[15] has emphasized the important role of intrafirm transaction to determin the low level of Japanese intra-industry trade coefficints. Multinational companies investigate always the optimal possibility to combine the most favorable production factors in the world in order to reduce the cost of operating. This promotes usually direct foreign investment to intensify advantageous intra-firm transactions under differences in product as well as factor market imperfections. For a theoretical analysis of factor market barriers, see Baldwin[1].

4) By investigating regional differences of intra-industry trade coefficients, we can confirm that factor endowments are the important determinants of trade flows.

5) Fundamental reforms in agricultural trade are now being attempted in the Uruguay Round. Governments in advanced countries are, though not so easy as one wishes, prepairing to make changes in more harmonized and long-standing policies after sucess of Uruguay Round. Consequently, future picture of agricultural products appear likely to change drastically.

6) Policy adjustments for removing trade and investment barriers in Japan are discussed at greater length in section 4.

7) Although reciprocity is contained originally in the spirit of GATT rules, there would be always a danger setting off a result-oriented policy stance for judging international trade, if policy initiatives of EC that stress achieving a Japanese market that allows a given quantity of imports equate openness with increased imports. This is one of the main reasons as to why Japanese government and business circle have reacted so sharply on the EC's reciprocity. For the interpretation of reciprocity in US, see Hudec[9].

8) GATT remains as the basic set of rules of international trade still today valid, we could not overlook the fact that GATT is by no means comprehensive and perfect. GATT does not contain an adequate set of rules for the so-called new issues in the negotiations of Uruguay Round, including service trade, intellectual property and government procurement. The claim of reciprocity by EC is consequently closely connected with this imcompleteness of GATT rules which are not sufficient to and adequate for the changing structure of international trade today.

9) However, it is worth noting that EC has adopted a directive authorizing unilateral retaliatory action against other countries that do not permit effective market access or national treatment to EC financial institutions.

10) A number of amendments to the EC's basic Antidumping Regulation, adopted by the EC Council of Ministers on 11. July 1988, have led to an important change in the character of the Regulation which was originally derived from the GATT Antidumping Code. Some of key points are the new provisions concerning profit margins for constructed normal value and concerning comparison of normal value and export price. According to the GATT Antidumping Code, a reasonable amount which shall not exceed the profit normally

realized is included in calculalting constructed value. The new provisions provide a clearer legal basis as a matter of Community for some of the Commission's more controversial practices. Whether these amendments of the Regulation are compatible with GATT Code is open to question.

11) A detailed and complete survey of photocopier case is in Messerlin and Noguchi[17]. Under the new Regulation, profit is to be determined "on the profitable sales of the like product on the domestic market", rather than "the profit normally realized on sales of products of the same general category on the domestic market of the country of origin". In addition, profit margins are narrowly derived from profitable sales, rather than from broad categories of sales which are profitable. Recalling actual business activities in "economies of scope", there could include some unprofitable unit sales in this broad categories of sales which are profitable. This would make possible to calculate an unusually high profit margin, thereby artificially inflating dumping margins, if the new Regulation applies.

12) It provides : "In order to effect a fair comparison between the export price and the domestic price in the exporting country..., the two prices shall be compared at the same level of trade, normally at ex-factory level, and in respect of sales made at as nearly as possible the same time. Due allowance shall be made in each case, on its merits, for the differences in conditions and terms of sale, for the differences in taxation, and for other differences affecting price comparability. [Where export price is constructed], allowance for costs, including duties and taxes, incurred between importation and resail, and for profits accruing, should also be made."

13) See Grossman[4], Hollander[8] and Vousden[25].

14) Although Japanese government insights the strategic position of foreign firms clearly, she has often tended to make decisions on a pragmatic basis without bringing the cases to the GATT panel, without the case of electronic typewriter. Contrary to the public stance to promote free trade, she don't like to confront with disputants and to form the de facto government-supported producers' cartel. As Okuno-Fujiwara[19] cited, this is the in Japanese bureaucracy popular method of solving trade conflicts, as long as the dispute is nonrepetitive. For estimating tariff equivalents of voluntary export restraints functioned as a tool of the new protectionism, see Hamilton[5].

15) There is no common definition of unfairness. Someone argues with

employing consistency with the GATT rules and other international conventions, and another judges with differences significantly from those practicized in his own country as unfair or undesirable. Thus the criteria judging unfairness are often using inconsitently in respective cases.

16) In the Monthly Newsletter on the Singe Internal Market delivered by the Commission of the European Communities, Martin Bangemann, Vice-President of the European Commission, expresses in April 1992 that "A modern conception of industrial policy ... has nothing in common with the protectionist initiatives of the past, unless it is the term. One cannot carry out an effective industrial policy today with out-dated protectionist concepts of subsidies and quotas." As the severe judgement on the Japanese industrial policy, Tyson[24] refers to important role of MITI in targeting leading industries and in encouraging competitiveness in targeted industries.

17) It may be necessary to remind again the careful distinction awakened by Lawrence[15] between markets that are open to products and markets that are open to firms, because "once established in Japan, foreign firms may find it in their interest to bolster rather than remove entry barriers."

18) Taking inflexible stance of Japanese government into account, continuous foreign pressure would be helpful and even effective for increasing consumers' welfare.

19) The US government in the SII talks proposed repeatedly stiffer sanctions against violations through a revision of the Japaniese Antimonopoly Law, While in enforcing the antitrust laws the US judiciary punishes violations with criminal penalties, it contrasts with the Japanese and European practices of countering violators by administrative measures.

20) See Saxonhouse[22] and Petri[20]. They and other foreign scholers suspect that the keiretsu or corporate groups do little more than exclude newcomers and impair free trade.

21) See Imai[10] and Ito[11]. They judge a network-building within the keiretsu or corporate groups as a positive response to a set of market failures under conditions of oligopoly, external economies and imperfect information. Although the keiretsu has such a raional basis in terms of industry-organizational structure, there would be inevitable gap between insider and outsider in the circumstances of more or less exclusionary business practices. If long--term relationships of transaction within the keiretsu is guaranteed with the leading role of some big corporations, the entry of outsiders

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into the Japanese market becomes much more difficult.

22) See Ito and Maruyama[13].

23) With regard to the close relationship with trade policy, Krishna[14] continues to say that "This matter has at least two aspects that are relavant for trade policy. The first is that in an effort to keep out competition, firms may deny networks linkages to competitors by making their product imcompatible with products of foreign firms, thereby effectively impeding competition. Often international competition is more effective in holding down excess profits than domestic competition, given the size of some firms in these industries."

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