

EUROPEAN UNIVERSITY INSTITUTE
Department of Political and Social Sciences

**EC-JAPAN RELATIONS, 1985-93:
The impact of foreign direct investment on regional political integration**

Thomas Bourke

Thesis submitted for assessment with
a view to obtaining the Degree of Doctor of the
European University Institute

FLORENCE, SEPTEMBER 1995

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FLORENCE, SEPTEMBER 1995

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July, 1995

INTRODUCTION

This thesis concerns the impact of global political economic dynamics on the evolution of regional political integration. Specifically, the thesis examines the impact of one manifestation of globalisation - Japanese foreign direct investment - on the European Community. A working hypothesis of this study is that the recent evolution of the EC has been determined as much by external dynamics as endogenous design. The thesis argues that the dominant emphasis on endogenous developments in the literature on European integration is increasingly inadequate in an era of transformation in the global political economy.

The research project began by approaching the relationship between the European Community and Japan in an 'international relations' paradigm. However, preliminary findings led to a shift in focus. Economic diplomacy between the Community and Japan since the Treaty of Rome has evolved into a major, although specialised, link in the global system. In this configuration, Japan is one of the many 'external relations' of the Community. The literature review below suggests that a bilateral paradigm was indeed fruitfully applied to the analysis of the relationship in earlier times. Chapter V of this thesis in some ways constitutes a microcosm of such an approach. But the traditional means of examining EC-Japan relations is no longer sufficient. The evolution away from a bi-lateral approach towards a systemic research question, involved both a narrowing of the empirical research and a broadening of the theoretical questions. The interaction between regional political integration and global economic integration emerged as the most important theoretical nexus in the analysis of EC-Japan affairs, 1985-93.

The European Community is both a structure and a strategy. The EC's constitutional reconstruction around the SEA and the '92 Programme was essentially a political and *de jure* strategy. Although processes of regional economic integration are present in western Europe, and although these may overlap with, and be mutually influenced by political integration; regional economic integration can take place in the absence of a centralised political authority. The regional European integration treated in this thesis is normally termed 'political integration' but may more accurately be termed 'political economic' integration. The term 'regional' as used here, refers to continental regions (eg. the European region) rather than regions of the EC member states which are referred to as *sub-states* or *sub-state regions* (eg.

Alsace).

The constitutional and competitiveness-enhancement projects of the EC during the 1980s, were launched in an environment of rapid systemic change. Such change was by no means *de jure*. In fact the period witnessed a distinct absence of credible global political economic regulation. Globalisation is understood as an organic, *de facto* mode of trans-territorial integration. The principal agent for such globalisation during the period was foreign direct investment.

The European Community's most important external relationship is with the United States of America. Relations with other European states are also important. Japan has dramatically grown in importance on the global political economic stage - her technological capability and strong presence in high value-added sectors underlining trends visible in trade and FDI volume. Japan thus constitutes one of the most important external relations of the EC. This thesis investigates the extent to which an (initial) externality can have an impact on the otherwise internal, *de jure* evolution of regional political integration. One area in which this dynamic is examined is in the role of Japanese firms in the evolution of the 'blueprint' for the single European market. The ability of the EC Commission to maintain 'internal' control of the market and establish itself as gatekeeper to that market is examined. The impact of FDI on the internal/external geopolitical makeup of the Community itself is then analysed.

Relations between the EC and Japan are predominantly economic. Despite mutual consideration of salient issues such as UN reform and joint aid programmes, the greater part of the EC-Japan agenda concerns economic issues. During the mid-1980s EC-Japan relations underwent a profound quantitative and qualitative transformation. The period of accelerated global FDI and the inception of a single European market was markedly different from the preceding era of EC-Japan affairs. While the preceding period (1973-c.1985) was dominated by trade, the new era was one of *trade plus investment*. Such a shift had fundamental political implications for the evolution of the European Community. This thesis explains why the advent of FDI was such an important determinant of the course of the Single Market Programme and of European integration itself.

The analysis primarily concerns the rise and consequences of inward Japanese *manufacturing* investment in the EC. Manufacturing investment presents an opportunity to evaluate important aspects of the EC *raison d'être*; external trade relations; internal political economic philosophy; and strategies for competitiveness and employment enhancement. Manufacturing FDI is also more immobile than financial investment. As such, manufacturing locational decisions are a significant external evaluation of the Community and its constituent parts.

From commencing as a study of structural and diplomatic elements in the relationship between the EC and Japan, the analysis came to focus on the impact of systemic change on the constitutional evolution of the Community. The advent of FDI as a major new dynamic in EC-Japan relations focuses attention on the role of Japanese firms as agents of Japan's contact with Europe. This distinguishes EC-Japan relations from those between the U.S. and Japan, where the role of the Security Treaty must be considered as a vital government-to-government strand, influencing commercial as well as 'salient' relations. Such a dimension is non-existent in EC-Japan affairs.

The evolution from bilateral relations to a complex multi-leveled systemic analysis, implied consideration of multiple actors. These were: the EC-level, the member states, the EC sub-states and Japanese firms. The reader may be surprised by the prominence given to sub-state regions here, however this is justified given the front-line status of sub-states in FDI matters. A detailed treatment of sub-state dispositions and activities [Ch.III], when juxtaposed with a treatment of EC member state roles [IV] leads to a more contextual evaluation of the role of the EC institutions [V] in this important aspect of EC-Japan affairs. On the European side therefore, it is the EC in its constitutional entirety which is analysed. Many of the conclusions of this research could perhaps be applied to the impact of FDI from any source, but the EC-Japan framework has been retained since the regionalisation/globalisation dynamic is at the heart of the relationship, and because Japanese FDI constituted a 'leading-edge' position in global FDI during the period.

Fundamental changes in the nature of the EC-Japan relationship came about in response to developments within the Community (increased awareness of deficit 'problems', anti-dumping, the SEA, the '92 Programme) and changes in the global political economic

environment (the 'take-off' of FDI, liberalisation of capital mobility, enhanced information technology). This shift produced a move away from a stage in which the actors were separated by 'trading distance' to one where the interests, agendas and even identities of actors became increasingly difficult to distinguish. The thesis examines the different strategies of political authorities in this changed political economic environment. Complex bargains between actors implied a difficulty in defining the interests of the Community. The concept of regional 'competitiveness' which so influenced the inception of the SEA was becoming increasingly difficult to sustain. Between negotiation of the SEA and the coming into effect of the '92 programme, FDI had proliferated and posited a new *défi*, not to the state - but to the ability of regional political integration to enhance competitiveness. The advent of FDI challenged the 'traditional' political economic geography of EC-Japan relations.

The shift from relatively easy actor-identification to a complex overlapping and inter-meshing of interests, alliances and bargains also influenced the methodological and theoretical framework of this thesis. Two sub-disciplines of political science which probe the evolution of systemic realities in a particularly prescient manner were utilised. These are international political economy (IPE) and the post-Cold War revitalised field of geopolitics (neo-geopolitics). IPE has, for about two decades, stressed the importance of economic phenomena in international affairs, and has stressed the need to include non-state actors in the analysis of systemic realities. Geopolitics, a traditional field of study which was largely dormant throughout the perceived 'static' Cold War era, has undergone a revival since 1989. These two sub-disciplines share much in common, and have determined the structure and the course of this research project.

Within this broader methodological framework, insights came from two sets of theoretical literature; theories of European integration and theories of globalisation. The former includes functionalism, neofunctionalism, intergovernmentalism and writings on federalism. The latter includes traditional literature on 'world-economies', theories of the growth of big business, and the more recent theories of globalisation. These theories are introduced and evaluated in the following chapter.

by a decline in such new stocks in the early 1990s. This is a strong factor in the determination of periodisation for this research. It is argued that Japanese FDI can be analysed as an phenomenon which provides an opportunity to examine both the impact of globalisation on the evolution of the EC; and the EC itself as revealed in its actions and reactions towards the manifestation of such globalisation.

CHAPTER I THEORY AND METHODOLOGY

INTRODUCTION

This chapter outlines a methodological framework for the analysis of the multifaceted relationship between the European Community and Japan, and evaluates theories which may be fruitful for such an analysis. Relations between the EC and Japan have largely been economic, but have more specifically concerned multi-leveled political economic interaction. A purely economic approach would not therefore accommodate many of the essential facets of the relationship. EC-Japan affairs also have a strong legalistic character which is particularly evident in the application of anti-dumping measures by the Community; in the Commission's attempts to extend trade measures to cover FDI regulation; and in Japan's maintenance of various legal and quasi-legal instruments to regulate investment access and imports. However focussing entirely on the legal regime would omit the paramount political control which is exercised over legal instruments, particularly in relation to EC external commercial relations.

The term 'international relations' is adequate for the sub-discipline of political science to which it pertains. However, in recent times consideration of *international* or inter-state relations has become increasingly problematic. Apart from difficulty with its application to the European Community as a systemic actor, a traditional international relations approach is also problematic when applied to an analysis of firms and European sub-state regions in EC-Japan affairs. 'Realities' is perhaps more accurate than 'relations' since structures and endogenous elements are frequently as important as 'relational' considerations.

1.2 INTERNATIONAL POLITICAL ECONOMY AND NEO-GEOPOLITICS

This research project benefits from the insights of two sub-disciplines within political science which have posed particularly probing questions regarding dynamic change in the global political economic system. International political economy (IPE) and post-Cold War revived geopolitics (here termed 'neo-geopolitics') share many theoretical concerns. This thesis

attempts to bring these two schools together in a framework for analysis of EC-Japan affairs.

The distinct field of international political economy (IPE) is a relatively recent sub-discipline which provides important linkages between political science and economics. This literature attempts to overcome the deficiencies both of international relations and of international economics and seeks to move political economic realities closer to the centre of the analysis of systemic political phenomena.

While Galbraith, Bhagwati and Dunning for example, have all made essentially 'political economic' contributions to knowledge - these writers come from the 'nests' of economic philosophy, economics and international business respectively. The *pioneers* of the specific field of IPE are Shonfield and Strange.¹ Andrew Shonfield began to redefine scholarship on the emerging political *economic* landscape during the 1960s:

The truth is that in most Western societies, although the Government possesses plenty of means which it can use - if it has the will - to bully or to cajole big private firms, it also has to be ready on occasion to bargain and to compromise with their independent wishes.²

Susan Strange developed the emergent *problématiques* into the coherent field of IPE.³ Strange's particular areas of concern have been the implications for the international system of the increasing power and mobility of capital and the proliferation and implications of state-firm bargaining. Strange writes that "...the complexity of firm-state bargaining suggests that the political character of enterprises - which may differ in practice just as widely as the political character of states - is an important variable in the determination of outcomes for

¹ Robert Gilpin, Stephen Gill and Ronen Palan are part of this tradition. Richard Higgott provides a comprehensive overview; 'International Political Economy' in Groom, A.J.R. and Margot Light *Contemporary International Relations: a guide to theory*, Pinter, London, 1994.

² Shonfield, Andrew *Modern Capitalism: the changing balance of public and private power*, Oxford University Press, [1965] 1970. p.380.

³ Especially in Strange, Susan *Casino Capitalism*, Blackwell, Oxford, 1986. *States and Markets*, Pinter, London, [1988] 1994. *Rival States, Rival Firms*, with John Stopford, Cambridge University Press, 1991. On methodology see: 'Wake up, Krasner! the world has changed' *Review of International Political Economy*, 1:2 Summer, 1994. pp.209-219. For an overview see Morgan, Roger *et al* (eds.) *New Diplomacy in the Post-Cold War World: essays for Susan Strange*, Macmillan, London, 1993.

individuals, regions, countries, continents, classes, genders and generations."⁴ This multivariate emphasis was distinct from the inter-state emphasis of the PIER (politics of international economic relations) approach.⁵

Robert Gilpin, another major contributor to this *genre*, identifies his contribution as "...part of an expanding body of scholarship on the political economy of international relations; it assumes that an understanding of the issues of trade, monetary affairs, and economic development requires the integration of the theoretical insights of the disciplines of economics and political science."⁶ The principal difference between Shonfield and Strange on one hand, and Gilpin on the other, is that while the former concentrate on systemic and global concerns; Gilpin tends to keep to an 'Ameri-centric' perspective. Robin Brown identifies three central aspects of IPE:

Firstly, the recognition that the state is as much an economic actor as a military one means that it will act to preserve national interests in a number of ways. Secondly, the above suggests that insecurity can be used to explain international outcomes that go beyond military threats. Thirdly, this change of perspective has important consequences for the concept of power.⁷

The IPE agenda stressed multivariate, interconnected dynamics (including the role of non-state

⁴ Strange, Susan 'Territory, State, Authority and Economy: a new realist ontology of global political economy.' *Symposium Paper POLITICAL AUTHORITY AND TERRITORIALITY*, European University Institute, Fiesole, November 1992. p.23. The 'actor' significance of multi-national firms has also been highlighted by J.L. Mucchielli: "While the position of the country in the hierarchy of nations is determined by its commercial trade and the nature of its bilateral trade, "its" multinational firms also play an important role in determining and changing this rank." 'French and Japanese Multinational Firms and the hierarchy of Nations', *Discussion paper series*, Institute for Economic Research, Washington, 1986. p.1 Following Strange and Stopford; Murphy and Tooze state that "governments have had, increasingly, to bargain with firms." Murphy, Craig N. and Roger Tooze (eds.) *The New International Political Economy*, Lynne Rienner, Boulder, 1991. p.43.

⁵ Joan Edelman Spero *The Politics of International Economic Relations*, George Allen & Unwin, London, 1977.

⁶ Gilpin, Robert with Jean M. Gilpin *The Political Economy of International Relations*, Princeton University Press, 1987. p.3.

⁷ Brown, Robin 'Towards a new synthesis of international relations', introduction to *From Cold War to Collapse: theory and world politics in the 1980s*, Bowker, Mike and Robin Brown (eds.) Cambridge University Press, 1993. p.8.

actors) in the global system, more quickly than economists or international relations scholars.⁸

The probing questions of the IPE agenda can be supplemented with the reviving geopolitical tradition in international studies. Since the demise of the Cold War, a number of scholars from the fields of political science, geography and economics have increasingly considered spatio-temporal dimensions in the evolution of the global political economic system as a means of understanding international relations and systemic change. Here these are identified as the neo-geopolitical school.⁹

This thesis does not treat the full lineage of geopolitical approaches. The new geopolitical scholarship is distinct from earlier geopolitical approaches of Mackinder and others, which flourished in the early years of the century.¹⁰ One author whose writings influenced the methodology of the more recent geopolitical approach, is Fernand Braudel.¹¹ Following an evaluation of the methodological importance of Braudel's work; the value of his approach will be assessed in its applicability to contemporary political economic phenomena - as distinct from the more distant past with which Braudel was concerned. It will be shown that the concerns of the IPE scholars discussed above, and the post-1989 neo-geopolitical scholars

⁸ Some however, have suggested that the 'boundaries' between politics and economics need to be strengthened. Caporaso and Levine write: "In our view, a main difficulty of political economy, common to different approaches, lies in a tendency to gloss over the separateness of the two spheres of the economic and the political, absorbing one into the other." Caporaso, James A. and David P. Levine *Theories of Political Economy*, Cambridge University Press, 1992. p.6.

⁹ This term, is coined specifically for the purposes of this argument. It is not claimed that such a 'school' actually exists - nor that the authors concerned (Barnes, Ledebur, Gipouloux, Smith, Demko, Wood and others) would consent to such categorisation. However it is argued that this group of authors seek an understanding of the global system in a manner which is close to (and frequently directly accredits) the approach of Fernand Braudel [*bio.fn.11*].

¹⁰ For a treatment of the historical evolution of this discipline see the introduction to Demko, George J. and William B. Wood (eds.) *Reordering the World*, Westview, Boulder, 1994.

¹¹ This French historian [1902-1985] authored, among other works; *The Mediterranean and the Mediterranean World in the Age of Philip II* (1949), and *Capitalism and Material Life, 1400-1800* (1967-1979).

influenced by Braudel (discussed below), possess incisive methodological tools for the analysis of contemporary systemic realities.

To Braudel, the global political economic system was by definition, multifaceted and interconnected. Any analysis of such a system embraced phenomena which were economic, political, geographic, legal and social, as a matter of course. Braudel's method was to place the *problématique* at the heart of the synthesis and to at least consider all potential elements which impinge upon the *problématique* as potentially relevant to the synthesis.

Aside from methodological considerations, another reason for recognising the value of Braudel's approach is the importance which he attached to what is now known as 'globalisation'.¹² Here the term requires immediate qualification. Although not using the term 'globalisation' in the sense which has emerged in the 1980s and '90s,¹³ Braudel was closely concerned with *the systemic* - rarely if ever recognising the territorial boundedness of the phenomena being analysed; constantly referring back to the geographical base, the socio-economic context and immediate events and their dynamics. A rigid exogenous-endogenous division (based on states for example) would be artificial in this methodology. As such, Braudel's writing - even about the distant past has a curiously modern feel. He writes of a world long gone, but the vivid power of his *association* of phenomena in the exposition and investigation of vastly complex realities is of such compulsion that his methodology (here augmented by IPE) can form a framework for analysis of international relations at the close of the 20th century.

In his *Afterthoughts on Material Civilization and Capitalism*, a series of lectures delivered at the Johns Hopkins University in 1976, Fernand Braudel reflected on his earlier work and (albeit in an historical context) addressed systemic issues which have become central among the concerns of international political economists. Many of the issues which concerned

¹² This discussion of 'proto-globalisation' only focuses on Braudel. For a full discussion of the longer lineage of 'global' concepts see Roland Robertson *Globalization: social theory and global culture*, Sage, London, 1992. Especially Ch.3 'Mapping the Global Condition'. (Recent concepts of globalisation are treated at I.5 below.)

¹³ To this writer's knowledge he did not use the term in any context.

Braudel in this analysis were directly related to the extent to which a 'global' system existed and the extent to which such a typology as 'global' was useful.

...it is clear that from the fifteenth to the eighteenth century the area forming the lively world of the market economy steadily increased. The harbinger and proof of this is the dominolike variation in market prices across the globe. For prices fluctuated throughout the entire world: in Japan and China, in India and throughout the Islamic world (for example, in the Turkish Empire), and in those parts of America where gold and silver played a role at an early date - that is, in New Spain, Brazil, and Peru.¹⁴

What concerns us here is not so much the subject of analysis, but the way in which precedence is given to dynamics, effects, exchanges and motion - rather than static elements. The relationship between Japan and the European Community, 1985-93, primarily concerns relations between Japanese firms in their *global* activities and the *regional* construction of a western European competitive space. Braudel identified what are now largely referred to as 'globalisation' and 'regional integration' in the terms; *economy of the world* and *world-economy*.

By *economy of the world* I mean the world economy as a whole, the "market of the universe," as Sismondi called it. By *world-economy* - a word I forged on the pattern of the German word *Weltwirtschaft* - I mean the economy of only one portion of our planet, to the degree that it forms an economic *whole*. Long ago I wrote that the Mediterranean of the sixteenth century was in itself a *Weltwirtschaft*, a world-economy, or, to use another German expression, "eine Welt für sich," a world unto itself.¹⁵

Braudel goes on to state that such world-economies have three facets: they occupy a "given geographic space"; they always have a pole or a center; and they have different zones - central, intermediate and peripheral.¹⁶ This research project will attempt to assess the role and 'actor integrity' of the EC (a *de jure* 'world-economy') in the globalising *economy of the world*. Specifically, it attempts to assess the extent to which regional political integration is challenged by globalisation. This juxtaposition of regional and global: *world economy* and *economy of the world*, when combined with the non-state emphasis of IPE, facilitates analysis of the complex issues of EC-Japan relations to a far greater extent than traditional

¹⁴ Braudel, Fernand *Afterthoughts on Material Civilization and Capitalism*, trans. Patricia M. Ranum. The Johns Hopkins University Press, Baltimore, 1977. p.42.

¹⁵ *ibid.* pp.80-81. (Original emphases)

¹⁶ *ibid.* pp.81-82.

international relations theory.

It is noted that the 'world-economy' Braudel was referring to was not a politically driven, *de jure*, economic space. It was an organic whole such as the Mediterranean 'world' or today's off-shore Chinese economy. This conception of world-economy is thus more an 'area' than a 'region'.¹⁷ Braudel treated with some considerable sophistication, systemic questions which are familiar to international relations and IPE scholars. His writing was so tuned to the mechanics of the evolving global political economic system, that certain 'indicators' in his work can be taken up as a basis for the synthesis of more modern realities.

One of the principal features of late 20th century global finance and production is its relative freedom from territorial constraints. Braudel notes that "...at the whim of circumstance there will always be one position more advantageous to adopt than the rest, one sector more profitable to exploit."¹⁸ It is this sense of *potentiality* which characterises Japanese firms' advances into Europe in the 1980s. It is also this kind of 'position more advantageous' which represents a sharp challenge to the link between integration and competitiveness, foreseen in the legalistic and territorial model of integration in western Europe. The empirical analysis presented below attempts to use these concepts of outreach and potentiality - analysing the power of such outreach by Japanese firms and its impact on the territorial logic of *de jure* integration in western Europe.

Another intuitive 'indicator' which is found in Braudel's writing, concerns the impact of externalities on endogenous developments. Again, the empirical sections of this thesis will evaluate the extent to which this may still obtain.¹⁹ In his celebrated address to the Collège

¹⁷ For a debate on these terms as applied to both Asia and Europe see the writer's *conference report* 'Europe in the Asia/Pacific Region: involvements, challenges, policy roles', European University Institute, Fiesole, April, 1994.

¹⁸ Braudel, Fernand *Capitalism and Material Life, 1400-1800*, trans. Miriam Kochan, Fontana, [1967] 1974. p.445.

¹⁹ Braudel writes: "I have even come to believe that every world-economy is on many occasions manipulated from without. The great historical events of Europe proclaim this insistently.." *Afterthoughts on Material Civilization and Capitalism*, trans. Patricia M. Ranum. The Johns Hopkins University Press, Baltimore, 1977. pp.93-94.

de France in 1950, Braudel illustrated the interconnectedness of phenomena and the challenge which this posed for synthesis. He illustrated this with reference to a recession in early modern Florence and its potential impact in East Asia. This passage is reproduced for its value as a methodological statement:

Endless tasks rear up and demand our attention, if we are to deal with even the simplest realities of these collective lives, such as, for instance, the short-lived economic rhythms of a particular conjuncture. Look, for example, at the fairly severe recession which led to a clearly identifiable crisis in Florence between 1580 and 1585, a recession which quickly grew in strength and which as quickly disappeared. Researches in and around Florence offer indications of it by such sure signs as the repatriation of the Florentine merchants who left France and Germany at that time, and who sometimes, even more significantly, sold their shops in order to buy land in Tuscany... but immediately the question arises whether the crisis was peculiar to Tuscany, or whether it was in fact a general crisis. Quickly we find traces of it in Venice, and without much difficulty in Ferrara. But just how far afield did it make itself felt? Without knowing its exact scope, we are unable to define its nature. Does this mean that the historian must set off to search every archive in Europe, seeking out series of prices which scholarship usually overlooks? It is an endless journey! The whole task still lies before him. And to top it all, a historian interested in China and India and believing that the Far East dominated the circulation of precious metals, and thus the rhythm of economic life throughout the world in the sixteenth century, will soon note that there were years of instability in the Far East for the trade in pepper and spices corresponding almost exactly to these years of difficulty in Florence.²⁰

Application of this interconnected methodology to the analysis of EC-Japan affairs demands that the complex bargains between Japanese firms, EC member states and sub-states cannot be ignored in favour of Commission-MITI dialogues. Having identified a *problématique*, Braudel's 'open-ended' method was to pursue its manifestations wherever they were to be found. It is important to stress that the *genre* of international political economy (IPE) has already developed in a manner which in effect, applies Braudelian method to systemic analysis. Andrew Shonfield, one of the IPE pioneers, outlined his approach as follows:

What I conceive myself to be doing is rather to tease out of a variegated mass of factual data some general indications of a *trend* in the institutional behaviour of the advanced industrial societies clustered around the North Atlantic area. If the conclusions that are suggested by this exercise lack the inevitability and force that they would have if they emerged from a systematic theoretical structure, that is one of the

²⁰ Braudel, Fernand 'The Situation of History in 1950.' *Inaugural lecture* given to the Collège de France, 1 December 1950. In Fernand Braudel *On History*, trans. Sarah Matthews, Weidenfeld and Nicolson, London, 1981. p.13.

overview of the post-Cold War revival of geopolitical approaches is offered by Demko and Wood:

...many of the new [post-Cold War] "global issues" were inherently geographic or had significant geographic dimensions... we maintain the firm belief that political geographic analyses of current international issues - now more than ever - can provide both useful insight for policy-makers and an exciting area of research and discussion for students and scholars... Applied political geography - the new geopolitics or geopolinomics - is emerging rapidly and vigorously.²⁴

In 1991 Barnes and Ledebur argued that metropolitan-centered economic spaces were more 'real' than national economies.²⁵ An exciting new study of the determinants of regionalisation in Asia (and implications for Euro-Asian relations), by François Gipouloux also adopts a consciously Braudelian methodology.²⁶ Michael Smith points to the difficulty of assuming that economic spaces are bounded by state territory: "...it is difficult to discern the boundaries of so-called 'national' economies."²⁷ This is a useful contribution to understanding the nature of *de facto* regional integration as distinct from the 'space' of the state or the 'space' of the politically integrating unit. The complex overlapping of states, sub-states and supra-state activities can cause policy dilemmas for territorial administrators. Such complex, but unavoidable realities require open, multifaceted analysis.²⁸ John Agnew has

²⁴ Demko, George J. and William B. Wood (eds.) *Reordering the World*, Westview Press, Boulder, 1994. pp.vii & 13.

²⁵ Barnes, W.R. and L.C. Ledebur 'Toward a new political economy of metropolitan regions' in *Environment and Planning C.: Government and Policy*, 1991, vol. 9. pp.127-141.

²⁶ Gipouloux, François 'Globalization and Regionalization in East Asia: stakes and strategies' in François Gipouloux (ed.) *Regional Economic Strategies in East Asia: a comparative perspective*, la Maison Franco-Japonaise, Tokyo, 1994.

²⁷ Michael Smith 'The United States and the European Single Market: federalism and diplomacy in a changing political economy' in Hocking, Brian (ed.) *Foreign Relations and Federal States*, Leicester University Press, 1993. p.260.

²⁸ Braudel speaks of the need to avoid being "...condemned to the study of well-walled gardens" in his volume *On History*, Weidenfeld & Nicholson, London, 1980. p.4. In EC studies an encouraging start has been made by the editors of a recent university text. Artis and Lee state that although their work is primarily about the economic activities of the EU "...a knowledge of the wider context - historical, political, and institutional is essential to an understanding of the economic activities." Artis, Mike and Norman Lee *The Economics of the European Union*, Oxford University Press, 1994. p.4. This can be compared with Keohane and Hoffmann's 1991 mixture of theoretical approaches. Keohane, Robert O. and Stanley

charted some distinctions between the new geopolitics and IR theory:

By means of three geographical assumptions, the territorial nation state has come to provide the foundation for conventional international relations theories - realist, neorealist, and idealist. The first of these is the assumption of the territorial state as existing prior to and as a container of society. The second is the division of the domestic from the international. The third, and most fundamental, is the reification of national spaces as fixed units of secure sovereign space. Each of these geographical assumptions is increasingly problematic.²⁹

This is precisely the kind of critique which IPE scholars have been making during the past decade. While the neo-geopolitical approach thus supports the major research questions already raised by IPE, its novelty is to stress the geographical dimension in the analysis of complex systemic realities. The IPE/neo-geopolitical framework is reflected in this thesis by the inclusion of sub-states and firms as units of analysis alongside the traditional EC Commission and member state actors.

I.3 THEORIES AND CONCEPTS OF REGIONAL INTEGRATION AND GLOBALISATION

The subject of this research concerns the political impact of Japanese direct investment on the European Community between 1985 and 1993; and the nature of the European Community as revealed by Japanese direct investment during this period. A major theme throughout this synthesis is the tension between the European Community and globalising firms. This however, is not a state-firm tension. Rather, it is a tension between firms which seek to extend their influence trans-nationally, and emergent schemes to improve state (and bloc) competitiveness through political economic integration. Both states and firms might be seen to attempt to 'integrate' trans-territorially.

An important distinction needs to be introduced. There are two dominant usages of the term

Hoffmann, 'Institutional Change in Europe in the 1980s' in Keohane and Hoffmann (eds.) *The New European Community: decisionmaking and institutional change*, Westview, Boulder, 1991.

²⁹ John A. Agnew 'Timeless Space and State-Centrism: the geographical assumptions of international relations theory' in Rosow, Stephen J. *et al* (eds.) *The Global Economy as Political Space*, Lynne Rienner, Boulder, 1994. p.106.

'integration'. The first refers primarily to economic phenomena such as 'market integration', or the integration of parts of the world which may be driven by commerce or other organic links. This form of integration is normally neither territorial nor legalistic (although it could support, overlap with, or even pose difficulties for integration reliant on these). The second kind of integration is that which is most commonly found in literature on the European Communities - that is 'political integration.' Such integration is primarily driven by states. A more accurate term for this form of integration - particularly since the Single European Act - would be '*political economic integration.*'

Panic addresses the distinction between different kinds of integration when he writes that "...de jure integration is not the same thing as de facto integration."³⁰ He traces the latter usage of the term 'integration' to the early 1970s and concludes that "Unlike the institutional attempts to integrate different economies, spontaneous integration is prompted by what the enterprises involved believe to be their corporate interest, not by considerations of national political and economic gains."³¹ This thesis implicitly evaluates the relative efficiency of these two modes of integration.

Because the *problématique* focuses on the impact of a global phenomenon (direct investment), upon a regional construct (the European Community), some examination must be made of two sets of theoretical literature: on European integration, and on globalisation. The usage of both 'integration' and 'globalisation' is of comparatively recent origin. Both imply a process³² and both envisage destinations, such as a 'federal Europe' or a 'borderless world.' Although useful towards an understanding of phenomena which are quite new; these terms do not, without qualification, describe actualities. The caution here is that, should integration or globalisation not materialise according to certain projections, the analysis of recent phenomena

³⁰ Panic, Milivoje *National Management of the International Economy*, Macmillan, London, 1988, p.4.

³¹ *ibid.* p.5

³² Such a process is also implied by their root nouns. George Yannopolous has used the careful but slightly inert term 'integration bloc' in 'Foreign Direct Investment and European Integration: the evidence from the formative years of the European Community', *Journal of Common Market Studies*, Vol.XXVIII, No.3, March 1990, p.255.

may be skewed by expectations of 'process'. In the conclusion, the extents of integration and globalisation will be assessed.

I.4 INTEGRATION THEORY

This section argues that among theoretical approaches, integration theory is unique - not due to its merits or demerits - but because of its important place in the history of the EC and the ideologies which have accompanied the evolution of the Communities. Some of the analysis of 'Europe' over the past several decades has given exaggerated weight to the phenomenon of integration in the overall evolution of the continent.³³ This is not only problematic because the EC constitutes just one part of Europe. Even in scholarship on western Europe, the phenomenon of integration often appears as the paramount factor in theoretical and historical studies.

Ultimately, only a wide-ranging context can account for the multiple strands which led to the creation and evolution of the European Communities. If one categorisation of the phenomenon of 'integration' were to be sought, it would be that the establishment and evolution of the EC, its evolution and present course are an historical *event*. The desire to secure peaceful coexistence in Europe, lessons from the inter-war era, customs union and ECSC bargaining, aspirations to improve material welfare and 'external' conditions such as the Cold War, all played important roles in leading to the establishment of the Communities.³⁴

³³ Reginald Harrison wrote: "The analysts [of European integration] with whom this work is concerned, with few exceptions, take twentieth century conditions as an obvious starting point, assume their existence in the explanatory hypotheses, and often appear to derive a personal commitment to integration from a conviction that it is an answer to some of the problems of this century." *Europe in Question: theories of regional international integration*, George Allen & Unwin, London, 1974. p.11. Amitai Etzioni expressed a similar view: "There are many observers who accept uncritically the EEC myth and who expect this time to be one of accelerated unification; a United Europe or *Europa* is frequently mentioned." *Political Unification*, Krieger, Huntington, 2nd ed., 1974. p.277.

³⁴ Many of these factors continue to influence the development of the EC/EU. Jonathan Story stresses bargains and the importance of 'men and ideas' in the launching of the EMS. (Such an approach is similar to that of James Joll.) 'The Launching of the EMS: an analysis

Ideas such as federalism, had within them some theoretical components. For the most part, immediate post-war visions or dogmas aimed at constructing a 'new Europe' belong to the history of ideas - rather than the theoretical literature on EC integration. However, there is considerable overlap between theory and ideas - particularly in functionalism, but also in neofunctionalist theory. The distinction offered here is that the early architects of the Community, including Monnet and Schuman were historical participants whose prescriptions belong to the history of ideas; while analysts such as Haas and Lindberg were seeking to explain what had happened, and what was happening.

The admixture of theory and ideas in EC writing tends to emphasise the 'process' of integration in Europe's recent and contemporary dynamics. De Gaulle's stance toward the Community led to a crisis in the perceived 'process' orientation of integration theory. Such was the neglect of potential counter-integrative forces in an early work, that Ernst Haas revised his position saying that: "...something is missing in the exploration of the integrative process presented in *The Uniting of Europe...* De Gaulle has proved us wrong. But how wrong?"³⁵

The Community touches upon many aspects of European life, but it is too simplistic to identify the development of the Community as the paramount strand in the recent history and contemporary life of the continent. This presumption, which runs through much of the theoretical writing on the Community, can distort understanding of modern Europe and its relationship with the rest of the world.³⁶ Theories and explanations of the development of the European Community also go through phases of influence, and are frequently (though

of change in foreign economic policy' *Political Studies*, Vol.XXXVI, No.3, September, 1988, pp.397-412.

³⁵ Haas, Ernst B. *The Uniting of Europe*, 2nd. ed., Stanford University Press, 1968. p.xxiii. Paul Taylor faulted neofunctionalism thus: "Neo-functionalism, precisely because of its striving after scientific rigour in the sense of the modern social sciences, became vulnerable to the short-term challenge of events." Introduction to David Mitrany *The Functional Theory of Politics*, Robertson for LSE, London, 1975. p.xix.

³⁶ Herbert Butterfield cautioned against the inclusion of assumptions of progress in synthesis in his influential *The Whig Interpretation of History*, [1931] Penguin ed., London, 1973.

seldom admittedly) a part of the greater context which they attempt to explain.

This discussion now turns to some specific theoretical approaches to European integration. These are *functionalism*, *neofunctionalism*, *intergovernmentalism* and *federalism*.³⁷ Paul Taylor has explained *functionalism* thus:

The major principles of functionalism are that man can be weaned away from his loyalty to the nation state by the experience of fruitful international co-operation... From small beginnings, in Professor Mitrany's view, the functional approach could eventually enmesh national governments in a dense network of inter-locking co-operative ventures.³⁸

The concept of functionalism was largely developed by David Mitrany and was distinct from but influenced by, economic liberalism.³⁹ Haas finds important similarities between Smith, Bentham, Mill and the functionalists who "...share the basic preference of classical Liberals for "society". Mitrany like Mill regards the state and government as something suspect, and elevates society to the place of honor in the hierarchy of human institutions."⁴⁰

Liberal internationalists felt that free trade would promote peace between peoples. This doctrine still has much momentum, having fed into modern *perceptions* of free trade. Mitrany was aware of the inheritance of liberalism. But he did not shy from criticising its lack of potential to create permanent structures: "Whatever the reasons, the period of free trade and cultural internationalism passed without coagulating into some common international system, leaving the twentieth century to face that imperative task."⁴¹ Mitrany regarded his designs

³⁷ The last of these is not strictly a 'theory' as discussed later in this section.

³⁸ Taylor, Paul 'Introduction' to David Mitrany *The Functional Theory of Politics*, Robertson for LSE, London, 1975. p.x.

³⁹ Lindberg and Scheinberg, writing in 1970, state that "Free trade was, of course, the method of the classical economic liberals of the nineteenth century. Economic integration, on the other hand, was based on the creation among the participating states of a single market..." Lindberg, Leon N. and Stuart A. Scheingold *Europe's Would-Be Polity*, Prentice Hall, New Jersey, 1970. p.8.

⁴⁰ Haas, Ernst B. *Beyond the Nation-State: functionalism and international organization*, Stanford University Press, 1964. p.32.

⁴¹ Mitrany, David *The Functional Theory of Politics*, Robertson for LSE, London, 1975. p.244.

for structures to support peace, as being similar to those of the liberal internationalists, but repeatedly stressed the concrete utility of his idea:

In every case action has been guided by need not by ideological drift, and in every case was organised to fit the particular need. 'Form follows function' has been the natural tenet in all that progress.⁴²

Functionalism implies an almost 'natural' progression of integration, emphasising economic forces and the ways in which they require management by governments and international organisations. Neofunctionalism places greater emphasis on political decision-making in a process of integration. Ernst Haas sought a greater understanding of the 'how?' question in structured international cooperation, and was largely responsible for developing *neofunctionalism*. In Lindberg & Scheingold's definition:

Neofunctionalism differs from traditional functionalism in that it establishes some prerequisites to effective problem-solving which involve a partial but direct threat to the autonomy of the nation-state. Specifically, it is argued that one must begin with a real delegation of decision-making authority to a supranational agency. In addition, it envisages a cumulative and expansive process whereby the supranational agency slowly extends its authority so as to progressively undermine the independence of the nation-state.⁴³

Sub-state and other actors were also perceived to contribute to such a dynamic. The concept of neofunctionalism has frequently been used to explain the evolution of the European Community.⁴⁴ Haas, the originator of neofunctionalism, stressed the consciously managed elements of sovereignty surrender: "My application of Functionalism thus discards any belief in the *immanence of progress* as flowing from a natural harmony of economic interests, and minimizes the possibility of relying on man's free will to change the sluggish law of group-based interest perception."⁴⁵ The concept of 'spillover' was central to Haas's explanation. Lindberg has defined this as "a situation in which a given action, related to a specific goal,

⁴² *ibid.* p.249

⁴³ Lindberg, Leon N. and Stuart A. Scheingold *Europe's Would-be Polity*, Prentice Hall, New Jersey, 1970. p.7.

⁴⁴ R.J. Harrison writes: "The neo-functional conception of international organization finds direct expression in the European Community." 'Neo-functionalism' in Groom, A.J.R. and P. Taylor *Frameworks for International Co-operation*, Pinter, London, 1990. p.139.

⁴⁵ Haas, Ernst B. *Beyond the Nation-State*, Stanford, 2nd ed., 1968, p.35. (emphasis added.)

creates a situation in which the original goal can be assured only by taking further actions, which in turn create a further condition and a need for more action and so forth."⁴⁶

A problem however, arises with differing visions of progress. Haas admits the shortcomings of his early framework in its inability to explain the actions and indeed the very existence of a phenomenon such as de Gaulle - who had a very different idea of progress from that offered by the European Commission. Taylor, Mitrany's principal interpreter, criticised neofunctional theory as potentially leading to a European superstate. Such would "simply recreate, on a larger scale, all the traditional problems of international society."⁴⁷ The exclusionary nature of focusing entirely on integration *processes*, common to both functionalism and neofunctionalism - underestimated other forces (including external actors and internal sub-states) which helped determine the evolution of the EC.⁴⁸

Federalism has as many emotive connotations as the idea of free trade. In Etzioni's definition: "Federalism is largely concerned with the conditions under which diverse social units find their place in one political community".⁴⁹ In the initial stages of the Community, federalism became quickly overshadowed, in Haas' view, by functional motivations:

..the decision to follow the gospel of Jean Monnet rather than that of the federalists -

⁴⁶ Lindberg, Leon N. *The Political Dynamics of European Economic Integration*, Stanford, 2nd ed., 1968. p.10. Martin Holland has cast doubt on the concept of spillover: "The initial expectations associated with the Community institutions were largely unfulfilled and spillover and progressive integration did not seem to be occurring; rather, the persistence of national self-interest indicated that the Community was closer to an intergovernmental grouping than any putative federation." *European Community Integration*, Pinter, London, 1993. p.17.

⁴⁷ Taylor, Paul 'Introduction' to David Mitrany *The Functional Theory of Politics*, Robertson for LSE, London, 1975. p.xiv. See also Taylor's article 'Functionalism: the approach of David Mitrany' in Groom, A.J.R. and P.Taylor, *Frameworks for International Co-operation*. Pinter, London, 1990.

⁴⁸ Baldwin and Lyons of Columbia University have recently explored the extent to which 'Euro-euphoria' might become self-fulfilling. Although eschewing any policy conclusions, the authors write: "...the shift from Euro-pessimism to Euro-euphoria might in and of itself help ameliorate the European unemployment problem." Baldwin, Richard and Richard Lyons 'External Economies and European Integration: the potential for self-fulfilling expectations' *Discussion Paper* No.471, Centre for Economic Policy Research, London, 1990. p.iii.

⁴⁹ Etzioni, Amitai *Political Unification*, Krieger, Huntington, 2nd ed., 1974. p.xi.

which was "political" in a pure sense - rested on a political commitment to realize peace and welfare by way of European unification. The statesmen who wrote the treaties of the European Communities and who guided them through their national parliaments were committed to the gradual, the indirect, the functional path toward political unity.⁵⁰

Federalism is not so much a tool of scholarly analysis as an idea, whose application was (and still is) meant to achieve concrete results for Europe's future.

In the early and mid-1990s, *intergovernmentalism* reemerged with strong explanatory potential.⁵¹ Intergovernmentalism in scholarship on the European Community, stresses inter-state diplomacy within the context of the Community.⁵² Keohane and Hoffmann emphasise that "Without the original Franco-German accord, neither the European Coal and Steel Community nor the Common Market would have ever existed."⁵³ Recent scholarship across disciplines, has stressed the powerful role of states in the European Community. Intergovernmentalism in EC studies is not distant from the realist and neo-realist traditions of international relations theory. Kenneth Waltz depicted "international politics as a competitive realm", stressing the importance of states in a mostly unchanging structure, which tended towards balance rather than the maximisation of power.⁵⁴ Waltz's neo-realism has been

⁵⁰ Haas, Ernst B. *The Uniting of Europe*, 2nd ed., Stanford, 1968.p.xx. For a full discussion of Monnet's 'federal credentials' see Holland, M. *European Community Integration*, Pinter, London, 1993. p.13.

⁵¹ Particularly in the work of Alan Milward, *The European Rescue of the Nation-State*, Routledge, London, 1992 and Susan Strange 'The Power Gap: member states and the world economy' in Brouwer, Frank et al. (eds.) *Economic Policy Making and the European Union*, Federal Trust, London, 1994.

⁵² A writer in *The Economist* has described intergovernmentalism as "...the practice of leaving tricky decisions for agreement among individual member governments..." 22 October 1994, p.16. Williams notes that "The political organization of the EC is unique although, in essence, it is a form of intergovernmentalism." Williams, Allan M. *The European Community: the contradictions of integration*, Blackwell, Oxford, 1991. p.11.

⁵³ Keohane, Robert O. and Stanley Hoffmann 'Institutional Change in Europe in the 1980s' in Keohane, Robert O. and Stanley Hoffmann (eds.) *The New European Community*, Westview Press, Boulder, 1991. p.17.

⁵⁴ Waltz, Kenneth N. *Theory of International Politics*, Random House, New York, 1979. p.126.

criticised for being ahistorical⁵⁵ and for tending towards the status quo.⁵⁶ Waltz introduces economic features to his earlier formulation of realism - but essentially does not depart from an inter-state scheme. Both international political economy, and neo-geopolitics (writings influenced by Fernand Braudel) go outside of international relations theoretical frameworks to examine dynamic systemic change. For international political economy, such dynamics cannot be solely explained by inter-state theorising; for the Braudelian tradition, world-economies and the *economy of the world* have a geo-historical dynamic which is distinct from inter-state relations. Economic phenomena therefore sit uncomfortably with purely 'political' explanations. The distinction between political integration and economic integration - and the uneven geopolitical 'fit' between these - is profoundly important.

Alan Milward and Andrew Moravcsik, an economic historian and a political scientist, have come to similar conclusions about the nature of the European Community as revealed by a closer examination of state actions and bargains.⁵⁷ Milward, in answering the canon of integration theory, creates a 'theoretical antithesis' rather than a traditional history. Although accurate in many of his specific conclusions, Milward underestimates important changes over time in the actions of states, which are different from the static model he proposes. This ties him to the theory that the EC has 'rescued the nation state'. Further, Milward's conclusion does not recognise that the EC system has, like markets, the power to influence the course of action of states themselves. Moravcsik strongly emphasises the role of states in the

⁵⁵ Little, Richard 'International relations and large-scale historical change' in Groom, A.J.R. and Margot Light *Contemporary International Relations: a guide to theory*, Pinter, London, 1994. pp.17-18.

⁵⁶ Susan Strange writes that neo-realism "tends to exclude hidden agendas and to leave unheard or unheeded complaints, whether they come from the underprivileged, the disenfranchised or the unborn, about the way the system works." 'Cave! Hic Dragones: A critique of regime analysis' in Stephen D. Krasner (ed.) *International Regimes*, Cornell University Press, Ithaca, 1983; quoted in George, Jim *Discourses of Global Politics: A critical (re)introduction to international relations*, Lynne Rienner, Boulder, 1994. p.134.

⁵⁷ Milward, Alan S. *The European Rescue of the Nation-State*, Routledge, London, 1992. Moravcsik, Andrew 'Preferences and Power in the European Community: a liberal intergovernmentalist approach' *Journal of Common Market Studies*, Vol.31, No.4, December 1993.

evolution of the Single European Act⁵⁸ positing that "...the EC can be analysed as a successful intergovernmental regime designed to manage economic interdependence through negotiated policy co-ordination... An understanding of the preferences and power of its Member States is a logical starting point for analysis."⁵⁹

This thesis argues that European integration theory, has overemphasised endogenous factors in the evolution of the European Communities. The relationship between the European Community and Japan is closely shadowed by issues of regional integration and the globalisation of business. The organisation of the empirical chapters below reflects an attempt to analyse the evolution of the EC system through its relations with one important externality. The results of this analysis are then applied to a reconsideration of European integration theory and the evolution of the European Community itself.

I.5 GLOBALISATION THEORY

Although the term 'globalisation' frequently refers to a *general* phenomenon of closer global interconnectedness,⁶⁰ this discussion predominantly treats the most important agent of globalisation - firm commercial activity. Braudel's treatment of historical 'global' concepts has been treated above. This section treats two further systemic-level approaches with a view to evaluating the impact of global political economic forces on the European Community.

⁵⁸ Moravcsik, Andrew 'Negotiating the Single European Act: national interests and conventional statecraft in the European Community,' *International Organization*, 45, 1, Winter 1991.

⁵⁹ Moravcsik, Andrew 'Preferences and Power in the European Community: a liberal intergovernmentalist approach,' *Journal of Common Market Studies*, Volume 31, No.4, December 1993. p.474.

⁶⁰ Despite Joan Spero's definition that "Interdependence is a relatively symmetrical relationship; dependence is an asymmetrical relationship" - the term 'interdependence' has become more value-laden than the neutral 'interconnectedness' used here. See Spero, Joan Edleman *The Politics of International Economic Relations*, George Allen & Unwin, London, 1977. p.14.

The first of these consists of literature on the development of *big business*⁶¹ and the second discusses recent attempts to treat systematically, the concept of *globalisation* and its systemic effects.

One specific area in which the logic of global reach has been discussed for some time has been the literature on the evolution of large business organisations. Business and organizational historians and economic historians have long analysed the potential for, and nature of, trans-territorial activities. Such literature differs from the more recent 'globalisation' literature in that it seldom adopted a systemic perspective, only occasionally referring to the structural impact of business activities - one of the principal concerns of the more recent 'globalisation' approach.

Alfred D. Chandler Jr. has written extensively on the organisational origins, growth and structure of big business.

These industries [late 19th century metals, machinery, chemicals &c.] quickly became dominated by a small number of large firms that almost immediately moved abroad to compete vigorously in international markets. National governments played little role in the creation of these global enterprises beyond setting protective tariffs for their domestic markets and encouraging (in the United States) or discouraging (in European countries) competition between firms.⁶²

The emphasis in this literature is largely endogenous to the firm - even as the firm becomes trans-national. Authors such as Hertner and Jones have stressed that "MNEs have been around a long time".⁶³ This is a useful corrective to the view that globalisation is entirely

⁶¹ 'Big Business' - an American usage - has been current for some time. It is arguably more accurate than 'the firm' or 'the company'. Increasingly, 'the firm' needs to imply not only structure and tangible assets - but firm networks, legal bargains, VERAs, alliances &c. 'Big Business' (or 'Global Business') embraces such phenomena and activities by definition.

⁶² Chandler, Alfred D. Jr. 'Big Business and the Global Coordination of Functional Activities' pre-conference paper, European University Institute, Fiesole, 1992. Published in *Proceedings of the Eleventh International Economic History Congress*, Università Bocconi, Milan, 1994. pp.161-2.

⁶³ Hertner, Peter and Geoffrey Jones 'Multinationals: theory and history' in Hertner and Jones (eds.) *Multinationals: theory and history*, Gower, Aldershot, 1986. p.1. Elsewhere, John H. Dunning writes: "Studies published in the last twenty or so years suggest that earlier scholars considerably underestimated the role of the MNE as an entrepreneur and as a transfer

new.⁶⁴ The expansion of business which Chandler analyses was given a plausible theoretical explanation in the 1930s by Ronald Coase who stressed the importance of 'transaction costs'.⁶⁵ Coase treated reasons for transactions being made internal to the firm, rather than being conducted through the broader market. His concept of *internalization* was later applied to analysis of the trans-national activities of firms.⁶⁶ This concept may be relevant not only to the development of firms. The analysis below will examine the extent to which internalisation might be applied to international relations. More specifically, the concept will be applied to EC-Japan affairs: a relationship which is essentially *political economic* - in which firms are the most important manifestation of the relationship on one side.

The proliferation of big business networks is the most tangible manifestation of global reach in the late 20th century, and it is perhaps unsurprising that the literature on the history and organizational development of firms is rich in insights which help introduce the more recently formulated concept of globalisation. Aside from the activities of firms, factors which have spurred an interest in globalisation include: technological and media advances, nuclear capability, global environmental problems and issues of 'new world order'. Concepts of globalisation pertain more to analysis of the system than Chandler's 'Big Business' or Braudel's 'world-economy'.

of intangible assets in the forty years prior to the First World War." 'Changes in the level and structure of international production: the last one hundred years' in Wilkins, M. (ed.) *The Growth of Multinationals*, Elgar, Aldershot, 1991. p.91.

⁶⁴ Susan Strange stresses that "...it is not international business which is new. It is the *extent* of international business." 'Wake up, Krasner! The world *has* changed' *Review of International Political Economy* 1:2 Summer 1994, p.210. Such is the proliferation of the discussion of MNEs, that the term 'uni-national firms' has now appeared. See Cox, Howard *et al* (eds.) *The growth of global business*, Routledge, London, 1993. --

⁶⁵ Coase, Ronald H. 'The Nature of the Firm' *Economica*, Vol.4, London, 1937. pp.386-405.

⁶⁶ Coase outlined the evolution of the 1937 article in his Nobel Memorial Prize Lecture of December 1991, published as 'The Institutional Structure of Production', Chapter 1 of Coase, R.H. *Essays on Economics and Economists*, University of Chicago Press, 1994. p.8. Alan Rugman gives an overview of the evolution and application of the concept of internalization in 'Internalization as a General Theory of Foreign Direct Investment: a re-appraisal of the literature' in *Weltwirtschaftliches Archiv./Review of World Economics*. 116, 1980, No.2. pp.365-379.

For the most part, theories of globalisation are still at an early stage of evolution.⁶⁷ Both Oman and Ruggie stress the microeconomic driving forces of globalisation. Oman writes:

From a policy perspective, globalisation is more usefully understood - notwithstanding the considerable impact of financial globalisation at the macroeconomic level - as a *microeconomic* phenomenon, one that is driven by the strategies and behaviour of firms.⁶⁸

Ruggie states that "Globalization today is assuming various microeconomic forms of increasingly extensive, diverse, and integrated institutional webs forged within markets and among firms across the globe."⁶⁹ Michael Biddiss states that interdependence has become "markedly more dense in texture, more continuous in time and more widespread in geographical ambit."⁷⁰ Increased globalisation has also been recognised by government officials. Robert Reich for example, has argued that ownership of production (whether domestic or foreign) is secondary to the issue of a well-trained, flexible work-force, which makes the greater contribution to productivity.⁷¹ One of the principal manifestations of this globalisation is the increase in foreign direct investment.⁷² Whilst writers such as DeAnne

⁶⁷ Apart from the important contributions of Chandler, Braudel, Wallerstein and many historians; the earliest usage with a similar *sense* to recent 'globalisation' is McLuhan's concept of 'global village'.

⁶⁸ Oman, Charles *Globalisation and Regionalisation: the challenge for developing countries*, OECD, Paris, 1994. p.13.

⁶⁹ Ruggie, John Gerard, 'At Home Abroad, Abroad at Home: international liberalization and domestic stability in the new world economy'. Jean Monnet Lecture Paper, European University Institute, Fiesole, 1995. p.28.

⁷⁰ Biddiss, Michael 'Global interdependence and the study of modern world history' in Parry, Geraint (ed.) *Politics in an Interdependent World: essays presented to Ghita Ionescu*, Elgar, Aldershot, 1994.

⁷¹ Reich, Robert B. 'Who is Us?' *Harvard Business Review*, January-February 1990, pp.53-64. Mark Mason and Dennis Encarnation (eds.) have also treated this issue in *Does Ownership matter?: Japanese multinationals in Europe*. Clarendon Press, Oxford, 1994.

⁷² Erich Gundlach and Peter Nunnenkamp write that "In 1982-92, worldwide FDI flows grew 3.3 times faster than international trade flows." 'The European Union in the Era of Globalisation; competitive challenges, structural unemployment, and policy responses.' Kiel Institute of World Economics, *Working Paper* No.650, 1994. p.4. See also, U.S. Congress, Office of Technology Assessment, *Multinationals and the U.S. Technology Base*, OTA-ITE-162, Washington, DC, 1994. p.iii.

Julius have examined the consequences of massively increased FDI for states, this research project examines the implications for the European Community.⁷³

Literature on globalisation in the 1990s has broadened from that on big business, both to examine the systemic *consequences* of global firm activity and the globalisation of the *system* itself. This recent literature on globalisation includes authors who are cautiously exploring greater global interconnectedness; those who exaggerate the impact of globalisation; and also some dissenting voices. Roland Robertson calls for a tighter definition of the term and more caution with regard to 'global complexity'.⁷⁴

The extent of 'globalisation' of both firms and the world economy has been debated. Sir Michael Butler, until 1985 the UK representative to the EC, has argued that the strategy of firms is answerable only to their headquarters and has cautioned against the view that firms lose their national identities when producing abroad.⁷⁵ David Gordon seriously questions the extent to which globalisation is actually occurring in the world economy⁷⁶; while Robertson's 'uncertainty phase'⁷⁷ echoes Galbraith.⁷⁸

⁷³ Julius, DeAnne *Global Companies and Public Policy*, Pinter for RIIA, London, 1990. Especially Chapter 5.

⁷⁴ He writes: "While there is rapidly growing interest in the issue of globalization, much of it is expressed very diffusely. It has become a widely used term in a number of theoretical, empirical and applied areas of intellectual inquiry, including the various 'policy sciences,' such as business studies and strategic studies. There is also a danger that 'globalization' will become an intellectual 'play zone,' a site for the expression of residual social-theoretical interests, interpretive indulgence, or the display of world-ideological preferences." Robertson, Roland *Globalization: social theory and global culture*, Sage, London, 1992. p.49.

⁷⁵ Butler, Sir Michael, *Financial Times*, 5 February 1986. p.21.

⁷⁶ Gordon, David 'New Edifice or Crumbling Foundation', *New Left Review* 168, March/April, 1988.

⁷⁷ Robertson, Roland *Globalization: social theory and global culture*, Sage, London, 1992. p.59.

⁷⁸ Galbraith, John Kenneth *The Age of Uncertainty*, Deutsch for BBC, London, 1977.

In light of these critiques, a definition of what the usage 'globalisation' does, and does *not* entail, is necessary. Globalisation is not a normative concept. It does not imply that greater levels of interconnectedness necessarily lead to greater cooperation or 'world order'. Secondly, even if MNEs retain national identities, as argued by Butler, this does not diminish the impact of their transnational activities upon the system. Although the concept may imply a more widespread form of capitalism it does not imply a more efficient or harmonious form of capitalism. 'Globalisation' is best understood in terms of the increased volume of transactions over territories since the mid-1970s, and the systemic consequences thereof.

The relationship between globalisation and regional political integration is at the theoretical nexus of this thesis. Some recent literature has begun to examine the evolution of the EC in a systemic context. John Grahl and Paul Teague were among the first to stress the problematic nature of an EC economic identity.⁷⁹ Erich Gundlach and Peter Nunnenkamp write that "...impaired competitiveness of EU industries is at the heart of labour market problems... Economic policy in the Community has been focused on regional integration, and discouraged European companies to go global and thereby to improve their competitiveness"⁸⁰ and Zhang Yunling has concluded that: "The 'internal benefit' doctrine is not necessarily a safeguard for the relations of EC member states with the rest of the world".⁸¹ These writers have explored the evolution of the EC in its broader environment, leaving some indicators as to the possible implications of globalisation for regional political integration. This thesis, through an empirical analysis of one important externality, attempts to assess these views and evaluates the evolution of the Community in its global context.

⁷⁹ The authors write: "...a European industrial identity cannot be brought about as a well-defined system of enterprises with close and continuing links to the territory of the EC." Grahl, John and Paul Teague 1992 - *The Big Market*, Lawrence & Wishart, London, 1990. p.142.

⁸⁰ Gundlach, Erich and Peter Nunnenkamp 'The European Union in the Era of Globalisation; competitive challenges, structural unemployment, and policy responses.' Kiel Institute of World Economics, *Working Paper*, No.650, 1994. p.1.

⁸¹ Yunling, Zhang 'European Economic Integration and East and South-East Asian Economy', European University Institute, *Working Paper* EPU no.92/15, Fiesole, 1992. p.16.

CONCLUSION

The relationship between firm globalisation and political economic integration is a central theme in EC-Japan affairs. There are a number of ways in which the distinct phenomena of regional political integration and global economic integration may be theoretically conceptualised. Firm globalisation may be understood as *de facto*, trans-territorial, organic⁸² or 'low political'.⁸³ Political economic integration can be understood as *de jure*, territorial, inorganic or 'high political'. A further dichotomy - between markets and institutions - is useful. Alessandra Casella defines "a *market* as a set of traders who exchange private goods" and an *institution* "as a "club" whose members decide together, finance, and enjoy an excludable public good."⁸⁴ Casella then distinguishes issues that do not require coordination as 'economic' from those which require collective decision-making as 'political'. Despite its simplicity, the distinction is useful. The concept of 'club' draws attention to what is referred to below as the *implicit sanction of non-membership* which European integration implies. This typology is similar to the 19th century liberal distinction between the economic and political realms. However the specific concept of 'club' brings into sharper focus the issue of *access*. The club/market distinction can be utilised to focus on the intended *inclusionary* benefits, and implicit *exclusionary* 'competitiveness' intent, of political integration.

In the analysis which follows, this issue is treated with regard to Commission attempts to regulate Japanese firm entry to the European market. The club/market distinction becomes literally more meaningful with consideration of the Single *Market* Programme - a strategy whereby the Commission sought to raise the international political economic stature of the

⁸² Shinji Hasegawa for example states that "Business activities in general consist of an *organic* chain composed of various operation functions such as R&D, manufacturing and sales. 'The multinationalisation of Japanese firms and the European market' in *The Japanese Presence in Europe*, Euro-Japan Economic Research Centre, Catholic University of Louvain, 1991. p.39. Emphasis added. The term is also used by Wallerstein.

⁸³ The terms 'low politics' and 'high politics' and their modified usefulness, are discussed in Ch.II.

⁸⁴ Alessandra Casella 'On Markets and Clubs: Economic and Political Integration of Regions with Unequal Productivity' in *The American Economic Review*, Vol.82, No.2, May 1992. p.115. The concept of clubs is accredited to James M. Buchanan.

Community through a market programme.

Motivations for attempting to integrate frequently differ between states and firms. Robson and Wooton, and Thomsen and Nicolaides have identified the potential *de facto* region-building capacity of firms.⁸⁵ However, whilst firms may assist in *economically* integrating an area; they can go further and faster with such integration, posing dilemmas for the *de jure* defined 'club'. Such a dynamic underlines a fundamental change in the spatiality of the political influence of firms since the Treaty of Rome. The (fixed) territoriality of the bloc and the (flexible) spatiality of the firm become crucial as the membership/non-membership sanction is challenged as an instrument of bloc power.

An analysis of EC-Japan relations touches upon many theoretical questions. The empirical results of this study may have implications for theories not used here; and likewise, diverse theoretical literature may shed additional light on the results obtained. Examples of such would include the voluminous literature on U.S.-Japan relations, policy studies and business organization. This thesis identifies strong similarities between the research approaches of international political economy (IPE) and the revitalised co-discipline of geopolitics (neo-geopolitics). The methodological framework derived from these two approaches is reflected in the structure of the analysis which follows. Both IPE and neo-geopolitics probe aspects of dynamic change in the global system which are particularly appropriate for an analysis of EC-Japan affairs. Specific theories which provide insights into EC-Japan relations are European integration theory and globalisation theory. Integration theory is supplemented with theory on sub-state regions and literature on the state, while the insights of globalisation are reinforced by the IPE emphasis on the role of firms in the global political economic system.

⁸⁵ Robson and Wooton write: "TNEs would already, in advance of formal regional integration, have brought about a substantial measure of regional or global cross-border integration through their capacity to surmount publicly imposed market distortions, in this case tariff barriers." Robson, Peter and Ian Wooton, 'The Transnational Enterprise and Regional Economic Integration,' *Journal of Common Market Studies*, Vol.31, No.1, March 1993. p.74. See also, Thomsen, Stephen and Stephen Woolcock *Direct Investment and European Integration*, Pinter for RIIA, London, 1993. p.6.

CHAPTER II EC-JAPAN RELATIONS: CONTEXT, THEMES AND UNITS OF ANALYSIS

INTRODUCTION

In the previous chapter, common research concerns between the co-disciplines of international political economy and neo-geopolitics were identified, and theories of European integration and globalisation were discussed. This chapter develops a periodisation of Euro-Japan relations, noting important distinctions between the most recent period and those preceding. Following an overview of the historical background, the major themes of recent EC-Japan relations are identified. The existing treatment of EC-Japan relations is assessed, and some lacunae in both the approaches and thematic content are noted. A discussion of the units of analysis in the EC-Japan relationship is followed by an outline of the empirical research strategy.

II.2 PERIODISATION AND CONTEXT

The periodisation of Euro-Japanese and EC-Japan affairs varies over different facets of relations. The construction of a general periodisation depends on the relative significance of these various facets. Periodisation is therefore closely associated with priority.

That Europe and Japan have a qualitative relationship in the recent past, is largely due to developments within Japan itself. Endogenous developments such as the capacity of Japanese firms to surmount geographical distance through trade and FDI competitiveness, have been central to the evolution of Japan's external relations - the relationship with Europe not being an exception. This geographical element is stressed, since the geopolitical dynamic of the relationship experienced a radical transformation with the surge in Japanese-EC direct investment in the mid-1980s.

In the period from first contacts in 1543, European missionary and trading interests in Japan

can be said to have been active. The era of closure (1639-1853) can be said to have been 'neutral' - only Dutch and Chinese traders, scientists and medical doctors being permitted significant dealings with Japan. Since the Meiji Restoration of 1868, the role of Japan in Euro-Japanese relations has been broadly active and that of Europe largely reactive - with the possible exception of the Anglo-Japanese alliance. The era commencing with the Pacific War witnessed the substantive decline of European power in Japanese and latterly, Asian affairs. The Euro-Japanese agenda from 1945 until the late 1960s was once again influenced by geographical distance, and importantly by the U.S.-Japan relationship.

Euro-Japanese relations were revolutionised by Japan's extraordinary post-war economic recovery and trading success, and subsequently by her enhanced investment capacity. The change in unit of analysis which this implies must immediately be noted. Despite the strong role of government, bureaucracy, political party and exogenous (largely U.S.) forces in Japan's economic transformation; economic developments were facilitated by Japanese firms. It is the successful internal development, and external manifestation of Japanese business which transformed her relationship with western Europe from one of thin contact to a relationship characterised by high-volume trade and investment activity.

The early 1960s saw Japanese alarm at the possibility of being excluded from EEC markets and the EC Commission commencing its long quest for a common external commercial policy. During the 1960s, Japan's rapid economic growth was increasingly noted in western Europe, with frequent comparisons being made to that country's craft and textile trade in the inter-war period. In the late 1960s, Japan's re-emerging economic prowess was being noted, but the issue of 'competitiveness' was largely absent. It was unclear at this time, how far Japanese industry would advance to high value-added sectors. Such speculations however, were to be quickly and dramatically resolved in the following decades. By the end of the 1960s Japan had surpassed every European country in terms of GNP. The oil crisis brought even greater pressure on Japan to export and in the mid-1970s, her trade imbalance became a political issue in Europe; aiding the EC Commission's campaign for a broadened external commercial policy mandate from the Council.

The period c.1973-c.1985, in EEC/EC-Japan affairs can be termed the 'era of trade'. This

is not to imply that trade ceased to be important after 1985 (in fact the record EC trade deficits with Japan were recorded after this date). Rather, this arbitrary term emphasises the virtual exclusivity of trade during a period when imported goods from Japan became highly visible within the Community. In geopolitical terms, the externality/internality of the relationship can be said to have been largely intact. Although in retrospect, it can now be seen to have been in transition from a largely external manifestation (imports) to a more complex, external *plus internal* form of production (imports *plus foreign direct investment*).

The mid-1980s increase in Japanese direct investment in the EC was not only significant in statistical terms. The geopolitical structure of the relationship was transformed, the actors realigned, and much of the EC-Japan agenda 'internalised' within the EC itself. It is this period; the 'era of investment and trade' which is the subject of the present research project.

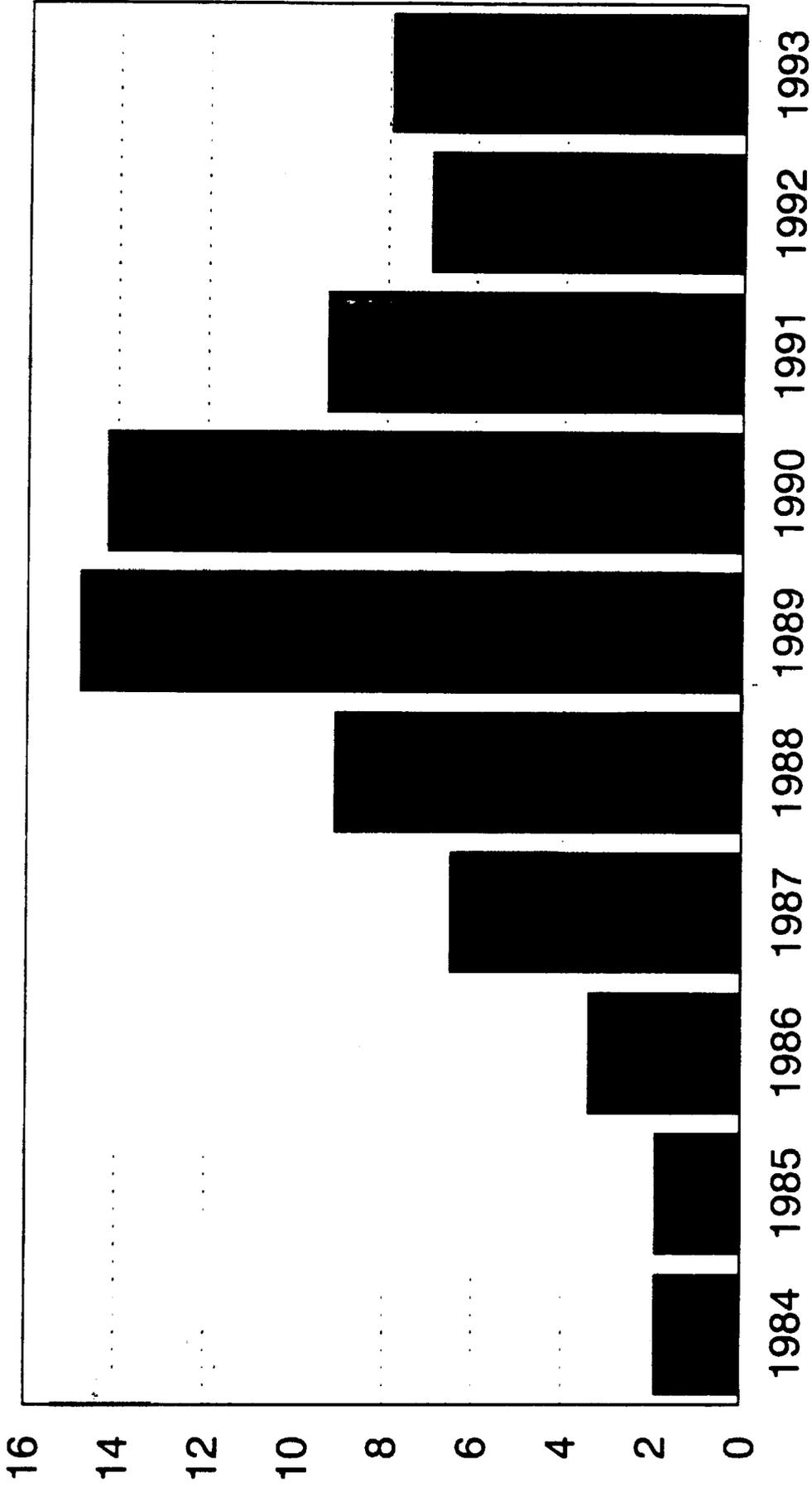
As established above, a general periodisation is closely associated with priorities accorded to phenomena whose periodisation may overlap. For example, trade has been an important continuous feature of EC-Japan affairs since the late 1960s. The EC-Japan agenda also incorporates non-commercial matters - for example cooperation on aid policies or discussion of UN reform. The situation is complicated by the continuance of bi-lateral relations between EC member states, some of which have had diplomatic missions in Japan for a century. However, the relationship underwent a significant qualitative and quantitative change in the mid-1980s. Levels of exchange (in both human and commercial terms) were raised to an historic high, bringing unprecedented Japanese involvement in European political economic affairs. The new phase was distinct from the previous 'era of trade'.

The issue then arises as to when such a period closes. Events may expose the relative arbitrariness of this exercise. However, the decline of *new* stocks of Japanese FDI in the early 1990s [CHART 1 over] and the continued importance of 'direct' trade in the relationship, would appear to indicate that the factor of investment in the relationship had stabilised by 1992/93.¹ New questions arise in the post-1993 phase - particularly those relating to the

¹ Hideki Yamawaki has treated this aspect in 'Exit of Japanese multinationals in U.S. and European manufacturing industries' paper at *Stratégies des firmes multinationales et impacts des délocalisations* conference, Paris, 1994.

CHART 1

Direct investment from Japan to Europe



\$US bn., 1984-93. Sources: MITI, Tokyo and (for '93) Keizai Koho Center

relationship between FDI and trade, and the extent to which FDI might or might not expand at 1980s levels. Caution must be exercised in interpreting the post-1991 decline in new stocks of Japanese-EC investment as a permanent trend. However, it must be noted that most major Japanese firms are now present within the Community. Low growth-rates in both Japan and the EC in the early 1990s contribute to the 'plateau' in investment, and there is evidence that western Europe is less important in the global strategic interests of Japanese firms than was the case in the 1980s and early 1990s. This trend is reflected in the flow of Japanese direct investment to Asia and the mixed returns on investments in western Europe.

There are other reasons for the 1985-93 periodisation. The SEA was signed in December 1985² and the new Delors Commission signaled an activist agenda. The period (1985-93) witnessed considerable constitutional movement and slow economic growth within the EC; Japan experienced political continuity until the fall of the LDP (1993) and strong economic growth until 1992.

II.3 THEMES IN EC-JAPAN RELATIONS, 1985-93

Major themes in EC-Japan relations, 1985-93 include: an active/reactive dynamic; an ambiguity and lack of consensus regarding the extent to which both Japan's Ministry of International Trade and Industry and the EC Commission could influence (their own and each other's) firm-generated phenomena; the geopolitical importance of firms; the *de jure* evolution of the EC itself; and the influence, both direct and indirect, of the U.S.-Japan relationship on EC-Japan affairs. The relationship presents an opportunity to evaluate the impact of globalisation on regional political integration.

The broad historical 'active/reactive' concepts introduced above are here recalled. Although systemic conditions may influence the decision to invest abroad, FDI is a firm-originating phenomenon, and as such is active. Both FDI and trade matters within the EC-Japan relationship are active on the Japanese side, with the EC being active on the issue of market

² The Act was ratified in all member states by mid-1987.

access.³ This cycle of action and reaction was based upon an asymmetry in the dynamics of political economic power. Throughout the period the EC ran a 'structural' trade deficit with Japan, and Japanese investment in the 12 member states far outweighed EC investment in Japan [CHART 2 over] If the years 1985-93 constitute an integral period; the relatively sudden appearance of the phenomenon of FDI in EC-Japan affairs, can be treated as an *event* to which the EC -not only diplomatically, but in its constitutional entirety - responded.

EEC/EC-Japan relations have been dominated by commercial matters since the Treaty of Rome. Economic diplomacy between the EC and Japan has been elevated to a point where it is an integral part of the salient political agenda. Chapter I above draws on the perspective of IPE scholars who argue convincingly that commercial and economic relations are indeed central to 'salient' international relations. The distinction between 'high politics' and 'low politics'⁴ may thus appear to be redundant. However, this distinction can still be useful - not to exclude economic dynamics from 'the political'⁵ - but rather to identify and locate political power which may be outside state spheres of control. The distinction can be applied to *draw attention to* the strategies which states use to harness - or attempt to harness - such power.

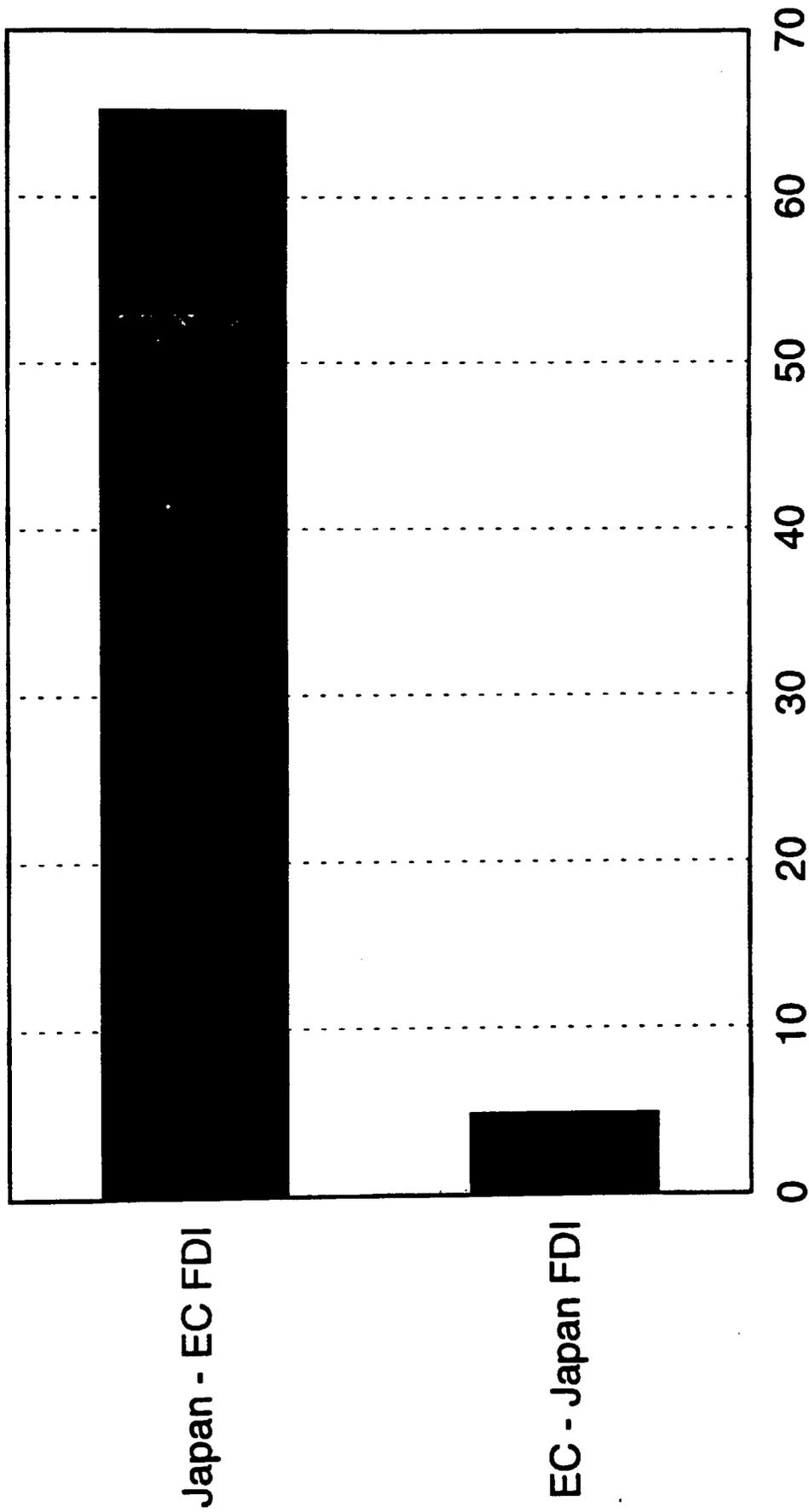
³ There is preliminary evidence that such a cycle may be forming in EC-Asian relations post-1993. In September of 1994, the EC Commission announced the imposition of anti-dumping duties on television sets imported from China, Korea, Malaysia, Singapore and Thailand. *International Herald Tribune*, 1 October 1994, p.11.

⁴ Roger Morgan writes that "It is tempting, and to a certain degree useful, to distinguish between the concepts of "foreign policy" and "external relations" by arguing that "foreign policy," as traditionally practiced by nation-states through their foreign offices and diplomatic agents, concerns such matters of "high policy" (or in Stanley Hoffmann's term *Grosspolitik*) as prestige, political influence, national security, and the pursuit of diplomatic objectives, whereas "external relations" covers more mundane activities such as the regulation of international trade, migration across frontiers, and other issues which might not unfairly be characterized as "low politics." Morgan, Roger P. *High Politics, Low Politics: toward a foreign policy for western Europe*, The Washington Papers, Vol.1, No.11, Sage, Beverly Hills and London, 1973. p.8. Pierre Jacquet follows this paradigm, writing that EC-Japan relations "belong to the realm of 'low politics'", 'Japan and Europe in the 90's: what scope for what economic cooperation?', Von Heynitz, A. and H. Maull (eds.) 'European-Japanese Relations: the next phase', *conference proceedings*, Stiftung Wissenschaft und Politik, Ebenhausen, November, 1989. p.64.

⁵ Morgan recognised the distinction as a methodological device: "...the attempt to separate economics and diplomacy, "low politics" and *Grosspolitik*, is clearly revealing itself as artificial, and is already being broken down by the pressure of events." *ibid.* p.60.

CHART 2

Japan-EC FDI flows, 1983-1992



\$US bn. Source: OECD, Paris

In July 1991, Prime Minister Kaifu adopted a 'politics-more-than-economy'⁶ approach at the EC-Japan summit in The Hague. *Agence Europe* reported that the Japanese side emphasised "the political significance of the declaration" and that the Community side insisted upon "*tangible results being sought as soon as possible*".⁷ Such positions reflect that participants maneuver to delineate or associate, 'high' and 'low' politics as strategic priorities demand. The unresolved dilemma posed for public authorities by the trans-territorial activities of firms, is the silent reality behind these positions. The EC Commission has repeatedly requested action from the Japanese government regarding a trade deficit which has eluded 'intervention'. Multi-lateral agreements such as the 1985 Plaza Accord, likewise did little to influence Japanese surpluses in trade and investment.

Japanese firms have played a central role in the evolution of EC-Japan affairs. This thesis is not primarily concerned with firm-state relations - rather it evaluates the extent to which trans-territorial bonds between (and within) firms, influence or overcome competitiveness-enhancement (integrationist) bonds between states. This tension is primarily manifest in the agent of FDI. The three central empirical chapters of this synthesis respectively treat Japanese FDI and EC sub-states; Japanese FDI and EC member states; and Japanese FDI and the EC institutional level. The activity of Japanese firms and the various responses to such activity are treated throughout, with a view to assessing the impact of such phenomena on the European Community itself in the period 1985-93.

Japanese firms, since the early 1970s have seen the gradual removal of constraints on outbound capital movements, to the point where such movements only need be registered with the Japanese Government. This trend was paralleled by the gradual softening of MITI influence during the 1970s and 1980s. The motives for Japanese investment are complex,

⁶ *The Japan Economic Review*, 15 August 1991, p.1. This policy was seen as a reversal of "Japan's past manner of carrying on its diplomacy on the basis and strength of Japanese economic cooperation or capacity".

⁷ *Europe* [Agence Europe], No. 5538, 19 July 1991, p.5 (original emphasis).

encompassing a combination of exogenous and endogenous factors.⁸ These include: reaction to/pre-emption of trade 'protection'; internal competition⁹; surplus capital and the desire to become 'commercial members' of emergent blocs. Shortage of labour in Japan and technological change, are among the many factors which must be considered in evaluating investment strategies.

Recognition of firms as political actors has been pioneered by Susan Strange. Subsequent work by Gerd Junne has posed the question as to what the *multiplicity* of trans-national enterprises implies for the system. Junne argues that the proliferation of multinational enterprises makes it "less important what any individual company is doing."¹⁰ For Junne this shifts the effect of MNEs to "the structures that have come about as the result of their collective actions".¹¹

Here a third dimension can be introduced. If the impact of individual firms is diluted by the *proliferation* of MNEs, then the extent to which firms of a common originating state may adopt similar strategies becomes important. Such a proposition is significant in the FDI relationship between Japan and the EC. If state interests can be reconstituted (with or without government guidance) through collective firm action, and if those firms seek (in the parlance of Coase) to 'internalise' transactions, then the possibility arises that firms might collectively internalise otherwise external political economic relations. This would be particularly applicable to relations in which the greater part of the agenda concerns the politics of

⁸ Edith Penrose states that "A comprehensive theory of the growth of the firm must explain several qualitatively different kinds of growth and must take account not only of the sequence of changes created by a firm's own activities but also of the effect of changes that are external to the firm and lie beyond its control." *The Theory of the Growth of the Firm*, Blackwell, Oxford [1959] 1980, p.4.

⁹ Ozawa has stressed that "Japan's overseas investment has been an integral part of its industrial restructuring at home and, in fact, a crucial instrument or catalyst for industrial upgrading". 'Japanese multinationals and 1992' in Buergermeier, B. and J.L. Mucchielli (eds.) *Multinationals and Europe 1992*. Routledge, London, 1991. p.137.

¹⁰ Junne, Gerd 'Multinational Enterprises as Actors' in Carlsnaes, Walter and Steve Smith *European Foreign Policy*, Sage, London, 1994. p.85.

¹¹ *ibid.*

economic affairs. This concept is distinct from neo-mercantilism, insofar as it claims that 'tandem' firm action can be autonomously generated - and can coincide with the interests of the home state. In EC-Japan affairs, the international relations 'frontier' has been significantly replaced by an internal EC dynamic, reflected by increased roles for non-DGI (external trade) directorates in the relationship.¹²

The changing *raison d'être* and structure of the EC itself is an important theme in EC-Japan affairs. Global economic competitiveness had become the central plank in the Community's existence by the mid-1980s. The importance of EC 'competitiveness enhancement' priorities, when compared with the relative easing of MITI-firm relations in Japan, may be a reflection of the asymmetry in economic power between the EC and Japan. Such an imbalance is not so much an imbalance of numbers (although these are striking) - more precisely there has been an imbalance in the dynamic use of economic power - including technology, information and business strategy in the period since the early 1970s.

A further theme in EC-Japan affairs since the mid-1980s has been a closer exogenous probing of certain fundamental assumptions of integration which were not sharply posed in the first quarter century after the Treaty of Rome. Although the *défi américain* was a factor in the economic development of Europe, the 1980s volume of investment and the enhanced mobility of capital posed a new challenge to the assumption that adjacent territories can derive advantage from policy 'economies of scale'. The institutional makeup of the Community is also substantively different in the period under review. Given the absence of the UK in the *défi américain* era, no meaningful structural evaluation of the EC can be drawn from comparisons with the 1985-93 period.

Increased global capital mobility in the 1980s highlighted the political economic philosophy differences between 'Atlantic' and 'Continental' states within the EC. Nowhere was this

¹² Saucier for example, has written that "Competition policy is probably going to be used to shape a new competition landscape in which extra-EC firms will not occupy dominant positions." Saucier, P. 'New Conditions for competition between Japanese and European firms' in Buergermeier, B. and J.L. Mucchielli (eds.) *Multinationals and Europe 1992*, Routledge, London, 1991. p.132.

more evident than in EC-Japan affairs.

Another theme which is manifest in EC-Japan affairs is the impact which FDI has had on the geopolitics of international relations. One of the consequences of this phenomenon is an alteration in the nature of membership and non-membership - from *de jure* territorial, to *de facto* trans-territorial. The 'membership' status of firms becomes crucial. During the 'era of trade' in EC-Japan relations (1973-1985), EC trade policy was the Commission's most powerful function. In the subsequent period, the advent of high-volume FDI posed dilemmas for the use of trade instruments as competitiveness enhancers. Unsurprisingly, anti-circumvention emerged as one of the most important issues in EC-Japan relations in the period under review. The issue of the decline of the implicit sanction of non-membership arises since non-member states may be able to promote their agendas through the collective action of firms. Such a phenomenon would imply a loss of Community power in the international political economic system.

Several authors have adopted a cooperation/conflict paradigm in explaining EC-Japan affairs. Such an approach may remain valid with regard to diplomatic relations. However, during the 1985-93 period, cooperation became driven by the relationship between Japanese firms and EC sub-states, and Japanese firms and liberal EC member-states. Cooperation was largely generated outside of the remit of the EC Commission and MITI. This cooperation is accompanied by tensions - with some 'continental' member states; with the EC Commission; or (infrequently) with local political authorities. Internalised 'cooperative tension' came to replace the cooperation/conflict paradigm.

A final and constant theme in EC-Japan relations is the relationship between the U.S. and Japan. The United States is Japan's largest trading partner and its most important ally. Significantly, there has been a prominent, controversial and evolving security relationship between the U.S. and Japan. Despite tensions between the two, the U.S.-Japan relationship remains fundamentally strong. The economic destinies of both nations are increasingly interlinked by foreign direct investment and trade. This reality and Europe's established Atlantic link, imply that the role of the US is significant in EC-Japan affairs. Brussels, Tokyo and Washington D.C. are constantly wary of being outmaneuvered by favorable commercial

terms negotiated or coerced between any other two. The EC Commission has been vigilant to the point of paranoia about any bi-lateral U.S.-Japan accords, (such as the 1986 US-Japan semiconductor agreement¹³ or the 1992 auto-component understanding). This has been accompanied by scepticism that Japanese market opening initiatives are merely part of US-Japan 'managed trade' initiatives for the facilitation of American goods. A 1989 EC Commission memorandum to the UK House of Lords Select Committee on the European Communities stated that "Japan has continued to be less than even-handed in deals which *de jure* apply *erga omnes*, but *de facto*, privilege the United States".¹⁴ This assessment remained current throughout the period.

This thesis does not attempt to compare U.S.-Japan with EC-Japan relations. Such comparisons can be freely drawn by the reader, and unfortunately, the all too simple recourse to 'triad' comparisons and dynamics makes only a contribution at the most general level. In exclusively concentrating upon the topic at hand, it is not suggested that EC-Japan relations are more important than other EC or Japanese external relations; rather that the 'third side' of the U.S.-Japan-EC 'tripod' has not been extensively treated.¹⁵

A final, paramount, theme which emerges from the relationship between Japanese firms and the EC, including its constituent parts, is the relationship between globalisation and regional integration. This theme is present throughout the chapters which follow. It is important to note that this research does not concern the impact of globalisation on regional *economic* integration, which appears to be a localised process of globalisation itself. Rather, the focus

¹³ See, Prendergast, James W. 'The European Economic Community's Challenge to the U.S.-Japan Semiconductor Arrangement' *Law and Policy in International Business*, Vol.19, No.3., 1987. pp.579-601.

¹⁴ Memorandum to House of Lords Select Committee on the European Communities; *Relations between the Community and Japan*, 13th Report, session 1988-89, *Evidence*, HMSO, London, 1989, p.31.

¹⁵ In the mid-1990s, both U.S. and European concerns are turning towards the strong Asian dimension in their relationship with Japan. Robert Taylor, in his *China, Japan and the European Community* (Athlone Press, London, 1990) added such a dimension to his consideration of EC-Asian affairs in 1990. The approach refreshingly recalls the existence of other 'tri-angles' in world political economic affairs.

of analysis is on the impact of increased globalisation on *de jure*, political economic integration - specifically in its unique, western European manifestation.

II.4 LITERATURE

Many scholars have treated Euro/EC-Japan relations within the context of Japan's relations with 'the West'. Endymion Wilkinson's *Japan versus the West; image and reality*¹⁶ draws heavily on the conflict/cooperation paradigm identified above - particularly in relation to misunderstanding in cultural communication. Whatever the relevance of misperception in past relations, this approach is strongly questionable in the era of firm-driven cooperation. The standard work on the evolution of Community relations with Japan is Albrecht Rothacher's *Economic diplomacy between the European Community and Japan, 1959-1981*.¹⁷ This work specifically treats the structure of the EC in its relations with Japan, according a central role to the EC institutional level in the conduct of EC-Japan affairs appropriate to the 'era of trade' analysed.¹⁸ William Nester's *European Power and the Japanese Challenge*,¹⁹ draws heavily on Rothacher's account of the evolution of the history of EEC-Japan relations. Surprisingly, Nester adopts the view that Japan's role in the relationship is essentially neo-mercantilist.²⁰ The emphasis on economic diplomacy, which Rothacher adopts, is still dominant in Nester's (1993) work. Such a static approach is inadequate for a relationship

¹⁶ Wilkinson, Endymion, *Japan Versus the West: image and reality*, Penguin ed., 1990. This work is one of the few which began as a Euro-Japan project and moved to the 'western' experience with Japan. Originally published as *Misunderstanding: Europe vs. Japan* [1981].

¹⁷ Rothacher, Albrecht *Economic diplomacy between the European Community and Japan, 1959-1981*, Gower, Aldershot, 1983.

¹⁸ A paper by Quinn Riordan at the Johns Hopkins Bologna Centre, examines inter-state relations and trade policy in this period. 'The true nature of European integration as revealed by the European Community's trade relationship with Japan' *paper*, [Library] Johns Hopkins Bologna Centre, Bologna, 1991.

¹⁹ Nester, William R. *European Power and the Japanese Challenge*, Macmillan, London, 1993.

²⁰ This view is fully outlined in Nester's *Japanese Industrial Targeting: the neomercantilist path to economic superpower*, Macmillan, London, 1991.

completely transformed by the agent of FDI and the involvement of TNCs during the 1980s.

In 1987 James Darby concluded a study of Japanese FDI in the UK and France with perception: "Inward investment policy may therefore occupy an increasingly important position within the general competence and objectives of industrial policy, as the competitiveness of foreign firms in individual sectors continues to become more apparent in terms of employment, technological capacity, and balance of payments considerations."²¹ Although Darby was not primarily concerned with the pan-European political effects of FDI on integration, his work raises many important issues from an earlier period of Japanese FDI in western Europe. A more recent study by Roger Strange examines the pivotal role of the UK in Euro-Japanese FDI relations, evaluating the impact of such investment on the UK economy.²²

Given the paramount importance of trade and investment issues in EC-Japan relations, it is unsurprising that many insights are to be found in literature on trade and more recently, investment. The FDI literature has been enriched by Dianne Julius,²³ who retains the European state, rather than the EC as her unit of analysis. Stephen Thomsen and Phedon Nicolaides²⁴ give a comprehensive assessment of Japanese direct investment in Europe, but do not significantly treat the political legacy of multi-leveled bargaining between EC constituents and Japanese firms. In a subsequent study, Thomsen and Woolcock do bring together direct investment and European integration - principally "...to place the rapid growth of direct investment in Europe during the 1980s in the context of European integration and to define more clearly those barriers to intra-European direct investment which still impede

²¹ Darby, James The Political Economy of Japanese Manufacturing Investment in France and the United Kingdom (1970-86) Ph.D. thesis, European University Institute, Fiesole, 1987.

²² Strange, Roger *Japanese Manufacturing Investment in Europe: its impact on the UK economy*, Routledge, London, 1993.

²³ Julius, DeAnne *Global Companies and Public Policy*, Pinter, London, 1990.

²⁴ Thomsen, Stephen and Phedon Nicolaides *The Evolution of Japanese Direct Investment in Europe: death of a transistor salesman*, Harvester Wheatsheaf, Hemel Hempstead, 1991.

European integration."²⁵ Important cutting-edge technologies accessible through extra-European investment are underestimated by a focus on intra-EC investment.²⁶ Although the total size of Japanese investment in the European economy is small, the qualitative contribution is an additional and largely non-quantifiable factor, which explains the very high priority accorded relations with Japan by those states wishing to harness sources of external competitiveness. The evolution of external direct investment in the EC and the multi-leveled roles and reactions of the EC in connecting with such investment is an important test of the systemic integrity of the Community.

The advent of the 1992 programme caused some concerns of exclusion in Japan which were not dissimilar to those of the late 1950s. Kenjiro Ishikawa discusses most of these in *Japan and the challenge of Europe 1992*,²⁷ while Ippei Yamazawa outlines the strong options of Japanese firms.²⁸

CONCLUSION

In *Japan and Western Europe*²⁹, Tsoukalis and White identified a central *problématique* which remained valid for the 1985-93 period of EC-Japan relations. Stating why they would not include a general analysis of the 'European side of the equation' - the central task of this

²⁵ Thomsen, Stephen and Stephen Woolcock *Direct Investment and European Integration*, Pinter for RIIA, London, 1993. p.6.

²⁶ Despite Honda's relatively small stake in Rover (the UK auto-maker), the technology infusion to Rover [which included some dividends from Honda's F-1 motor-racing capacity] were sufficient to reinvigorate the UK company. BMW's subsequent acquisition of the majority British Aerospace share in the company in 1994 would have been unimaginable without the small but crucial Honda investment.

²⁷ Ishikawa, Kenjiro *Japan and the challenge of Europe 1992*. Pinter, London, 1990.

²⁸ Yamazawa, Ippei 'Japan', Ch.15 of Borner, Silvio and Herbert Grubel (eds.) *The European Community after 1992*, Macmillan, London, 1992.

²⁹ Tsoukalis, Loukas and Maureen White (eds.) *Japan and Western Europe: conflict and cooperation*. Pinter, London, 1982.

thesis - the editors wrote:

"Whenever reference is made to Western Europe as an international partner, it is almost invariably the European Community that is implied. The Community... is not, at least as yet, a federal state. Nor is it, however, an example of a traditional inter-governmental organisation in which case there would be little point in talking about EC-Japan relations. The hybrid nature of the Community makes it a very complex subject to study but also a difficult interlocutor, as many Japanese negotiations must have discovered in their dealings with it and at the cost of certain frustration. The existence of the Community may be seen as an additional complicating factor in Euro-Japanese relations but also potentially as a factor that may make the effective management of those relations more likely."³⁰

The analysis which follows addresses the issues raised in this overview with a view to making a definitive statement concerning the European Community's integrity as global interlocutor. The themes of EC-Japan affairs, 1985-93 suggest four central units of analysis in the relationship. These are: Japanese firms, the EC institutional-level, EC member states, and EC sub-states. In the three empirical chapters which follow, Japanese firms, as the agents of FDI are treated in their relations, bargains and impact upon the EC in its structural entirety.

Japanese firm-EC sub-state relations constitute a 'front-line', tactile and flexible strand of the overall relationship. While the EC Commission was preparing competitiveness-enhancing strategies in the mid-1980s, the sub-states were beginning to seek their own welfare enhancement outside of the integration bloc. This development is even more evident among liberal member states. The role of the EC Council and the continuance of bi-lateral relations supports the importance attached to the Japanese firm-EC member state dimension. The EC Commission is also important, given its legal competence over external trade policy - the instruments of which constitute an important causal factor in the advent of Japanese FDI. However, the analysis which follows is not a static one. Rather, the emphasis is on the dynamics of the evolution of the EC through its experience in one important external relationship. Attempts by the Commission to extend traditional trade instruments to include FDI regulation reveal a dynamic, multi-variate evolution which involved powerful roles for externalities.

This tri-level analysis of EC-Japan relations affords an assessment of the impact of Japanese

³⁰ *ibid.* p.xii.

FDI on the Community, and an evaluation of the EC as revealed in its actions to, and reactions towards this externality. From this assessment, the central *problématique* concerning the impact of globalisation on regional political integration can be addressed.

CHAPTER III EC SUB-STATES AND JAPANESE INVESTMENT

INTRODUCTION

Analysis of the role of sub-states in EC-Japan affairs is an imperative component of the international political economy/geopolitics methodology outlined in the first chapter. However, the inclusion of sub-states is also a practical choice. By virtue of the presence of almost 40 EC sub-state representations in Japan, and the 'front-line' role of regional authorities interacting with Japanese firms; sub-states are an important strand in EC-Japan affairs. The sub-state level is given a prominent place in the empirical scheme, both for the practical reasons mentioned above, and because such a treatment provides important insights into 'ground-level' issues which EC solutions, regulations and initiatives are frequently intended to address. The treatment of member states in EC-Japan FDI relations [Ch.IV] and the EC institutional level [V] is made more immediate and more complete by this early focus on the area of strongest interface between Japan and Europe.

This chapter is arranged in four parts. Recent theoretical literature on the role of sub-states in international relations is reviewed. This is followed by the presentation of the author's survey on EC sub-state representations in Tokyo. The European presence in Japanese regions is assessed for comparative insights and the conclusion evaluates theoretical literature in view of the empirical findings. The analysis explores the relationship between the EC member states and their internal sub-states; and also the contextual role of EC sub-states in the EC system.

III.2 SUB-STATES IN THE INTERNATIONAL SYSTEM

Sub-state entities¹ have increasingly attracted attention in the literature on international affairs

¹ In the EC these are largely sub-state *regions*. However, many of those EC sub-states represented in Japan are not officially designated regions. Such include representations of metropolitan areas. The term *sub-national* is sometimes used. For a discussion on

during recent years. This section firstly considers literature on the role of sub-state entities in federal systems. Secondly, recent evaluations of the U.S. states' role in international [particularly political economic] relations will be evaluated for comparative insights.² Thirdly, the quasi-legal debate on 'subsidiarity' provides an opportunity to evaluate the extent to which such concepts might have an effect on the real ability of sub-states to exert their identities. Finally, geopolitical methodologies, which emphasise the 'organic' interconnectedness of capital, people and other dynamics are evaluated with reference to EC sub-states.

The literature on sub-state external relations in federal systems has provided valuable insights regarding sub-state external relations generally. An analysis of sub-states in Australia, Austria, Belgium, Canada, Germany, Switzerland and the US by Michelmann, Soldatos and others, concentrates upon federal states. Michelmann concludes that "...the state-centered view of international relations, in which actions and interactions in the international system emanate from and are directed towards nation-state actors almost exclusively, is a gross distortion of reality..."³ This premise does not however, advocate the 'neo-Braudelian' approach which largely echews state and even regional boundaries. The consolidated conclusion of Michelmann and Soldatos is that "...no country-chapter author concludes that the international activities of his federation's component units seriously threaten the foreign-policy prerogatives of the national government..."⁴ The empirical survey of EC sub-state activity in Japan evaluates this conclusion. The empirical evidence presented below treats both federal and non-federal EC sub-states, and indicates that sub-states play strong external relations roles in

terminology see Jan de Meyer, 'External Relations of Federated States' in Morgan, Roger (ed.) *Regionalism in European Politics*, P.S.I., London, 1986. pp.155-6.

² The experience of U.S. states in U.S.-Japan relations is compared with the experience of European sub-states in EC-Japan relations.

³ Michelmann, Hans J. and Panayotis Soldatos (eds.) *Federalism and International Relations; the role of subnational units*, Clarendon Press, Oxford, 1990. p.312.

⁴ *op.cit.* p.313.

both federal and non-federal states.⁵

Discussion of sub-state external relations has largely hinged on the potential diplomatic or treaty-making powers (or lack of such powers) of sub-states.⁶ A crucial change occurred during the 1980s with increased interaction between EC sub-states and external firms. The advent of increased levels of global FDI in the 1980s ensured an enhanced role for firms in political developments. Bargains between sub-states and firms lay outside the traditional modes of diplomatic representation. The engagement between European sub-states and global firms was made possible firstly by the external firms themselves, and secondly by the strategy of the sub-states to seek welfare enhancement through global interface with MNEs. The role of sub-states and liberal member states, which allied with Japanese firms in political economic bargaining illustrates the concurrent nature of internal and external welfare enhancement strategies. EC sub-states seek to enhance welfare not only through bargains with their state and the EC, but simultaneously through their relations with entities outside of the EC. There is no chronological lag between efficiency and redistribution in this regard. A similar *regional/global* dynamic has been at play regarding the relationship between the EC institutions and the EC member-states. Whilst trade policy was being centralised, the political economic power derived from FDI relations and trade promotion was within the competence of the member states.

In general terms, the U.S. can be compared to Germany in the role which U.S. sub-federal units play in U.S.-Japan investment relations. Despite a large trade deficit, the U.S. has maintained competitiveness and productivity. Germany also runs a trade deficit with Japan, but her competitive stature (in terms of exports to Japan and third-market competition with Japan) remains strong. Although the U.S. is as open as the U.K. and the Netherlands in terms

⁵ Non-federal states are included in the analysis of Morgan et al, *Regionalism in European Politics*, P.S.I., London, 1986. John Kincaid includes both Japan and France in the growing number of unitary states asserting "consumership and citizenship interests internationally." 'Consumership versus citizenship: is there wiggle room for local regulation in the global economy?' in Hocking, Brian (ed.) *Foreign Relations and Federal States*, Leicester University Press, 1993, p.27.

⁶ See De Meyer, Jan, 'External Relations of Federated States' in Morgan, Roger (ed.) *Regionalism in European Politics*, P.S.I., London 1986. pp.157-8.

of its disposition towards FDI; the constitutional structure of the U.S. invites comparisons with Europe's most evolved federal state. Investment from Japan to the U.S. has involved low levels of federal regulation⁷ and an important role for U.S. state-Japanese firm relations. In Germany, regulation and guidance have been less liberal than in the U.S., and the *Länder* have played strong roles. The *Länder* themselves have also acted as proxies for German federal scepticism towards a completely liberalised environment for inbound investment.

Significant Japanese FDI in the U.S. predates that of the EC by approximately one decade. U.S. state representation has intensified competition between individual states represented in Tokyo⁸ which has been termed a 'war between the states.'⁹ For state leaders, investment seeking is a high priority - then Governor Bill Clinton for example, visited Japan three times seeking investment for Arkansas.¹⁰ Many of the experiences of U.S. states are echoed in those of EC sub-states. The setting up of state offices to negotiate with Japanese firms for investment purposes; the searching for new roles in the more recent period of declining

⁷ Michael Hodges observes that "The official US policy toward inward investment is 'neutrality with encouragement'.." 'The Japanese Industrial Presence in America: same bed, different dreams,' in Newland, K. (ed.) *The International Relations of Japan*, Macmillan, London, 1990. p.49.

⁸ The following list of U.S. states with representative offices in Japan was compiled from the JETRO Directory of external missions, 1992 and the Tokyo Classified Telephone Directory, 1993: Alabama, Alaska, Arkansas, California, Colorado, Connecticut, Delaware, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nevada, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas, Utah, Washington, Wisconsin, Virginia and West Virginia. *The Florida Department of Citrus* is represented, as are the city and port representations of *Dallas*, *Greater Houston Partnership*, *San Diego Economic Development Corp.*, *Richmond Metropolitan Economic Development Council*, *The Port of Portland*, *The Port Authority of New York & New Jersey*, and the *Port of New Orleans*. There are also Japanese representative offices of *San Bernardino County of California* and the *Tennessee Valley Industrial Development Association*. [The *Economic Development Administration of Puerto Rico* and the *Guam Visitors Bureau* are also represented.] See also, Morita, Akio 'Japanese investment in the US and US-Japan trade problems,' in *Japan and the World Economy*, Vol.3, No.1, 1991. p.113.

⁹ *Tokyo Business Today*, April 1987, p.1. See also 'Civil War, Round Two' in *Barron's*, 3 April 1995. pp.23-26.

¹⁰ *The Independent*, 5 November 1992, p.16.

outbound Japanese investment; the extent to which sub-states¹¹ represent a challenge or a compliment to national authority, are issues which invite comparison with EC sub-states and member states.

Recent writing on the external relations experience of federal sub-states and the external role of U.S. states, can be supplemented with reference to the debate on the concept of 'subsidiarity' within the EC.¹² A common feature of literature on EC regions is the scant treatment of their external roles. Such is also the case with regard to most considerations of subsidiarity. The experience of global increases in FDI in the 1980s and the recognition of the political role of firms by Strange, Junne and others indicates that any consideration of *de facto* subsidiarity ought to examine the external role of EC sub-states.

In a discussion on the impact of the principle of subsidiarity, Renaud Dehousse writes: "Yet there is still no clear understanding of the actual scope of the subsidiarity principle, nor of the ways in which it could be used by the Community institutions."¹³ Despite renewed attention to this principle from 1990 onwards, there has been little reference to the phenomenon of considerable EC sub-state representation in the international realm, which predated the Maastricht recognition of subsidiarity.¹⁴ *De jure* recognition of this principle lagged behind actual sub-state interaction with political economic externalities. Increased interaction between sub-state entities and large multi-national enterprises, rather than concepts of power demarcation, was the defining sub-state characteristic of the period. Kees Van Kersbergen and Bertjan Verbeek, in their discussion of subsidiarity, also ignore the

¹¹ ie. U.S. states

¹² Article 3B, of the *Treaty on European Union* refers to subsidiarity: "In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community." Council, Commission of the European Communities, Luxembourg, 1992.

¹³ Dehousse, Renaud 'Does Subsidiarity Really Matter?' *E.U.I. Working Paper in Law*, no.92/32, Fiesole, 1992. p.2.

¹⁴ TAB. 5 lists the dates of establishment of EC sub-state representations in Japan.

opportunities for enhanced sub-state roles through relations with external firms. As with Dehousse, these authors are pessimistic about the future utility of the subsidiarity concept in EC evolution.¹⁵

Literature on federal structures in international relations uses a comparative political systems approach while that on subsidiarity largely focuses upon *de jure* principles. However, recent geopolitical writing is very much concerned with the realities of exchange and the actualities of the conditions for change in the global political economy. The importance of regional networks determined by geographical or geo-economic realities, has been stressed by François Gipouloux. The following paragraph discussing urban centres illustrates this methodology:

..as an economic entity, a city is not limited to its municipality, but embraces a wide range of activities and interests which can be metropolitan as well as regional. It is necessary however, that exchanges between cities not be restricted to formal channels or national initiatives; they should increase direct contact and links without passing through capital cities.¹⁶

To Gipouloux, considerations of proximity, geographic features and change over time, are fundamental to the understanding of international and regional change. Such tools are traditional. However, their potential to accurately explain complex international political economic realities, exceeds the explanatory power of Cold War era international relations theory. Barnes and Ledebur also build on Braudel to point to tensions between the territoriality of political authority and the scope of economic activity:

The emergence of the nation-state created what is now referred to as the national economy by the imposition of political boundaries on emerging patterns of market organization and development. A central thrust of economics and economic policy in the last century has been oriented to bringing rationality and coherence to this artificial economic construct.¹⁷

¹⁵ Van Kersbergen, Kees and Bertjan Verbeek 'The Politics of Subsidiarity in the European Union' *Journal of Common Market Studies*, Vol.32, No.2, June 1994. On the latter point see p.229. The authors comprehensively treat the historical evolution of the concept of subsidiarity in western Europe.

¹⁶ Gipouloux, François 'Globalization and Regionalization in East Asia: stakes and strategies' in François Gipouloux (ed.) *Regional Economic Strategies in East Asia: a comparative perspective*. Maison Franco-Japonaise, Tokyo, 1994. p.31.

¹⁷ Barnes, W.R. and L.C. Ledebur 'Toward a new political economy of metropolitan regions' *Environment and Planning C: Government and Policy*, 1991, Vol. 9. p.130. The authors write: "This system of MERs [metropolitan economic regions] overlays the geography

A similar view has been espoused by Patrick Smith, who writes: "Traditional distinctions between domestic and foreign policy have given way to 'intermestic' definitions which merge the two."¹⁸

The introduction of geopolitical approaches is particularly prescient in the post-cold war era. The logic and integrity of territorial entities as effected by a world of movement, expansion, interaction, mobility of trade and finance is at the heart of EC evolution in the global system. The geopolitical approach, combined with IPE can be used to analyse multiple levels of political authority in their interactions with externalities. The first of these levels, that of sub-states in the EC-Japan FDI relationship is now examined in depth.

III.3 SURVEY OF EC SUB-STATE REGIONAL REPRESENTATIONS IN JAPAN

Whilst studies of US-Japan relations have frequently analysed the role of U.S. states in the field of U.S.-Japanese relations, the role of European sub-state regional representations in relations with Japan has been completely ignored. The survey presented below attempts to redress this lacuna in the understanding of EC-Japan relations.

Tokyo constitutes an international political economic 'microcosm' in which more European, American and other sub-state representations interact with firms than in any other world

of the USA but does not respect national boundaries. Because of the intertwining of MERs in the global economy, these functional regional economies transcend geographical and political boundaries. The emergence of the multinational firm creates a network within the global system of MERs that functions, to a great extent, independently from national governments. The geographic profile both of national and of international corporations, however, reflect the spatial organization of the MER system. It can be argued that the organizing principle of the geographical orientation of national and multinational corporations is presence in, or access to, these regional metropolitan economies both in domestic and in international economies. If this is indeed the case, policies of national and multinational corporations reflect the reality of MERs and the system of regions far better than federal policies." pp. 135-6.

¹⁸ Smith, Patrick J. 'Policy Phases, Subnational Foreign Relations and Constituent Diplomacy in the United States and Canada: city, provincial and state global activity in British Columbia and Washington' in Hocking, Brian (ed.) *Foreign Relations and Federal States*, Leicester University Press, 1993. p.211.

centre. During mid-1993 the writer conducted a survey in Tokyo examining diverse aspects of the activities of EC sub-states. Following the presentation of the results of this survey and a comparative consideration of Japanese prefectures in EC-Japan affairs, the theoretical and general literature introduced above will be evaluated.

TAB.1 Profile of Survey of EC sub-state regional representations in Japan

Place of survey:	Tokyo
Dates of survey:	12 March - 22 July 1993
Number of representations identified:	38
Number of respondents:	27
Response rate:	71%

The purpose of this survey was to determine the level and nature of EC sub-state regional representation in Japan and the role of such representation in EC-Japan affairs. The following list of EC sub-state regions and metropolitan areas represented in Japan as of mid-1993 was compiled from the JETRO (Japan External Trade Organization) directory of external economic representations, Tokyo, 1992; and the 'Embassies, Consulates & Govt. Offices' section of the Tokyo Telephone Directory, 1993.¹⁹ The following list constitutes the full set of representations contacted for the survey, with their operational names.

TAB.2 List of EC sub-states represented in Japan

GERMANY: **Baden-Württemberg** Representative of the Ministry of Economic Affairs; **Bavarian** Ministry of Economics, Office for Economic Promotion; **Berlin** Economic Development Corporation; The Economic Development Corporation of the Federal State of **Bremen**; Japan Representative Office of the **Ports of Bremen/Bremerhaven**; The Industrial Development and Trust Company, State of **Hessen**; State Government of **Niedersachsen** Office of Industrial Location; **North Rhine-Westphalia** (NRW Japan K.K.) Economic Development Corporation; Economic Development Corporation for the German State of **Rheinland-Pfalz**; **Saar** Contact Japan; Economic Development Corporation of **Schleswig-Holstein** (joint representation with) **Hamburg** Business Development Corporation; **Treuhandanstalt** Representative Office [c/o German Chamber of Industry and Commerce in Japan].²⁰ **UNITED KINGDOM:** **Devon & Cornwall** Development Bureau; **Kent** Enterprise Office; **Milton Keynes** Development Corporation; Commission for the **New Towns**;

¹⁹ For representative offices outside of Tokyo see TAB.5.

²⁰ This is a federal government agency with responsibility for the privatisation of formerly state-owned industry in the eastern German *Länder*.

Northern Development Company (of England); **Industrial Development Board for Northern Ireland**²¹; **North West England (INWARD)**; **Nottinghamshire County Council**; **Locate in Scotland**; **Welsh Development International**; **West Midlands Development Agency**; **Yorkshire & Humberside Development Association Ltd.** **FRANCE:** Tokyo Office for **Alsace**, **Alsace Development Agency** (joint representation with) **Gascogne Office**; **Belfort Japan Office**; **Bordeaux Chamber of Commerce and Industry**; **Bretagne Region, Trade and Economic Development**; Tokyo Office for **Grenoble-Isère**; **Le Havre Port Authority**; Japan representative office of **Loiret**; **Representative Office of Touraine in Japan.** **SPAIN:** **Andalusian Autonomous Government**; **Basque Development Board**; **Centre d'Informació i Desenvolupament Empresarial, Generalitat de Catalunya (CIDEM)**; **Instituto de Fomento Region de Murcia**; **Valencia Investment & Trade Office.** **BELGIUM:** **Attaché of the Flemish Community Flanders.**

A number of observations on this set of sub-state representations are necessary. Firstly, some sub-state regions and cities are represented for reasons which are little related to their constitutional position or even their economic strength. The aspiration of particular regions to diversify their economic profiles, or the dynamism of local governors accounts for the presence of some regions on this list.²² Some 'regions' such as the UK *Commission for the*

²¹ Northern Ireland is represented as a region of the United Kingdom. The IDB for Northern Ireland is in receipt of direct financial and other assistance from the Invest in Britain Bureau (IBB). [Investment attraction to the Republic of Ireland is dealt with solely by the Industrial Development Authority of Ireland (IDA), which operates an office in Tokyo. The Republic of Ireland's inbound investment attraction activities are discussed in Ch.IV.] The role of foreign direct investment in reviving the economy of Northern Ireland was frequently referred to in discussions and analysis of the 'complete cessation' of September 1994. A joint delegation of the Irish [Republic's] Business & Employers' Confederation and the Belfast office of the Confederation of British Industry, visited Brussels in September 1994. Although there was no alteration in the constitutional position of the CBI or the IBB in Northern Ireland, one report stated that "The delegation was promoting an "island of Ireland" approach to economic development." *The Irish Emigrant*, issue No.400, 3 October 1994. UK Prime Minister Major hosted an international inward investment conference in Belfast in December 1994. The President of Ireland, Mary Robinson, invited Japanese businessmen to consider investment opportunities throughout Ireland at a reception in Tokyo in February 1995. *ibid.* iss. 421, 27 February 1995. President Clinton opened a U.S.-sponsored Irish investment conference in Washington D.C. in May 1995.

²² Andrew F. Cooper refers to these as 'maverick non-central actors.' He quotes Queensland's then premier Bjelke-Petersen as saying to Japanese investors at the inauguration of Queensland's Tokyo office: "Come to Queensland, not to Australia" 'Towards a typology of non-central foreign economic behaviour: the case of agricultural trade' in Hocking, Brian (ed.) *Foreign Relations and Federal States*, Leicester University Press, 1993. p.57. citing Hocking 'Pluralism and Foreign Policy: the states and the management of Australia's external relations,' *Yearbook of World Affairs*, vol.38, Stevens, London, 1984. p.1. The *Mainichi*

New Towns are not to be found on traditional EC lists of regions; yet they constitute an important conduit in EC-Japan affairs. Secondly, some sub-states rely on information-gathering visits to Japan rather than offices. Thirdly, Japanese firm negotiations with EC states which do not have strong sub-state roles in attracting inbound FDI do include negotiations with local officials. Such links can be developed by the investing Japanese firm or by a European firm seeking a partner, and can involve a strong role for the national authority which 'devolves' functions to regional players.²³ Sub-state activity does therefore exist within states which have centralised inbound FDI roles. Fourthly, sub-state representative activity is constantly changing with the climate for FDI.²⁴ Despite these caveats, a clear picture of the role of EC sub-state entities in EC-Japan relations 1985-93 can be constructed from the data.

TAB. 3 Survey questions put to EC sub-states represented in Japan

- How many offices does your regional authority/mission have world-wide?
 What year did your office open in Japan?
 Do you have more than one representative office in Japan? (If so, please state where any others are.)
 How many European staff do you have?
 How many Japanese staff do you have?
 What are the main activities of your mission?
 How highly would you rate investment-attraction among your activities?

Daily News referred to the role of David Bookbinder, leader of the Derbyshire County Council who negotiated the Toyota/Derbyshire deal in three months as "...determined to sweep aside all obstacles." 1 August 1990, p.7.

²³ Interviewed at the Danish embassy in Tokyo, Ms. Jaspersen stated that in Denmark "there is a sub-committee which represents the regions." *Interview*, Embassy of Denmark, Tokyo, 9 July 1993. As is the case with the Republic of Ireland, such regions do not have external representations in Japan.

²⁴ The survey does not include regional or municipal representations which were both established *and disestablished* prior to 1993. An example of such would be the Couseil Général de Vaucluse which ceased to be represented in Japan in 1992. The Chamber of Commerce and Industry of Madrid is represented *c/o Banco Exterior de España*. This representation was not listed in the aforementioned sources and was subsequently identified through the Commercial Office of the Embassy of Spain, too late for inclusion in the survey. The Thuringian Economic Development Corp. established a representative link through BOT Research International Ltd. during 1992/93. Sachsen began to be represented by this firm [which is associated with the Bank of Tokyo] in mid-1993.

- How do you promote your region?
 Have your activities been successful?
 Does your office have a special relationship with any single firm or industry?
 How does your regional activity differ from the efforts of your state embassy?
 Do you co-ordinate with the embassy of your European state?
 Do you co-ordinate with the EC?
 How does your regional activity differ from the efforts of the EC?
 Do you plan to maintain your office in Japan into the future?
 - Short-term, Medium-term, Long-term²⁵

71% of the representations responded to the survey. Some chose not to answer all of the queries. Absences of responses are indicated; reasons for not responding are reported where given. Those sub-state representations which responded to the survey are identified in the following table.

TAB.4 Sub-state representations responding

Baden-Württemberg²⁶	
Bavaria	R
Berlin	R
Bremen	-
Ports of Bremen	R
Hessen	R
Niedersachsen	R
North Rhine-Westphalia	R
Rheinland-Pfalz	R
Saar	R
Schleswig-Holstein / Hamburg²⁷	R
Treuhandanstalt	R
Devon & Cornwall	-
Kent	R
Milton Keynes	-

²⁵ An additional question regarding the number of Japanese firms which invested in particular regions was spoilt due to the inclusion of sales outlets, distributors &c. Regions were also asked if they employed European regional civil servants. Nord Rhein Westphalia reported two; Scotland reported two UK civil servants on secondment.

²⁶ The representative office of Baden-Württemberg did not formally reply to this survey, but did grant an interview.

²⁷ Schleswig-Holstein and Hamburg are jointly represented in Japan. This is also the case in Brussels. 'Index of Representative Offices Based in Brussels' in *The New Regional Policy of the EC*, Club de Bruxelles, 1993. p.A228.

Comm. New Towns	R
Northern England	R
Northern Ireland	R
North West England	-
Nottinghamshire	R
Scotland	R
Wales	R
West Midlands	-
Yorkshire & Humberside	R
Alsace / Gascogne²⁸	R
Belfort	-
Bordeaux	-
Bretagne	-
Grenoble-Isère	R
Le Havre	-
Loiret	R
Touraine	R
Andalusia	R
Basque	R
Catalonia	R
Murcia	R
Valencia	R
Flanders²⁹	-

In order to determine the scope of representation, the EC sub-states were asked questions concerning the extent of their representation world-wide; the length of time which their office in Japan had been operational; and whether they had a Japanese representative office outside of Tokyo.

²⁸ Alsace and Gascogne are represented by the same consultancy firm in Japan. Replies in this survey only apply to Alsace.

²⁹ Located in Osaka, c/o Belgium Flanders Exchange Center. This representation is due to move to Tokyo in 1995.

TAB.5 Duration and scope of regional representation³⁰

	Year Tokyo representation commenced ³¹	Other offices in Japan ³²	Offices globally ³³
Bavaria	1989	-	2
Berlin	1981	-	7³⁴
Ports of Bremen	1975	-	15³⁵
Hessen	1987	-	1
Niedersachsen	1992	-	1
North Rhine-Westphalia	1991	-	4
Rheinland-Pfalz	1985	-	3
Saar	1987	-	3
S.-Holstein/Hamburg	1989	-	-
Treuhandanstalt	1991	-	2³⁶
Kent	1985	Osaka (1988)	3³⁷
Comm. New Towns	1992	-	5
Northern England	1987	Osaka (1989)	12
Northern Ireland	1987	-	10
Nottinghamshire	1989	-	2³⁸
Scotland	1984 ³⁹	-	7⁴⁰
Wales	1985	-	10

³⁰ Sub-state representations not responding to the survey (see TAB.4) are not listed on this and subsequent tables.

³¹ *'What year did your office open in Japan?'*

³² *'Do you have more than one representative office in Japan? (If so, please state where any others are.)'*

³³ *'How many offices does your regional authority/mission have world-wide?'*

³⁴ Surrey, San Francisco, Boston, Vienna, Tokyo, Seoul and Taipei.

³⁵ Includes agents; 3 in North and Latin America, 12 in Asia/Pacific.

³⁶ "... and 7 honorary representatives in Europe."

³⁷ Philadelphia, Tokyo and Osaka.

³⁸ Bad Honnef (Germany) and Tokyo.

³⁹ Through agents until 1988.

⁴⁰ 4 in the U.S.A., Brussels, Tokyo and Hong Kong.

Yorkshire & Humberside	1985	-	4
Alsace	1982	Nagoya ⁴¹	4 ⁴²
Grenoble-Isère	1989	-	2 ⁴³
Loiret	1987	-	2
Touraine	1986	-	2 ⁴⁴
Andalusia	1989	-	2 ⁴⁵
Basque	1990	-	6
Catalonia	1988	-	4 ⁴⁶
Murcia	1991	-	4
Valencia	1990	-	5

The date of the establishment of representation in Japan is highly significant in addressing the nature of the role of European sub-state activity in Japan. 85% of respondents set up offices during the 1985-92 'era of investment.' [The preeminence of the investment function is confirmed by the responses in TABS.7 and 8.] This indicates a quite narrow activity range for the sub-state offices. However since the advent of Japanese FDI was the most significant development of the era, the sub-states can be said to have played a frontline role in EC-Japan affairs during the period. TAB.5 above indicates that only 11% of EC sub-states had Japanese representations outside of Tokyo.⁴⁷ [The European presence in Japanese prefectures is treated at Section *III.4.* below.]

The response of sub-state entities was flexible and welcoming to Japanese firms. While the dispositions of EC member states towards the advent of Japanese FDI was widely variant,

⁴¹ This is the main office.

⁴² U.S.A., Japan (2), Australia.

⁴³ Agent in the U.S.A.

⁴⁴ Consultant in the U.S.A.

⁴⁵ Brussels and Tokyo.

⁴⁶ Tokyo, Brussels, New York and San Francisco.

⁴⁷ Two of these three representations are located in Osaka, which would not indicate an interest in prefectural-interface so much as the seeking of opportunities in Japan's second industrial metropolis - now an Asia/Pacific economic centre in its own right.

sub-states were generally willing to embrace Japanese FDI in the hope of developing their economies, irrespective of their member states' dispositions. This is reflected in the following tabulation, extrapolated from information in TAB.5, which indicates the median set-up date of regions by member state:

TAB.5A Median set-up dates of sub-state representations, by member state category

France	1986		
U.K.	1986	[2nd half of]	
Germany	1986	"	"
Spain	1989	"	"

This result surprisingly, shows French sub-state regions as the most keen to link with Japanese firms.⁴⁸ The findings must immediately be put in the context of a low sample for France (ie. 4.), and perhaps more importantly, the fact that French representations are predominantly conducted through consultants (TAB.6). Additionally, the UK's *Invest in Britain Bureau* has promoted a strong embassy-led inward investment campaign since the 1970s.⁴⁹ Nevertheless, the view of France as an exclusively *dirigiste* political economic entity needs to be tempered in view of these findings. The role of the changing climate in the French state towards Japan is also a factor.

Whilst it would be premature to question the general picture of France's position in the EC-Japan policy debate, these results indicate that an analysis solely based on the Commission or the member states is inadequate for a thorough examination of EC-Japan affairs. Rather, EC institutional-level, member state and sub-state relations with Japan and particularly, Japanese firms becomes an analytical imperative.

⁴⁸ Caroline Bray and Roger Morgan write that "Traditionally, French governments have resisted the development by the Community of a very active regional policy, which was seen as a challenge to the sovereignty of the State, i.e. central government." *The European Community and Central-Local Government Relations*, E.S.R.C., London, 1985. p.31. This view is partially based on research by Yves Mény.

⁴⁹ See Strange, Roger *Japanese Manufacturing Investment in Europe: its impact on the UK economy*. Routledge, London, 1993. pp.115-117.

The costs of maintaining any form of official representation in Tokyo were the highest for any metropolitan area in the world through the 1980s.⁵⁰ EC sub-state regions have a number of options as to how such connections with Japanese firms can be established. They can; adopt a passive stance (as did Italy during the period); visit Japan on a regular basis; establish representation through agencies or consultants; or, open a representative office. This survey only pertains to the last two options, although both of these also involve visits from EC sub-state regional headquarters during critical negotiations. The option of opening a full representative office is the most costly, but potentially the most rewarding.⁵¹ TAB.6 examines the forms of representation favoured by respondents and the size of each representation by numbers of employees.

TAB.6 Form and size of representation

	Form of representation	No. of employees (Japanese) ⁵²	No. of employees (European) ⁵³
Bavaria	Representative Office	1	-
Berlin	c/o Scope Int'l Ltd.	4	-
Ports of Bremen	Representative Office	3	-
Hessen	Representative Office	2	-
Niedersachsen	Representative Office	4	-
North Rhine-Westphalia	Representative Office	5	6 ⁵⁴

⁵⁰ This continued to be the case in the early 1990s. *Reuter*, quoting Japanese Economic Planning Agency (EPA), 8 July 1993. A JETRO official also commented that the 'Japanese style of business' (formal visits &c.) was expensive, but that European authorities who did not follow business formalities would not impress Japanese firms. *Interview*, Tokyo, 22 March 1993.

⁵¹ Ivo Duchacek writes: "Establishment of permanent offices in foreign capitals or centres of commerce and industry to represent non-central governments abroad - [are] the most visible and expensive signs of what we have called 'globalization of provincialism.'" Duchacek, Ivo D. 'Perforated Sovereignties: towards a typology of new actors in international relations' in Michelmann, Hans J. and Panayotis Soldatos (eds.) *Federalism and International Relations: the role of subnational units*, Clarendon Press, Oxford, 1990. p.14.

⁵² 'How many Japanese staff do you have?'

⁵³ 'How many European staff do you have?'

⁵⁴ Including 2 state civil servants.

Rheinland-Pfalz	c/o JEP (Japan) Ltd.	4	-
Saar	c/o CRC Research Inst.Inc.	1	-
S.-Holstein/Hamburg	ILLIES Consult Ltd. ⁵⁵	-	-
Treuhandanstalt	Representative Office ⁵⁶	1	2
Kent	Representative Office	3	-
Comm. New Towns	Representative Office	3	-
Northern England	Representative Office	5	-
Northern Ireland	Representative Office	3	-
Nottinghamshire	Representative Office	2	-
Scotland	Representative Office	2	2 ⁵⁷
Wales	Representative Office	3	1
Yorkshire & Humberside	Representative Office	2	-
Alsace	I.M.T. Ltd.	5	-
Grenoble-Isère	JITEX Consulting	3	8 ⁵⁸
Loiret	D.M.L. & Associates	5	-
Touraine	J.M.S. Corp. (C'sult)	5	3 ⁵⁹
Andalusia	Representative Office	1	1
Basque	Representative Office	2	3 ⁶⁰
Catalonia	Representative Office	4	-
Murcia	Representative Office	-	1
Valencia	Representative Office	3	3

The above table indicates that 70% of EC sub-state regions responding preferred full representative offices. This is markedly so in the case of the UK and Spain (100% in each case) indicating a very high regional priority given to inbound FDI from Japan. Four German regions preferred consultative representation, whilst the commitment of French regions was more tentative. Staffing of representative offices was predominantly Japanese (71% of total). The high degree of liaison with Japanese firms (see TABS.7 & 9) and the organisation of fairs and information seminars, particularly in the initial stages of liaison with a Japanese firm,

⁵⁵ Represented by a German consulting firm on a "consulting contract basis."

⁵⁶ c/o German Chamber of Commerce and Industry in Japan.

⁵⁷ And "2 UK government civil servants on secondment."

⁵⁸ Consulting firm executives.

⁵⁹ Consulting firm executives.

⁶⁰ Including 2 trainees.

were largely conducted by Japanese employees. The sub-state representation-firm relationship in Tokyo is characterised by a fluid and flexible cooperation between public authority, consultancies and private firms. For example, the former head of the Niedersachsen representation was in 1993, promoting the German Machinery and Plant Manufacturers Association.

If conclusions regarding the political power and political economic preferences of sub-states are to be drawn, the intention of sub-state 'para-diplomacy' has to be gauged. Replies to an inquiry into the nature of sub-state representation activities generated the verbatim responses tabulated below.

TAB.7 Main representation activities⁶¹

Bavaria	To invite Japanese companies to Bavaria. To promote investment in Bavaria. - The only purpose of this office.
Berlin	- Attract Japanese investors (mainly manufacturing) to Berlin - Organize/assist Japanese business delegations' visit to Berlin - Conduct investment promotion seminars - Maintain contacts with Japanese government/industry/business - Disseminate information/data on Berlin in Japan, etc.
Ports of Bremen	1. Liaison & Coordination 2. Port Marketing 3. Public Relations
Hessen	Advice and Information to the Japanese Investors. Organisation of Study-Tours to Germany.
Niedersachsen	Investment promotion
North Rhine-Westphalia	Investment promotion PR-activities for the state of NRW in various fields (taking part in and visiting fairs nationwide, providing information of any kind concerning NRW...etc.)
Rheinland-Pfalz	PR activities of our state Information, consulting activities for direct investment
Saar	Inviting Japanese investment to Saarland, Germany
S.-Holstein/Hamburg Treuhandanstalt	Acquiring Japanese investors - Investment promotion - PR - Trade Assistance
Kent	· To induce investment by Japanese companies in Kent - plant, stock-point, sales office, or R&D centre.

⁶¹ 'What are the main activities of your mission?' Replies are given in full.

Comm. New Towns	· To help promote Kent companies' business in Japan
Northern England	Investment promotion (industrial) To invite Japanese investment (mainly manufacturers) to the North East of England.
Northern Ireland	To attract inward investment from Japanese companies to Northern Ireland.
Nottinghamshire	To induce Japanese firms to invest (incl. establish operation bases) in Nottinghamshire.
Scotland	Inward investment (Manufacturing and to a lesser extent R&D)
Wales	Securing manufacturing investment in Wales, U.K.
Yorkshire & Humberside	Introducing the region to companies to attract their investment, and supporting them for starting business smoothly and managing well afterwards.
Alsace	1) Promotion of Japanese investment in Alsace 2) " " tourism in Alsace 3) Promotion of cultural and overall exchanges between Alsace and Japan.
Grenoble-Isère	Find new industrial investors. The investment can be a production unit, R&D center.
Loiret	To attract investment by Japanese companies to our region.
Touraine	Find Japanese makers able to open factories (to "solve" the unemployment pbl.) in the prefecture ⁶² of Indre-et-Loire (Touraine region)
Andalusia	- Diffusion of general information on economic situation, investment climate, etc. - Diffusion of particular information on specific subjects, industrial sectors, etc. - Search for industrial partners. - Arrangement of business missions from/to Andalusia.
Basque	- To promote industrial cooperation (technology transfer, technical assistance, J-V distributorship agreement) between Basque & Japanese companies. - To promote Japanese investment in our region (Green field) - To promote our region
Catalonia	* Promotion of industrial investment from Japan and other Asian countries to Catalonia by offering legal, economical, individual information on Catalonia, or by consulting on any relevant issues. * Assistance to Catalan companies to find Japanese partners * Any support to deepen economical relationship between Catalonia and Japan
Murcia	Trade & investment promotion

⁶² Department.

Valencia

- Investment promotion
- Export promotion
- Technology transfer
- Joint-ventures (local partners presentations)

The overwhelming importance of FDI facilitation is evident throughout these responses. (This result is reinforced in TAB.8) The final section below will treat the issue of the extent to which general conclusions as to the power of sub-state entities in the international⁶³ political economic system can be drawn from what is largely a single-purpose form of representation.

With the end of the *Heisei* boom and the 'plateau' in new stocks of outbound FDI from Japan⁶⁴, EC sub-state entities in Tokyo face a difficult strategic choice. They can either diversify into other spheres of activity; or they can exit. Thus far, EC sub-state representations in Japan have not been heavily involved in trade affairs. Trade agreements are the preserve of the Commission (Ch.V), which also negotiates for trade and FDI access; the member states are the primary players in trade promotion, and also play a strong role in trade and FDI access issues. For EC sub-states to assume a role in trade issues would be difficult and not necessarily practicable since for example, those French or Spanish firms interested in pursuing a Japan strategy are typically large enough to have an interest throughout their domestic *state*, if not the entire EC, making reliance on local authorities unlikely. However, for regional representations, exit is a reverse gamble. New infusions of investment, particularly in high-technological sectors, are necessary to validate what has gone before.⁶⁵ The highly successful Welsh Development Authority points out in its response (TAB.9) that liaison with *established* investors is important for new projects. Of course, new high technology, or other projects, need not come from Japan. An option for budget-

⁶³ 'Inter-entity realities' is a more apt term than 'international relations.' This is due to the importance of sub-states, states, international organizations and firms. 'Realities' is preferred to 'relations' since concepts such as 'disposition' (see Ch.IV) 'structure' and endogenous factors in states and firms, are considered to be as significant as relational dynamics.

⁶⁴ See JETRO's *10th Survey of European Operations of Japanese Companies in the Manufacturing Sector*, Tokyo, October 1994. p.2.

⁶⁵ "Without new investment, memory-chip making plants are likely to wither and die.." *The Observer*, 25 September 1994. p.B.5

conscious regions would be to open and close offices in Tokyo, San Francisco etc., on an *ad hoc* basis determined by FDI flows. Such a strategy could generate questions as to the reliability of the region as a partner.

Sub-state regions have established, largely for cultural and educational relations, twinning arrangements between Japanese prefectures and European regions. Tourism is also one area where the regions may have a promotional role, but the existence of national airlines may temper such a move.

The following tabulation regarding the priority of inward investment attraction indicates that 77% of respondents regarded this activity to be of the highest priority.

TAB.8 Priority rating of investment attraction activity⁶⁶

	<i>key</i>				
	5	4	3	2	1
Bavaria	■				
Berlin	■				
Ports of Bremen	■				
Hessen	■				
Niedersachsen	■				
North Rhine-Westphalia	■				
Rheinland-Pfalz		■			
Saar	■				
S.-Holstein/Hamburg ⁶⁷					
Treuhandanstalt	■				
Kent		■			
Comm. New Towns	■				
Northern England	■				
Northern Ireland	■				
Nottinghamshire			■		

⁶⁶ 'How highly would you rate investment-attraction among your activities?'

⁶⁷ This response was spoilt.

Scotland	■	
Wales	■	
Yorkshire & Humberside	■	
Alsace	■	
Grenoble-Isère	■	
Loiret	■	
Touraine	■	
Andalusia		■
Basque	■	
Catalonia	■	
Murcia		■
Valencia	■	

The issue of promotion strategy is important in illustrating the flexibility of EC sub-state regions potential to directly bargain with Japanese firms. The activities within the promotion strategy also explain the high level of Japanese staffing in sub-state offices (see TAB.6). The following table indicates the main methods of sub-state outreach to Japanese firms.

TAB.9 Promotion strategy⁶⁸

Bavaria	Direct contact with firms; investment seminars
Berlin	- Mostly direct contacts, but seminars are also a main activity. - Effectiveness of advertisements is questionable.
Ports of Bremen	Space advertisement through trade papers, journals and other media by allocated budgets on regular basis.
Hessen	Advertisement through publications; seminars etc.
Niedersachsen	Direct contact with firms
North Rhine-Westphalia	Organizing seminars; receptions; working discussions; advertisements; trade fairs, direct contact with firms.
Rheinland-Pfalz	Direct contact with firms
Saar	Direct telephone calls; visits; direct mail; investment seminars
S.-Holstein/Hamburg	Direct contact with firms
Treuhandanstalt	- Investment seminars & workshops - Regional promotion & trade fairs - Press campaigns - One-on-one company visits - Study trips to regions

⁶⁸ 'How do you promote your region? (eg. adverts. trade fairs, direct contact with firms etc.)' Replies are given in full.

Kent	Direct mail; telephone contacts; company visits. (Seminar was popular in earlier days, but out-of-date now. Many are fed-up with it.)
Comm. New Towns Northern England	Direct contact with firms A) Holding seminars targeted at every prospective industry. B) Advertisements through newspapers. C) Direct contact with firms. (This is the most effective method) D) Propaganda at the booth whenever IBB ⁶⁹ holds seminars.
Northern Ireland	Seminars (IDB ⁷⁰ Solo - sponsored seminar) (IDB Seminar - Coordination for participation) Questionnaire survey Joint business exhibition Market Survey Trade mission
Nottinghamshire	IBB seminars; brochures; company calls (with local staff, twice a year)
Scotland	Company visits plus PR activities
Wales	All of the above. ⁷¹ Plus advice from a network of friends and, of course, from companies who already have set up in Wales. ⁷²
Yorkshire & Humberside	1) direct contact with firms 2) holding seminars several times a year in cooperation with the embassy or individually 3) participation in trade fairs
Alsace	Direct contacts and indirect publicity of all aspects of Alsace in Japan, and vice-versa, that is, the promotion of Japanese information for Alsatian people.
Grenoble-Isère	Almost all is done through direct contact. Sometimes, seminars.

⁶⁹ The Invest in Britain Bureau, an office of the UK Department of Trade and Industry.

⁷⁰ The Industrial Development Board for Northern Ireland.

⁷¹ 'Adverts. trade fairs, direct contact with firms.'

⁷² This means of investment attraction is highly important. NEC's decision to invest in Scotland in 1994 followed earlier inroads by the company. The Baden-Württemberg representative in Tokyo stated: "We have high expectation for the expansion of existing facilities." Interview, Mr. Kiyoshi Kobori, Tokyo 21 July 1993. The follow-on effect further diminishes the possibility of a more even spread of Japanese FDI through the Community. "Around 50% of all [UK] inward investment is accounted for by expanding existing projects." *The Observer*, 25 September 1994, p.B.5. In October 1994, the UK Department of Trade and Industry announced that Samsung of Korea would make its biggest European investment in the UK. One aspect of the agreement was that Samsung would move its European headquarters from Frankfurt to London. *The Financial Times*, 18 October 1994. p.1.

	The means are documents in Japanese. We are regularly publishing a Newsletter called 'Grenoble Tsushin.'
Loiret	By all those activities [see index 38]
Touraine	<ol style="list-style-type: none"> 1. Direct contact with private companies. 2. Organization and/or participation of/at seminars, receptions, exhibitions. 3. Publication of a newsletter (2-3 times/year) 4. Organization of technical missions from Japan to Touraine.
Andalusia	<ol style="list-style-type: none"> 1. Direct contacts 2. Mailings 3. Fairs and seminars
Basque	<ul style="list-style-type: none"> - Trade fairs - Seminars - Banks, tradings - Direct contact
Catalonia	Direct and individual contact with firms/ Contacts and cooperation with intermediate organizations like banks, trading and public institutes/ Trade fairs and seminars / Advertisements
Murcia	<ul style="list-style-type: none"> - Trade fairs - Direct contact
Valencia	<ul style="list-style-type: none"> - Direct contact with manufacturers, trading cos., Banks, etc.. - Trade fairs, Investment fairs. - Investment seminars (Tokyo, Osaka, Nagoya) - Mailing of 'Newsletter.'

Derived from these verbatim replies, the following tabulation of most frequently noted methods of sub-state outreach to firms can be constructed:

TAB.9A Prominent methods of sub-state promotion strategy⁷³

Direct contact with firms	23
Seminars/receptions	16
Trade fairs	10
Advertisements	9
Newsletter/mailings	9⁷⁴
Through banks/trading cos.	3

⁷³ Multiple responses included. Frequency of 3 or more included.

⁷⁴ Examples of these include: 'The Chance of the '90s: Investing in Eastern Germany,' 'Technology Partner Saarland,' 'Eurotunnel Briefing' [Kent] and 'Setting up Business in Catalonia.'

TABS.9 AND 9A indicate that EC sub-states interface directly with Japanese firms in their attempts to improve local economic welfare.⁷⁵ A second reason for the strong presence of EC sub-state regions in Japan is simply functional. A Japanese firm interested in investing in Europe needs specific information about candidate location sites. Much of this information is only available from the regions themselves. This is confirmed by interviews with Japanese firms.⁷⁶

The kind of operational activity of an EC sub-state regional representation in Tokyo can be illustrated by the following example. In late March 1993 NRW Japan [the North Rhine-Westphalia Economic Development Corporation's representation] held a two-day conference in a Tokyo Hotel. With about 200 Japanese executives attending, four themes were explored in a seminar format: 'Construction of an Ecological Infrastructure for Industrial Vitalization,' 'Logistics and Distribution in the Single Market,' 'The EC's Largest R&D Cities - Technology Development and Transfer Processes,' and 'System Communication EC - The Center of Europe's hardware and Software Communications.' Vigorous and competitive promotion of regions in their European context is common. The Netherlands promotes both Rotterdam and the entire country as the 'Gateway to Europe.' The title of the NRW Japan

⁷⁵ This is also the case with U.S. states. Cynthia Day Wallace and John M. Kline write that: "Experience with their various investment promotion programs has now imprinted on the consciousness of sub-national government officials the realization that foreign investment can be an important factor in the welfare of their local economies." *EC92 and Changing Global Investment Patterns*, Vol.XIV, #10, Significant Issues Series, Center for Strategic and International Studies, Washington, D.C. 1992. p.23.

⁷⁶ Mr. Hisashi Tainaka, General Manager of Canon, Affiliates Management Division in Tokyo stated that although his firm was monitoring EC regulations, local regulations were "more important at the moment." *Interview*, Tokyo, 15 June 1993. Mr. Michio Sasamori, Manager of the European Business Development Department at Hitachi Ltd. stated "At least as a first contact its easier for us to deal with regions." He also stated that discussions were multi-layered, with national, regional and city authorities. *Interview*, Tokyo, 30 June 1993. In the case of Nissan's large investment in the UK, Mr. Yoshiaki Gogami, Manager, European & American Operations of Nissan stated: "First we contacted the UK government, then the region." *Interview*, Tokyo, 15 July 1993. Mr. C.E.A. Ripley of the British embassy in Tokyo reported that this phase of decision-making for Japanese firms on average lasts for 18 months. This compares with an average of 12-36 months for European firms in Japan. Commission of the European Communities/EXPROM *Guide for European Investment in Japan*, based on a study by Booz Allen & Hamilton, Brussels, Tokyo, 1990. p.85.

conference was 'Challenge of NRW - the EC frontier.' The emphasis on R&D plays on the fact that Germany is second only to the UK in the number of Japanese R&D facilities it has attracted.⁷⁷ The *land* representation co-ordinated the participation of metropolitan, county and industrial park authorities in an exhibition setting. Represented were: the City of Köln, MediaPark Köln, City of Bonn, City of Mönchengladbach, City of Krefeld, Kleve County, Wesel County, City of Duisburg and the ('MEO') Cities of Mülheim an der Ruhr, Essen and Oberhausen. Westdeutsche Landesbank executives and the *land's* economic affairs minister participated. Whilst earlier attempts to attract Japanese companies had focused on tax breaks and subsidies, by the 1990s the competition for FDI projects and (from late 1991) the economic recession in Japan demanded greater sophistication from sub-state representations. The seminar titles above reflect this. Dr. Thomas Klante, Advisor to the Chairman of the board of RWE AG, an electricity supply company, presented the concept of "public-private partnership" in the management of enviro-economic issues. "The term 'public-private partnership' implies a co-operation between public law and private industry with a view to solving major problems facing the [local] community... This is taking place in the shape of joint ventures and working associations"⁷⁸ he said. This sophisticated and tactile approach goes well beyond tax-breaks and encourages an organic relationship between Japanese firm and host region. The flexible and direct approach of EC sub-state regions raises the issue of the relationship between sub-state entities and states in the international system. This is a recurrent theme in much of the introductory literature. However, more pertinent for the purposes of this study is the nature of the relationship between EC sub-states, member states and the EC institutions (particularly the Commission). TABS.10 & 11 report responses to queries regarding the multi-layered relationship between different levels of political authority as gauged by their external manifestation in Japan. TAB.10 displays responses to questions regarding co-ordination between sub-state offices, embassies and the EC Commission Delegation in Tokyo. TAB.11 reports responses to questions regarding the difference in *function* between sub-state entities, embassies and the EC Commission Delegation in Tokyo.

⁷⁷ JETRO *The 9th Survey of European Operations of Japanese Companies in the Manufacturing Sector*. Tokyo, October 1993. Table I-1, p.3.

⁷⁸ Author's notes. NRW Japan conference, Otani Hotel, Tokyo, 29 March 1993.

TAB.10 Coordination with state and EC levels⁷⁹

	<i>State</i> ⁸⁰	<i>EC</i> ⁸¹
Bavaria	The embassy of F.R.G. supports our activities	No
Berlin	Yes. Seminar arrangements, visits by Berlin government leaders et.al.	Yes. Seminar arrangement
Ports of Bremen	Yes	No
Hessen	Each state ⁸² is in charge of promoting its own investment activities, and the embassy helps it.	Until now there was no connection.
Niedersachsen	No	No
North Rhine-Westphalia	We don't coordinate, but we help each other if possible	No
Rheinland-Pfalz	Yes	Sometimes
Saar	No	Have been contacting the EC representative in Tokyo sometimes for getting information
S.-Holstein/Hamburg	No	No
Treuhandanstalt	No, sometimes marginally	Don't know
Kent	Yes, with British consulate in Osaka	No, their scope is too wide
Comm. New Towns	Yes	Not specifically
Northern England	Yes, we do very much	Not much here, ⁸³ but our head office in Newcastle does.
Northern Ireland	Yes - British embassy	No
Nottinghamshire	Only with the British embassy	Not significantly
Scotland	Yes	No
Wales	Yes	Not really
Yorkshire & Humberside	Yes	No

⁷⁹ Replies are given in full.

⁸⁰ 'Do you co-ordinate with the embassy of your European state?'

⁸¹ 'Do you co-ordinate with the EC?'

⁸² Land

⁸³ Tokyo

Alsace	Yes, very much with French embassy	Yes, very much
Grenoble-Isère	Not really. We made one seminar together.	No
Loiret	No	No
Touraine	We collaborate with DATAR, the French agency that represents the 22 French regions. (Seminars & exhibitions together.)	No
Andalusia	Yes	Not so much
Basque	Yes, for promotion	Not much
Catalonia	—	—
Murcia	We try	No
Valencia	Yes	No

74% of responding sub-state regional authorities reported positive relations with their state's embassies. The following tabulation extrapolated from TAB.10, treats levels of positive relations by member state category:

TAB.10A Variation in levels of reported sub-state positive relations with embassies

UK	100%
Spain	80%
Germany	70%
France	50%

The highly positive relationship between UK sub-state regions and UK government departments reflects the centralised nature of internal government in that state, but also the vigorous and consistent policy of the UK government to pursue, promote and encourage inbound FDI as a means of economic welfare enhancement *at state level*. Within this approach the role of the UK sub-states frequently perform state-auxiliary roles. An interview at the British embassy in Tokyo revealed very strong co-ordination by the government, of regional in-bound investment promotional activities. This includes direct financial support for external sub-state promotion since 1975. Mr. C.E.A. Ripley, First Secretary (Inward Investment) stated that the Invest in Britain Bureau co-ordinated the regions and acted as "a

catalyst."⁸⁴ Each of the official regions bids for state assistance for a percentage of their costs on an annual basis. The Committee on Overseas Promotion meets quarterly and regions give notice of their promotional activities abroad. "We don't want four regions putting on four similar events in Japan on the same day" said Mr. Ripley. UK regional representatives meet at the embassy in Tokyo every second month. However, such meetings do not appear to dull competition between regions in the UK: "I wouldn't say they're cutting each other's throats but there is vigorous competition" said Mr. Ripley. UK pro-FDI policy was manifested by government support for Japanese FDI access in inter-member state negotiations. In this respect, the *de facto* role of the UK as represented in Japan, although structured like Spain, Germany, France and Belgium - is actually more similar to the state-centric approach of the second most successful inbound FDI destination in the EC - the Netherlands. The size of the UK, more than its constitutional nature, has given rise to sub-state representation in Tokyo. It might also be inferred that a strong role for the state (whether through regional offices in the UK case, or direct government promotion in the case of the Netherlands) is a highly efficient means of promoting inbound FDI from Japan.

The Spanish embassy in Japan also has a coordinating role in the activities of the regions represented at sub-state level. At the Global Business Opportunities Convention (G-BOC) organised by the Osaka Chamber of Commerce and Industry, 12-15 October 1993, the Spanish Embassy's Commercial Office co-ordinated the participation of all Spanish regions represented in Japan. This large-scale business fair involved foreign and domestic firms and regions from all over the world. In the survey, Spain's regions showed a high degree of positive relations with the state, from which advice on such matters as technology transfer and joint-ventures emanates, in a form of 'administrative guidance' not unknown in Japan itself. The UK government however, offers no such stipulations to its regions - preferring to raise local content *after* the establishment of a plant. The role of central government is therefore apparent in policies of liberalisation and of stipulation. There is no evidence that a high level of centralisation in this domain implies less liberalisation.

Germany exhibited a level of *Länder* cooperation of 70% in the survey. This reflects an

⁸⁴ *Interview*, Tokyo, 23 March 1993.

evolved federal system, financially secure representative offices and perhaps, the realistic and slightly sceptical view of the federal government towards inbound FDI. The federal government is scrupulous in not promoting one *land* over another, in the matter of inbound FDI. At interview Mr. Kiyoshi Kobori, Representative for Baden-Württemberg stated; "We sometimes need embassy support. But because of the German federal republic [structure] it does not function like England. If a firm wants to set up, it's a competitive situation and the German embassy cannot show favour... Every three months we have a meeting between the *Länder* in Tokyo [at which] a representative of the embassy attends. But it is only a general information project." He added: "Thatcher visited Nissan - but Kohl has never done so."⁸⁵

As with TAB.5A above, the French response must be viewed in the context of the small number of French regions represented and responding, and the fact that these are predominantly represented through consultancies. A central government co-ordination role of the regions was strongly evident in the 1989 Franco-Japanese initiative to encourage investment between the two states. Each government decided to set up a council to encourage investment. "The members of the council on the French side will include officials of municipal governments concerned, while the French national government's Industry and Land Development Ministry will take part in the capacity of observer."⁸⁶ The disposition of France, and changes in that disposition during the 1980s are treated in Ch.IV. Here however, it is important to stress the variance of disposition within France toward Japanese investment. Although Prime Minister Cresson was negatively disposed, Fauroux and particularly Chirac, stressed the need for France to connect more closely with Japanese firms. The commercial section of the French embassy in Tokyo adopted a pragmatic, exploratory approach - in 1986 inviting Japanese company chairmen to visit France with a view to investment.⁸⁷ Perhaps

⁸⁵ *Interview*, Tokyo 21 July 1993.

⁸⁶ *Daily Yomui*, 22 February 1989, p.4. The agreement was negotiated by Hiroshi Mitsuzuka, Japan's MITI minister and Roger Fauroux, Minister of Industry of France. *Asahi Evening News*, 3 February 1989, p.3. As with the examples of Denmark and Ireland above, this is a further example of sub-state involvement in international relations *through* the offices of the state.

⁸⁷ *Interview*, Mr. Jean-Pierre Dubois, Commercial counsellor, Embassy of France, Tokyo, 21 July 1993.

significantly, this was the median year of the setting up of French sub-state regional promotional contacts in Japan.

The Belgian region represented in Japan did not respond to the survey, however the efficiency of fragmented external authorities in a small member state was questioned by Shigeru Horikoshi at the Ogaki Kyoritsu Bank (Europe) S.A. in Brussels. "In Belgium there are problems as to whom to address."⁸⁸

The second column of TAB.10 concerns co-ordination between sub-state regions and the EC. Before conclusions can be drawn from this data, it is important to stress that the EC has no direct role in inbound FDI *promotion* from Japan, and has encountered opposition in attempting to extend its *de facto* role in the realm of inbound FDI *policy* (Ch.V). Secondly, as noted above, the primary and sometimes exclusive activity of sub-state regional representations in Japan is concerned with this very matter. There is consequently little overlap between the functional spheres of activity of sub-state regional offices and the EC Commission delegation in Tokyo. This does not however preclude important political consequences emanating from the demarcation of FDI competencies within the EC itself.

The data in TAB.10 show that although there is a high level of co-ordination between EC sub-states and member states (74%); there is a very low level of interaction between the sub-state representations and the EC delegation. Only 15% of responding sub-state representations indicated any form of collaboration, with no significant variance across member states. This cannot however be interpreted as an antipathetic disposition towards either the EC or the EC Commission delegation in Tokyo, and is more a reflection of the functional division of tasks regarding inbound FDI.

The possibility that "poorer regions may be unable to participate effectively in the process" of investment attraction has been raised by Hill and Munday.⁸⁹ That poorer regions have

⁸⁸ *Interview*, Mr. Shigeru Horikoshi, Brussels, 22 July 1992.

⁸⁹ Hill, Stephen and Max Munday 'The UK Regional Distribution of Foreign Direct Investment: Analysis and Determinants' *Regional Studies*, Vol. 26.6, 1992. p.543.

difficulty staying in the inbound investment inducement orbit is confirmed by a JETRO official. However Hill and Munday's view that the EC ought to have "an important role in co-ordinating packages of assistance available in different regions", although shared by the Commission, has been resisted by member states. Alliances between Japanese firms and liberal European states (and sub-states) had a direct influence on the course of the evolution of the Single Market Programme. As noted earlier, the relationship between the EC-level and the member states is markedly different from the relationship between states and their internal regions. The latter relationship involves a complex set of checks and balances (even in liberal states) whilst any form of guidance from the EC level is absent in the former relationship.

One sphere in which the EC Commission does have a direct and somewhat adversarial relationship to sub-state regions in EC-Japan affairs is that of the investigative role of the Commission regarding subsidies to investing firms. This power has been used neither frequently nor with force. However, firms are aware of Commission monitoring of land and infrastructural deals with regional authorities, and the prospect of having to alter location, suffer adverse publicity or face penalties is not relished by any firm. Such an investigation concerned one of the biggest Japanese projects in Europe - Toyota Motor Corporation's investment in Burnaston, Derbyshire. In 1990, the EC Competition directorate general calculated that Toyota had acquired a site for less than market value (£9.9m as distinct from an independent evaluation of £12.6m⁹⁰). Since the land in question (an old airstrip) was local authority property, the investigation directly concerned Derbyshire local Councils. In July of 1991 the Commission ruled that Toyota had received an illegal subsidy from Derbyshire and told between the UK government "to ensure that Toyota repays £4.2 million to Derbyshire."⁹¹ In response to a conference question by the writer in 1994, Mr. Osamu Komori, Deputy Managing Director of Toyota Motor Manufacturing U.K. Ltd. stated that "The amount was very small compared to the total investment."⁹²

⁹⁰ *Mainichi Daily News*, 1 August 1990, p.7.

⁹¹ *The Guardian*, 1 August 1991, p.11.

⁹² DIALOGUE EUROPE AND JAPAN 1994, Canon Foundation/E.U.I. conference, Fiesole, 13 June 1994.

The competition among and between states and sub-states obviously produces winners as well as losers in project terms. The Derbyshire/Toyota case was said to have caused tension between Derbyshire and Wales, but also the UK and France. However, as an official at the Portuguese embassy perceptively pointed out, the engagement between European regions and Japanese firms - even in instances where a project might eventually be located elsewhere, can be highly beneficial to a region seeking advice on how to improve the efficiency of their regional matrix for potentially investing firms.⁹³ Such exchanges are not simply one-way. A professor at the Tohoku University in Japan has concluded that Baden-Württemberg provided "the best model for the development of Tohoku."⁹⁴

In conducting firm-sub-state negotiations, external firms are participating in a process of integration. However, that process is not constrained by the authority of provinces, states or supra-national authorities. Any integration which is 'gained' from the process is at least *potentially* global rather than regional.

TAB.11 displays responses to questions regarding the function of sub-state entities as distinct from embassies and the EC Commission Delegation.

TAB.11 Variations in functions⁹⁵

	<i>vis. State</i> ⁹⁶	<i>vis. EC</i> ⁹⁷
Bavaria	We are not a diplomatic agency in Japan	—
Berlin	- Due to the nature of the	Our focus/interest

⁹³ *Interview*, Mr. Rui Boavista Marques, Manager Investment Dept., ICEP, Portugal, Tokyo, 8 July 1993.

⁹⁴ *Interview*, Mr. Kiyoshi Kobori, Representative, Baden-Württemberg, Tokyo, 21 July 1993. The Tohoku region consists of the north-east prefectures of Honshu, Japan's principal island.

⁹⁵ Replies are given in full.

⁹⁶ 'How does your regional activity differ from the efforts of your state embassy?'

⁹⁷ 'How does your regional activity differ from the efforts of the EC?'

	Federal state (Germany), most of economic/investment matters are taken care of by State (Berlin) Government. - We of course work closely with the German Embassy for seminars etc.	is in Berlin as a part of EC
Ports of Bremen	In the broad sense, we are dedicating our effort to promote the international trade of Germany through our ports. It is our mission and different from foreign service like German Embassy in Japan.	In the broad sense, we contribute to their market as a gateway port. However, we do not work for EC
Hessen	Our office is working for Germany	Our activities are limited "regional activities."
Niedersachsen	Unknown	Unknown
North Rhine-Westphalia	The state ⁹⁸ embassy doesn't do any concrete investment promotion for only one state of Germany	← referred to
Rheinland-Pfalz	[We] Concentrate on services for direct investment	← referred to
Saar	German Embassy undertakes the whole of Federal affairs, not of each state.	—
S.-Holstein/Hamburg Treuhandanstalt	No relation Embassy does not promote specific regions	— Don't know
Kent	Limited to our several business tasks and research centre	Our's is limited to our area
Comm. New Towns Northern England	None Basically the same. However, we just take care of one small region of England, so our work is much tougher than that of the embassy.	— Ours is more specific
Northern Ireland	We deal solely with the Japanese sector of the market	—

⁹⁸ Federal

Nottinghamshire	Difference in levels between national and regional	← referred to
Scotland	Company visiting programme reflects Scotland's particular strengths rather than those of UK as a whole	EC not heavily involved in inward investment promotion
Wales	More focused	Difficult to say. Fundamentally it probably does not.
Yorkshire & Humberside	Basically there is no difference in the field of attracting inward investment	—
Alsace	Same, but we do more regionally	Same, but we do more locally
Grenoble-Isère	The action of the DATAR office is more oriented to the "régions défavorisées" which is not the case of Grenoble	Don't know what efforts the EC is actually doing. Difficult to answer.
Loiret	We promote Loiret region only	We promote Loiret region only
Touraine	We are able to provide <u>very quick & accurate</u> information & arrange meetings for Japanese clients... but only for one prefecture. ⁹⁹	—
Andalusia	More personalised and more specialised in our region (better knowledge of and contacts with businesses in Andalusia). We complement our embassy activities.	—
Basque	We work more with real cases for industrial agreements. Embassy is just promotion.	Do not know EC activities
Catalonia	Detailed and practical information and services Acting as an intermediate agency	—

⁹⁹ ie. Touraine

Murcia	Consultation, eg. ¹⁰⁰ We promote just companies from our region	—
Valencia	We give concrete and specific service that the embassy can not provide	The EC delegation in Japan doesn't do anything for promoting Japanese investment in Europe

The first column of TAB.11 underscores the complementary relationship between sub-states and states as revealed in TAB.10. Specifically, the data in the first column above emphasises the function of regional activity within overall state strategy. Sub-state regional representations stress the immediate and practical dimension of bargaining with Japanese firms as distinct from the general 'promotional' activities of member state embassies. Sub-state regional representatives saw their role as more specific than EC activity. The second column of TAB.11 again illustrates the low level of EC involvement in inbound FDI affairs.

The issue of the success of sub-state regional offices is closely related to the cost of operation and the perceptions of future prospects and roles of representations in Japan (TAB.13). In order to assess the perceived usefulness of sub-state regional representation in enhancing the economic welfare of a particular region, representatives were asked to assess their degree of inbound investment success. Responses to this enquiry are reproduced in TAB.12.

TAB.12 Perceived success of activities¹⁰¹

Bavaria	Yes
Berlin	Very successful in terms of dramatically increased attention to Berlin by the Japanese business and number of investments, etc.

¹⁰⁰ Catalonia response ctd.:

- ** We look for M/A partners in accordance with a specific request and act as an intermediate
- * We assist investor's feasibility studies
- * We answer to particular and individual questions
- * We help to find their site in accordance with request"

¹⁰¹ 'Have your activities been successful?' Replies are given in full.

Ports of Bremen	Yes. Our ports are highly regarded among shipping companies who are calling our ports as the gateway port to European market
Hessen	In some cases it was successful and in some cases it is difficult to say if it was successful
Niedersachsen	Hard to say
North Rhine-Westphalia	Yes, they have been the most successful in all Germany
Rheinland-Pfalz	Yes
Saar	Partly
S.-Holstein/Hamburg	—
Treuhandanstalt	Moderately
Kent	Yes, to a certain degree
Comm. New Towns	Yes
Northern England	Very successful up to now, but we are facing a difficulty due to the serious depression at present
Northern Ireland	Yes
Nottinghamshire	Yes
Scotland	Yes
Wales	Yes, very
Yorkshire & Humberside	Yes, they have been successful, but a bit difficult recently as companies are experiencing a severe period because of this recession
Alsace	We think so
Grenoble-Isère	Not for the moment
Loiret	Yes, but not enough
Touraine	-
Andalusia	Quite successful in implementing plans
Basque	Not as much as we would like. Economic situation is the reason.
Catalonia	Yes. Number of Japanese companies established in our region has been tripled from 37 to 120 after the opening of

Murcia	the office. ¹⁰² We are just one and a half years in Japan so I think it is too early to talk about success. Anyway there is a great interest in exports to Japan among companies of our region.
Valencia	Yes

63% of respondents considered their activities to have been successful. However, reports of success are tempered by references to recessionary conditions in Japan c.1992- and the downturn in outbound investment. This downturn is not an insignificant development, and may give clues as to whether or not the dramatic rise in global FDI will continue exponentially as envisaged by Julius; or whether Japan-EC FDI fits the 'sudden spurt' phenomenon of FDI with accompanying disequilibria, outlined by Marcello De Cecco.¹⁰³ Should the volume of global FDI stabilise or even decline, the FDI phenomenon may recede in importance when compared with trade. The era of high-volume new stocks of Japan-EC FDI assumes an historical periodisation (c.1985-c.1993) with preliminary indications challenging the view that FDI will continue to rise at rates close to those of the 1980s.

Closely tied to the question of perceived sub-state investment attraction success, is the issue of future representation intentions. The following table illustrates responses to the relevant question.

¹⁰² Includes sales and distribution outlets

¹⁰³ Marcello De Cecco has noted that while FDI has a broadly positive impact, sudden increases or decreases in FDI can also have 'instability' effects. DIALOGUE EUROPE AND JAPAN 1994, Canon Foundation/E.U.I. conference, San Domenico di Fiesole. June, 1994. Author's notes.

TAB.13 Future representation intentions¹⁰⁴

	3	2	1
Bavaria	■		
Berlin	■		
Ports of Bremen	■		
Hessen	■		
Niedersachsen	■		
North Rhine-Westphalia	■		
Rheinland-Pfalz	■		
Saar			■
S.-Holstein/Hamburg¹⁰⁵			
Treuhandanstalt			■
Kent		■	
Comm. New Towns		■	
Northern England	■		
Northern Ireland	■		
Nottinghamshire		■	
Scotland	■		
Wales	■		
Yorkshire & Humberside	■		
Alsace	■		
Grenoble-Isère¹⁰⁶			
Loiret¹⁰⁷			
Touraine		■ ¹⁰⁸	

key

3 - Long-term

2 - Medium-term

1 - Short-term

¹⁰⁴ 'Do you plan to maintain your office in Japan into the future?

Short-term

Medium-term

Long-term'

¹⁰⁵ 'no'

¹⁰⁶ "GID is deciding [currently]."

¹⁰⁷ "As for the continuation of our activities in Japan, it is depending upon the decision made by the general council of Loiret department."

¹⁰⁸ "3-5 years"

Andalusia	■ ¹⁰⁹
Basque ¹¹⁰	
Catalonia	■
Murcia	■
Valencia	■

59% of respondents reported intentions to remain in Japan in the long term. In the context of recessionary investment conditions, this represents a high proportion. The possibility that sub-state regions could diversify their activities more in the direction of trade promotion activity thus becomes a possibility - particularly for sub-states whose representations are of recent vintage. Such a development is becoming more widespread in US-Japan relations, where Japanese firm-U.S. state relations are more mature than Japanese firm-EC sub-state relations. The experience of some U.S. state representations in Japan also suggests that once new lanes of FDI have been established, trade may follow. The director of Missouri's office in Japan has stated: "Its natural that our activity in trade would increase right now. We can help Missouri manufacturers with general market research, help them create their own strategy for exporting. And we will provide them with lists of contacts and make introductions."¹¹¹

Another possible avenue of concentration for EC sub-state representations is the promotion of investment by small and medium-sized Japanese firms which have an interest in investing in Europe. Gerd Junne has stressed the important role of medium and small sized multi-nationals in the economic system.¹¹² Although these have thus far not been to the fore in EC-Japan affairs, an increase in their investment role would be a favourable development for European sub-state representations in Japan. Another possibility is that FDI *into* Japan could increase. However, for the 1985-93 period, EC sub-state representations did not report a role

¹⁰⁹ "At least"

¹¹⁰ Short-term: "For sure." Medium-term: "I think so." Long-term: "I hope so."

¹¹¹ John A. King quoted in *Japan Economic Journal*, 29 September 1990, p.7. At interview, Baden-Württemberg's representative Mr. Kiyoshi Kobori stated that "Our function is to attract investment, but quite recently we have had a cross corporate function for exports and technology cooperation." *Interview*, Tokyo, 21 July 1993.

¹¹² Junne, Gerd 'Multinational Enterprises as Actors,' in Carlsnaes, Walter and Steve Smith (eds.) *European Foreign Policy*, Sage, London, 1994, p.85.

in the promotion of European investment in Japan. A further possibility is that sub-states might begin to interact with Asian mainland firms and political authorities. Many EC sub-state offices are already nominally 'Asian' or 'Asia/Pacific' representations, although thus far there has been a low level of connection with non-Japanese firms or authorities. The possible advent of outbound FDI in other Asian countries, could give sub-states a renewed general Asian role.¹¹³ Mr. Kobori of the Baden-Württemberg office stressed the future need for partnerships in general Asian access: "... to develop China, German business people need the assistance of Japan."¹¹⁴

EC sub-states play a minor role in facilitating European FDI access to Japan. This is due to a number of factors. FDI strategy is frequently made solely within large European firms; medium and small-sized European firms (which might need assistance) have not invested in Japan to any significant degree thus far; the European Business Community's Investment Committee is active in representations to the Japanese government regarding problem areas for European firms attempting to access Japan;¹¹⁵ (as is the EC Commission delegation¹¹⁶) and frequently investment *promotion* is, like trade *promotion*, a *de facto* competence of the

¹¹³ Two developments may indicate a trend in this direction. Firstly, in late 1994, the EC Commission decided to impose anti-dumping duties on Asian television sets (some of which were produced by Japanese firms, but none actually produced in Japan). This may increase FDI from Asia to Europe. *The Financial Times*, 16 September 1994, p.1., *International Herald Tribune*, 1 October 1994, p.11. Secondly, in October 1994, the UK won a significant project from Samsung of Korea which entails the eventual creation of 3,000 jobs in the north of England. *The Financial Times*, 18 October 1994, p.1.

¹¹⁴ *Interview*, Tokyo, 21 July 1993.

¹¹⁵ Issues identified by the EBC Investment Committee include the high collateral requirements by Japanese banks, high corporate tax levels, "extreme difficulties" in M & A and the *keiretsu* (conglomerate) structure of some firms. *Interview*, Dr. Reinhard Neumann, Investment Committee Chairman, European Business Community, Tokyo, 18 June 1993. On *keiretsu*, see Strange, Susan, 'European Business in Japan: a policy crossroads?' *Journal of Common Market Studies*, Vol.33, No.1, March 1995.

¹¹⁶ With the support of Brussels officials. For example EC Commission Vice President Bangemann lobbied the Japanese government to take action on obstacles to investment during his visit in March 1993.

member states.¹¹⁷ This situation may however be undergoing change with the deceleration in Japanese investment to Europe. This in turn could lead EC sub-states to take a more active role in facilitating European investment in Japan. For example the Baden-Württemberg representation was actively proposing that a 'German village' be constructed in Japan in order to facilitate German investment and other German-Japanese economic exchanges.

The continued ability of EC regions to attract whatever FDI is available,¹¹⁸ their ability to assist medium-sized local European enterprises export to Japan, and the possibility of attracting small or medium-sized Japanese firms, emerge as the tests of EC sub-state representations' success and survival in Japan into the late 1990s.

A supplementary question to sub-state regional representatives concerned industry-specific relations.¹¹⁹ Some EC member states are particularly interested in certain sectors or categories. Examples include; Ireland for pharmaceuticals and secondary manufacturing, and Portugal attempting to attract Japanese firms considering a second European plant. Sub-state representatives addressed the issue of special relations with particular industries as follows:

¹¹⁷ See Ch.V for discussion of the interconnectedness of trade and investment policy, and the dilemmas presented by their separation at EC level.

¹¹⁸ Despite the down-turn, new investment has not ceased. In September of 1994 Scotland secured its largest single Japanese plant investment; an NEC plant at Livingston due to employ 430.

¹¹⁹ Tab. 14 presents data on the issue of whether or not specific regions have special relations with particular industries or firms in Japan. [In addition to sub-state regional and municipal representations there are some miscellaneous representations which are associated with specific industries. These include the *Representation of the Leipzig Fair in Japan* and the *Institute of Small and Medium Sized Industry of Valencia*. There also exist miscellaneous state commercial organisations, frequently constituted on sectoral lines. These include the *Danish Agricultural Marketing Board*, the *French Fashion and Textile Center* and the *Greek National Tourism Organization*. The *German Machinery and Plant Manufacturers Association* for example, has been represented through a Japan Liaison Office since 1980.]

TAB.14 Relationship with particular industries¹²⁰

Bavaria	No
Berlin	No
Ports of Bremen	Shipping industry in Japan
Hessen	Yes. The main body of our office is the "Nippon Carl Duisberg Society Inc." (Business: Exchange of vocational trainees between Japan and Germany.)
Niedersachsen	No
North Rhine-Westphalia	No
Rheinland-Pfalz	—
Saar	—
S.-Holstein/Hamburg	No
Treuhandanstalt	No, several M&A mandates with Japanese financial institutions
Kent	Not quite, but maintains contact with industry suitable for Kent (Hi-tech, Hi-added value etc.)
Comm. New Towns	No
Northern England	Yes ¹²¹
Northern Ireland	Yes we have, but it's confidential
Nottinghamshire	No
Scotland	Closest links are with major Japanese electronics companies because of Scotland's strengths in electronics.
Wales	No. Relationship is very close with all potential firms/industries
Yorkshire & Humberside	No
Alsace	No overall
Grenoble-Isère	Not really, but we are looking for the industries which matches with the "Pôle d'excellence" of Grenoble.
Loiret	—
Touraine	Medical field. (We prospect a lot in the pharmaceutical and medical equipment & bio-technology fields.)
Andalusia	Yes ¹²²
Basque	- Machine tools - Auto parts
Catalonia	Not particularly
Murcia	No
Valencia	No

¹²⁰ *'Does your office have a special relationship with any single firm or industry?'* Replies are given in full.

¹²¹ No details given.

¹²² No details given.

Generally EC sub-states were eager to accept investment from any source. However, regions such as Scotland and Touraine were targeting firms in sectors from which they had already received investment and perhaps had established a sectoral comparative advantage in terms of skills and supply. Some regions refused to disclose details of relationships with individual firms and/or sectors on the grounds of confidentiality.

Before evaluating the theoretical literature outlined at the beginning of this chapter, the role of Japanese prefectures in EC-Japan relations, and the European presence in Japanese regions are treated.

III.4 JAPANESE PREFECTURES AND EC-JAPAN FDI RELATIONS

The role of Japanese prefectures in the international relations of Japan has been largely conditioned by the very high degree of administrative centralisation in that country. This centralisation is reflected in the presence of nine regional Ministry of International Trade and Industry prefectural bureaux within Japan.¹²³

The low level of direct external prefectural representation cannot be ascribed to constitutional convention alone. The level of FDI penetration by external firms in Japan (the lowest among major industrialised states) corresponds to the low level of external outreach by prefectures.

MITI and JETRO disseminate information about the 47 prefectures abroad, and the Development Bank of Japan also promotes foreign investment in the regions.¹²⁴ The EC delegation in Tokyo has attempted to encourage Japanese prefectures to bring European investment into their regions. This strategy was motivated by the assessment that many local

¹²³ *Interview*, Mr. Yuji Hosoya, International Business Affairs Division, MITI, Tokyo, 16 June 1993.

¹²⁴ With acknowledgements to Professor Gorow Ono, MITI Research Institute, Tokyo, for discussions on this subject. "JETRO is the window for regional representation abroad" said Dr. Reinhard Neumann, Chairman of the Investment Committee of the European Business Community in Japan. *Interview*, 18 June 1993.

regions wished to have more direct investment and trade links with external firms, rather than relying on the large trading houses, banks and ministries in Tokyo. This theme was taken up by the EC Head of Delegation in Tokyo, Andreas Van Agt, in the inaugural speech to the Kagawa-EC Association in 1989:

....we know from increasing evidence that Japanese business people, and especially Japanese SME's, want to do business directly with EC enterprises, that they want to buy on their own account instead of always relying on a trading company which may control distribution and price: and they, like the regions of Europe, also seek foreign investment.¹²⁵

Commencing in 1986/87, the EC Commission Tokyo delegation pioneered the setting up of EC Associations in provincial prefectures with a view to making direct contact with local commercial leaders. The associations are usually headed by local bank or firm presidents¹²⁶and involve the prefectural and metropolitan governors in information dissemination and meetings with European firms and business experts.¹²⁷ In this regard, the Commission can be seen to have exercised a quick-reflex response to local geo-economic political realities. This was in marked contrast to the Commission's campaign to extend its trade authority to include inbound FDI regulation (Ch.V below).

By mid-1993 there existed twelve EC Associations in Japan.

TAB.15 EC Associations in Japan

The Aizu-EC Association
The Gifu-EC Association
The Hyogo-EC Association
The Kagawa-EC Association
The Kumamoto-EC Association
The Matsuyama-EC Association
The Miyagi-EC Association
The Nagano-EC Association
The Oita-EC Association

¹²⁵ Andreas Van Agt, *Speech*, Kagawa-EC Association, Takamatsu, 25 January 1989. *EC News*, PR.1/89(E).

¹²⁶ For example the President of a Kumamoto Bank was also the chairman of the Kumamoto-EC Association.

¹²⁷ These associations are not directly related to the EC Documentation Centres such as that at Sophia University in Tokyo.

**The Saga-EC Association
The Yamagata-EC Association
The Yamaguchi-EC Association**

The EC Commission attempts to promote relations between the EC and the regional prefectures by encouraging such regions to become more interactive with Europe - particularly in trade and investment affairs.¹²⁸ At the Yamagata-EC Association Annual General Meeting in July 1993, the writer made the following remarks concerning the roles of regions in EC-Japan relations:

The EC assists regions through structural funds. Regions in receipt of assistance are those whose development is lagging behind; areas affected by industrial conversion; and less-favoured rural areas. In addition to receiving aid however, it is very important to emphasise that most European regions are taking an active stance in helping themselves. They are doing this by establishing important trade and investment links with each other, and importantly, with the world economy at large... Problems which European firms face when investing in Japan include the complexity of M&A activity in Japan and the difficulty of obtaining information on companies for sale. By becoming aware of the problems which foreign firms face in investing in Japan, regions can make a valuable contribution to positive national change. If regional authorities feel that they would benefit from European investment, European know-how, European expertise and European style, they ought to establish links with European firms. If it is not feasible to have a permanent office in the EC, Japanese regions should visit European firms and regions at least once a year, and co-ordinate closely with those national agencies which represent them abroad... EC-Japan co-operation would be strengthened if European inward investment into Japan is

¹²⁸ The member-states also have a presence in regional prefectures. While some larger states have consular missions, smaller states hold seminars. An example of the latter is the series organised by the Portuguese embassy in October 1993 which visited Chiba, Kawasaki, Nagoya, Osaka, Toyama and Fukuoka. Only a small number of EC sub-state regions have representations outside of Tokyo. (See TAB.5.) Some regions have established twin city arrangements for educational and cultural exchange purposes. One region-to-region relationship which appears to be successful is the 'mutual exchange' between Baden-Württemberg and the Kanagawa region near Tokyo. The representative of the German *land* said: "This area is similar to Baden-Württemberg. The Kanagawa region introduces us to many high-tech companies." The link was established in 1985. With reference to cross-national sub-state co-operation in external affairs, Mr. Kiyoshi Kobori said that although Baden-Württemberg had special Links with Lombardia, Catalonia and Loire, there was no co-ordination between them in Japan. *Interview*, Tokyo, 21 July 1993. The very high instance of direct company contact revealed in Tab.9a indicates that sub-state representatives in Japan travel extensively on company visits.

facilitated by the host country, and importantly, by the host regions.¹²⁹

Foreign firms have continued to experience difficulties in gaining access to Japan for investment and trade distributive purposes. The negotiations under the framework of the American Structural Impediments Initiative¹³⁰ led to an increasingly strident critique of cultural, social and historical 'non-tariff barriers' which emerged as a more important excluder of foreign firm activity than government policy. However, the distribution system and other aspects of socio-economic organisation in Japan, are essential elements of a much broader social fabric embracing elements such as employment practice and the care of the elderly. The EC critique has been less piquant than that of the U.S. and the Trade Assessment Mechanism, preferred by the Commission in the mid-1990s eschews direct critiques of Japanese society.

The trend towards 'internationalisation' and the 'internationalisation of the regions' which is officially encouraged by the government,¹³¹ has been tempered by the economic slow-down in Japan. The recession of c.1992- rendered investment in exploratory sales networks in regional or remote areas by European firms potentially risky.¹³² The question of European FDI to Japan is framed in the context of overall FDI intentions of European firms and specifically, the environment for direct investment in Japan. The role of Japanese prefectural and metropolitan authorities as active outreach hosts for such investment from Europe is limited by the territorial administrative structure within Japan, and perhaps more importantly, by the demographic and economic-structural constraints which have produced the continuously

¹²⁹ Bourke, Thomas 'EC-Japan relations and the role of regions', *address*, ANNUAL GENERAL MEETING OF THE YAMAGATA-EC ASSOCIATION, Yamagata, 19 July 1993. *Text*, pp.3-4.

¹³⁰ The S.I.I. (1988-92) was the most detailed government market access effort undertaken in recent times.

¹³¹ An example of this is the Japanese government's JET programme, through which foreign nationals are hired to teach in Japanese high schools or work on overseas promotion in prefectural or municipal offices.

¹³² The EC Ambassador [Press conference, EC delegation, Tokyo, 17 June 1993] and the U.S. administration [U.S. Trade Representative Kantor, Press Conference, 24 May 1994] have identified the stimulation of consumer demand within Japan as one of the principal pillars in a strategy to reduce their respective trade deficits with that country.

low propensity toward inbound FDI within Japan. It is against this background that the EC Commission introduced its strategy in the regions of Japan.

An assessment of conditions for investment in Japan was produced by the Commission of the EC in conjunction with EXPROM¹³³ in 1990. The *Guide for European Investment in Japan* was based on a study by Booz Allen & Hamilton.¹³⁴ The report contains valuable reflections on political economic conditions for relations with European firms in the Japanese prefectures, citing four 'important investment location criteria cited by foreign companies in Japan':

- Labour access; i.e. the ability to recruit high quality people
- Land availability and price
- Distance to customers; suppliers; key government officials
- Transportation infrastructure¹³⁵

These results give a high priority to two factors which are not major concerns in Japanese firms' investment decisions in Europe: labour and land. The very low level of unemployment in Japan, the continued preference of graduates to work for Japanese firms, and the long-term demographic labour shortage, make hiring local staff difficult.¹³⁶ Land is less available and more expensive in Japan than in most parts of western Europe. There are some measures which local prefectures can and do take to alleviate these conditions. Some provide consultancy services to assist with hiring; while prefectures more distant from Tokyo advertise lower land prices. Generally however, the leeway for prefectural authorities to influence geo-economic factors in investment conditionality is limited. European firms noted that there was

¹³³ The export promotion unit of the EC Commission.

¹³⁴ Booz Allen & Hamilton, *Guide for European Investment in Japan*, Brussels and Tokyo, 1990.

¹³⁵ *ibid.* p.45.

¹³⁶ The problem is not limited to external firms; Japanese firms compete vigorously at graduate fairs each year. Manual and unskilled sectors also experience difficulties. In 1993 the number of foreign workers exceeded 1% of the population of Japan for the first time in Japanese history. I am grateful to Fr. Horgan of the Immigrant Workers Advice Bureau of Yokohama for this information.

"not that large a difference in the levels of incentive which are offered by local governments."¹³⁷ The national government is thus entrusted with measures which may effect the geographical spread of industrial activity. A number of measures such as the establishment of Tsukuba Science City¹³⁸ and legal provisions during the 1960s and 1970s¹³⁹ were enacted in an attempt to decentralise aspects of the economy and respond to chronic early 1970s pollution in Tokyo.

Gerald Curtis has recently addressed growing prefectural assertiveness, saying that there was relatively little understanding among foreign businessmen that local prefectures in Japan compete for inbound investment. There had been cases where local governments had overturned MITI objections to such investments. Cargill Corp., for example, had built a fertilizer plant in Kagoshima, Kyushu "using the power of the Kagoshima government to overwhelm MITI's opposition." In Oita prefecture and the Tohoku region of the North-East, there were also vigorous attempts to draw in foreign investment.¹⁴⁰ As in the EC - but to a far lesser degree - there is potential conflict between the centralised 'protecting' trade

¹³⁷ *Booz Allen & Hamilton Guide for European Investment in Japan*, Brussels and Tokyo, 1990. p.45.

¹³⁸ This specially designated urban area was conceived in the early 1960s and administered by the Science and Technology Agency of the Prime Minister's Office as a 'science city' for the enhancement of Japanese research and development. The metropolitan area has a population of 180,000 - significantly lower than early projections which envisaged entire Japanese government departments moving to Tsukuba, some 80km from Tokyo. 47 national research institutes and 170 private research institutions have facilities there. The ability of the city to compete with Silicon Valley and other hi-tech centres has recently been questioned. The weakening of MITI's role in the co-ordination of Japanese competitiveness enhancement and the fact that large firms are conducting their own research challenges the utility of such an 'administered' centre. Writer's field visit in collaboration with Executive Training Programme of the EC Commission, Tokyo.

¹³⁹ For example 'The Law for the Promotion of Industries in Rural Areas' (1961), 'The Law for the Development of New Industrial Cities' (1962) and 'The Industrial Relocation Promotion Law' (1972). Commission of the European Communities/EXPROM *Guide for European Investment in Japan*, based on a study by Booz Allen & Hamilton, Brussels, Tokyo, 1990. Appendices.

¹⁴⁰ Gerald Curtis quoted in 'Europe in the Asia/Pacific Region - involvements, challenges, policy roles', *conference report*, Thomas Bourke, *rappporteur*, E.U.I., Fiesole, April 1994. p.30.

policies of government and the hospitable economic welfare enhancement outreach of regions.

CONCLUSION

The theoretical literature outlined above treated the external relations of sub-states in federal systems; the applicability of the principle of subsidiarity to the external relations activities of sub-state regions; and the new geopolitical literature on the 'organic' development and activities of regions. The latter vision of change in the global political economy is particularly useful. Scholars such as Gipouloux, Barnes and Ledebur and Smith have been influenced by Braudel's work. This stresses the spatio-temporal and organic nature of political economic activity - with its emphasis on the local the relational and the potentially global *economy of the world* - better capturing the pulse of post-1989 change than the more formal - albeit useful - literature on federal systems and subsidiarity.

The central issues investigated in the empirical survey were: What is the extent of EC sub-state activity in EC-Japan relations; how important is their role; and how does what they do relate to the state and EC-level institutions? The role of Japanese prefectures in EC-Japan affairs was examined in a comparative context.

The significant increase in levels of global FDI in the 1980s brought trans-national corporations into direct contact with multiple levels of political authority. This dynamic was particularly evident between Japan and the EC. In this environment, EC sub-states exhibited a strong degree of flexible interaction with global capital and production. The function of sub-state representation was largely confined to the sphere of investment attraction. The welfare enhancement nature of this function gives it a high priority. Sub-states were sufficiently flexible to participate fully in the most important development in recent EC-Japan history; the intensification of direct links between Japan and the EC through FDI.

The involvement of sub-states in this important external development in EC affairs raises the issue of how the role of sub-states relates to those of states and the EC institutions. As anticipated in some of the introductory theoretical reflections, the state/sub-state relationship

in EC external affairs is largely co-operative. Particularly impressive was the institutionalised structure (grants, regular meetings, joint representations) of EC state/sub-state relations in Tokyo. This confirms the view of Soldatos that "decentralization could enhance unity and efficiency in external relations.." ¹⁴¹ This is particularly evident in the case of the UK and Spain. State/sub-state relations are not without tensions and the relationship resembles a partnership in which the state is leading. The interaction between sub-states and external firms also brings a 'leverage of transparency' which favours the sub-states in their dealings with states regarding FDI activity.

The relationship between sub-state entities and the EC institutions is markedly different from that between sub-states' and member states. Sub-states in external affairs have little contact with the EC Commission delegation in Tokyo, while in Europe, sub-states are wary of DGIV intrusion in highly sensitive external deals.

More important than the simple functional relationship however, is the evolution of the EC 'system' in the important sphere of external bargains regarding economic welfare enhancement. Since the mid-1980s, the configuration of tri-level external representation on this crucial issue with Japan has favoured the enhancement of state and sub-state (shared) power to a greater degree than the enhancement of EC institutional power.

The EC institutional/member state/sub-state relationship can be compared to the NAFTA/U.S./state relationship. From an integrationist perspective, Hans Michelmann envisages difficulties arising from the wide variety of subnational laws and policies:

As world trade and international investments continue to grow, these become more visible.. [and] will have to be considerably curtailed if they are not to provoke substantial irritation in the North American free-trade area; similarly, analogous practices in the West German *Länder* will be limited by the higher degree of EC integration brought about by the completion of the EC domestic market. ¹⁴²

Such a view is not supported by the empirical evidence above. Just as there is no trend

¹⁴¹ Soldatos, Panayotis 'An Explanatory Framework for the Study of Federated States as Foreign-policy Actors' in Michelmann, Hans, J. and Panayotis Soldatos (eds.) *Federalism and International Relations: the role of subnational units*, Clarendon Press, Oxford, 1990. p.42.

¹⁴² Michelmann, Hans J. in Michelmann and Soldatos, *op.cit.* p.309.

towards sub-states and the EC 'ganging up' on the state, there is no evidence from the involvement of German *Länder* in EC-Japan affairs, that sub-states will be limited by any 'higher degree of EC integration.' The external representative powers of sub-states are largely supported by member states as an efficient extension of state predisposition and policy. The fact that sub-states negotiated efficiently and speedily with firms in the 1980s and 1990s, prior to the Maastricht position on subsidiarity, indicates that the *de facto* nexus of relations between sub-states, states and firms was the defining and more powerful integrating force of the era.

CHAPTER IV EC MEMBER STATES AND JAPANESE INVESTMENT

INTRODUCTION

Both states and firms have played central roles in the evolution of EC-Japan relations. The literature on the interaction between states and firms, such as the work of Vernon¹ and Servan-Schreiber², has examined the challenge to state authority posed by firms in an age of increasing capital mobility and transnational control of production. This chapter - while focusing on states - is not primarily concerned with the state/firm sovereignty debate. Rather than focus on the challenge of firms to state power; it is the integrative power of member states versus the integrative power of transnational corporations which is under examination.

FDI is an important and (in terms of volume) a relatively novel, extension of transnational firm power.³ This is particularly the case in 'the age of investment' in EC-Japan relations. European integration is a key host political condition (eg. Commission trade policy), which provides options and a framework of network bargains, influencing and influenced by exogenous and endogenous factors.

Literature which treats multinational corporations relative to regional integration, tends to do so in terms of *economic* integration alone. Here, it is the *political* dynamic which is the focus of analysis.⁴

¹ Vernon, Raymond *Sovereignty at Bay: the multi-national spread of the U.S. enterprise*, Longman, London, 1971.

² Servan-Schreiber, Jean Jacques *Le défi américain*, Denoel, Paris, 1967.

³ DeAnne Julius has written that "As a means of international economic integration, FDI is in its take-off phase; perhaps in a position comparable to world trade at the end of the 1940s." *Global Companies and Public Policy*, RIIA/Pinter, London, 1990, p.36.

⁴ Neil Mitchell notes that: "The issues raised by FDI are more clearly defined and the claims more easily testable in the economic than the political debate." Mitchell, Neil J. *Review Essay 'Foreign Money & American Politics'*, *Polity*, Vol. XXIV, Number 2, Winter, 1991, p.338. Peter Dicken has also commented on the political economic mix: "Foreign direct investment is both an economic and a political phenomenon. In the case of Japanese FDI it

Due to the rapid rise in FDI from c.1985 and the decrease in new stocks from c.1991; the investment phenomenon assumes a clear periodisation. The impact of this 'event' upon European integration, and the extent to which such FDI reveals the nature of European integration are analysed. Chapter V below, will examine the EC institutional level response to Japanese firms in the period of increased inbound FDI from Japan. Some of the issues raised in the course of that analysis will include reflections upon the actions, roles and nature of EC member states. Strong state involvement is evident in the analysis of the role of Japanese firms in the evolution of the single European market - particularly in their testing of the applicability of the movement of goods principle (sect. V.6) - and concerning Commission power and Japanese production (V.10 & V.11). The treatment of sub-states, member states and the EC institutional level, forms an analysis of the constitutional 'totality' of the EC in this important external relationship.

The importance of member states in EC-Japan affairs has been noted by Jean-Pierre Lehmann: "... at least until very recently, the expression 'Euro-Japanese relationship' was somewhat misleading. One had Franco-Japanese relations, Anglo-Japanese relations, German-Japanese relations, but the unified, *Europe-wide* policy towards Japan implied by the phrase 'Euro-Japanese' simply did not exist. To say that it exists would be premature."⁵ Opinion among Japanese investors predicted that "moves toward the economic and monetary unification would probably be slowed down by various factors such as the coordination of interests between member countries."⁶ In the analysis which follows, an emergent theme is the manner in which Japanese firms highlight *pre-existing* differences between member state external commercial priorities.

is especially difficult to disentangle the two dimensions." 'The changing geography of Japanese foreign direct investment in manufacturing industry. A global perspective' in Morris, Jonathan (ed.) *Japan and the Global Economy*, Routledge, London, 1991. p.15.

⁵ Lehmann, Jean-Pierre 'France, Japan, Europe, and industrial competition', *International Affairs*, Vol.68, Number 1, January, 1992. p.40.

⁶ JETRO *The 9th Survey of European Operations of Japanese Companies in the Manufacturing Sector*, Tokyo, 1993. p.3.

IV.2 MEMBER STATES AND TRANS-NATIONAL CORPORATIONS

Alan Milward and Andrew Moravcsik implicitly question the extent to which integration is occurring.⁷ Cafruny and Rosenthal write from a different perspective: "... important symbolic as well as real elements of national power, if not sovereignty, have been surrendered to the Community. The power of the nation-state has been diminished, both as a result of the EC and of global economic interdependence."⁸ The question of the extent to which the changing geometry of power within the Community may be attributable to such political economic forces as 'global economic interdependence' is frequently lacking in EC studies. In the case of EC-Japan relations, this is particularly important due to the predominantly economic nature of the relationship, and secondly, due to increased FDI flows in the 1980s.

In the opening theoretical discussion a number of theories of European integration were discussed. The analysis below contradicts functionalist theory - member states did not relinquish FDI powers. Although neo-functionalism may plausibly explain states' ratification of the SEA - the lack of a centralised 'gate-keeper' function at Commission level actually led to the continuance of inter-governmental bargaining over sensitive inbound FDI issues. Inter-governmental explanations however were found to overestimate endogenous state developments and non-state actors.

Changes in the configuration of state power and EC executive power occurred while the EC (through the SEA) stressed economic competitiveness more than at any previous time. Secondly, the Commission selected the market as the vehicle for competitiveness enhancement precisely at the point when FDI was accelerating. In order to reap competitiveness gains, the Commission's task of establishing an 'internal market' (with its implicit, logical exclusionary implications) emerged as a fundamental test of the power of integration to 'fence off' an area of the increasingly globalised economy for regional political economic dividends.

⁷ Discussed in the theoretical survey at I.V above.

⁸ Cafruny, Alan W. and Glenda G. Rosenthal *The State of the European Community*, Longman, Harlow, 1993. p.5.

Attempts to increase the momentum of EC political integration, and the reality of increased global economic integration, have considerably overlapped since 1985 (the year of the Milan Summit and the Plaza Accord). One may shadow the other, and the threads of causality are difficult to disentangle. However, in seeking to reinvigorate the Community with the SEA, (in response to U.S. and Japanese TNC competitiveness) the Commission, perhaps unwittingly underlined the importance of the *global* political economy.

DeAnne Julius has stressed the continuing relevance of the state in FDI dynamics:

Thus, except for expatriates and purchases by travellers, the ultimate benefits from open markets (both for imports and for inward FDI) can still be defined in terms of the nation-state. They accrue to consumers, and consumers have a clear domicile - unlike multinational companies. Thus the efficiency/distribution trade-off can still be considered in a national context.⁹

By reserving the bulk of inward FDI policy functions, Community member states exercised an important external economic relationship function. The member states presented differing approaches to investment policy at a time when the Commission attempted to present a uniform external trade policy. It is stressed however, that although the states are 'reserving' their FDI powers (and their non-merchandise trade powers), such have increased in importance due to the activities of firms. The arrival of high-volume FDI could conceivably strengthen member state-firm bargaining at the expense of member state-EC level relations.

The advantage in the state-firm bargain rests with the investing firms.¹⁰ Diverse authors have addressed the issue of firm-public policy dynamics. Vernon concludes that "So far, the world has managed to stagger on without effectively addressing the many facets of

⁹ Julius, DeAnne *Global Companies and Public Policy*, RIIA/Pinter, London 1990, p.43.

¹⁰ Daniel Drache has compared states to unions in this regard. They are he says "...forced to bargain with powerful groups of capital to attract investment and prevent widespread disinvestment in a nation's industrial capacity." 'The World Economy and the Nation-State: the new international order' in Drache, Daniel and Meric S. Gertler (eds.) *The New Era of Global Competition*, McGill Queen's University Press, 1991, p.8/9. Charles J. McMillan has written that "...in a world of very high factor mobility, multinational firms are capable of moving from one jurisdiction to another, and if economies of scale are great enough (as they usually are), they can exploit the differentials created by national policy to their own profitable advantage." *The Japanese Industrial System*, de Gruyter, Berlin, 1985, p.270. All of these arguments apply to states in general and not just EC member states.

jurisdictional conflict and without directly acknowledging the inescapable fact that the behavior of any affiliate is unavoidably influenced by external forces."¹¹ Dunning, less convinced of the *défi* thesis, stresses that the presence of foreign-owned firms is not so recent a phenomenon.

The ability of Japanese firms to choose between states, and between sub-state regions confirms a careful, information based, multi-locale strategy. In the EC, this approach eschewed overly aggressive lobbying of the kind which drew negative attention in the US.¹² As such, the actions of Japanese firms can be understood in terms of a refinement of the concept of 'exit'. Like consumers, if such firms do not find one location suitable, they can go somewhere else.¹³ Selection of sites by Japanese manufacturing firms in Western Europe in the 1980s was a matter for the firms themselves, and for competing states and sub-state regions *within* the EC. Just 42 Japanese manufacturing plants were located in EFTA states by the beginning of 1993, compared to 671 in EC member states¹⁴ and 90% of Japanese direct investment in Europe, including financial investment, was in EC member states.¹⁵

¹¹ Vernon, Raymond *Exploring the Global Economy*, University Press of America, Lanham, 1985. pp. 59-60. Vernon implies that sovereignty is impaired by the activities of multinational enterprises. But absent from this view is a definition of the threshold at which the surrender of sovereignty reaches a critical mass. Foreign banks, embassies, spies, illegal aliens &c. have been (albeit often reluctantly) tolerated within states for quite some time. Any of three propositions could be true: either sovereignty is being surrendered; no sovereignty is being surrendered or a *certain amount* of sovereignty is being surrendered. Milward has suggested that the state retains sovereignty even when it decides to surrender certain aspects of sovereignty in pursuit of its own strategic interests. Again however, the *point* at which the state reaches an 'integrating mass' is not defined.

¹² See for example, Pat Choate *Agents of Influence*, Knopf, New York, 1990.

¹³ Caporaso, James A. and David P. Levine state that "If the consumer dislikes price, quality, or mere existence of a commodity, he or she exercises the power to search elsewhere... the option of dialogue, argument, or persuasion hardly exists as an independent form of influence." *Theories of Political Economy*, Cambridge University Press, 1992, p.223.

¹⁴ JETRO *The 9th Survey of European Operations of Japanese Companies in the Manufacturing Sector*, Tokyo, 1993. p.3.

¹⁵ This figure is calculated from the OECD *International Direct Investment Statistics Yearbook 1994*, Paris, 1994.

Transnational corporations exhibit highly mobile strategies.¹⁶ The member states of the Community, although constrained in the pursuit of trade *agreements*, still exhibit considerable autonomy *vis-à-vis* trade *promotion* and FDI policy. The Community level, is compromised in its quest for greater regulatory authority by the strategic mobility of Japanese firms and the *de facto*, residual strategic options of member states. States making alliances with firms - Britain and the Netherlands are the obvious examples in EC-Japan relations - can directly affect the broad constitutional evolution of the EC.

The choice of location for investment is the outcome of many factors, among which no single outstanding locational factor appears paramount. In his analysis, Charles McMillan has pointed out that "in a world of very high factor mobility, multinational firms are capable of moving from one jurisdiction to another, and if economies of scale are great enough (as they usually are), they can exploit the differentials created by national policy to their own profitable advantage."¹⁷ Criteria for choice of investment sites now tend to focus on factors such as 'technology support' rather than production and labour costs alone. The Paris-based HEC Eurasia Institute supports Lutkenhorst's¹⁸ view empirically, finding that "the location

¹⁶ Susan Strange writes that "resource-based, manufacturing and service enterprises have all discovered that this accelerating rate of change does not give them sufficient time to recoup in profits *derived solely from local, national markets* the costs of developing and-or installing new products or new processes. To keep up with their competitors, who may already be transnational corporations, they are obliged to sell on several national markets at once." 'Big Business and the State' in Eden, Lorraine and Evan H. Potter (eds.) *Multinationals in the Global Political Economy*, Macmillan, London, 1993. p.104.

¹⁷ McMillan, Charles J., *The Japanese Industrial System*, 2nd ed., de Gruyter, Berlin, 1985, p.270.

¹⁸ Cheap labour is not the overriding concern of investing firms in the view of Wilfried Lutkenhorst. 'Challenges from New Trends in Foreign Direct Investment' in *Intereconomics*, vol. 23, 1988, p.222. Stopford and Strange state that "Attractive sites for new investment are increasingly those supplying skilled workers and efficient infrastructures. These new demands from firms affect how governments allocate resources to attract wealth-generating investment." *Rival States, Rival Firms*, Cambridge University Press, 1991, p.2. The conclusion regarding skills and infrastructure is clearly borne out by Japanese firm strategies in Europe. Governments continue to be the main enhancers of such factors. In the absence of an FDI policy the EC Commission could distribute regional funds with FDI locational considerations in mind. Thus far this has not occurred, although EC funds in road projects in Ireland for example have indirectly influenced Japanese FDI decisions.

of Japanese industrial plant clearly shows that the Japanese [firms] have a well thought out and well established strategy, positioning themselves at the heart of the large European markets rather than seeking comparative advantages, such as lower salary costs, in the outlying areas of Europe."¹⁹ John Doherty, Director of the Industrial Development Authority of Ireland in Tokyo stated that "the Japanese have gone to big markets rather than the EC as a whole."²⁰

A subtle argument has been made by Ozawa, who suggests that the *heterogeneity* of conditions within the Community is an advantage for Japanese firms:

..the EC, whose membership has recently included Spain and Portugal, is an economic entity more suitable for transplanting Japan's multi-layered system of manufacturing than the US market, since wages and other labour-market conditions are regionally still so diverse and structurally heterogeneous that a vertical division of labour through sub-contracting can be more appropriately arranged and implemented.²¹

This, combined with what Steven Globerman calls the "major change in the environment for foreign direct investment"²² brought about by the liberalisation of state policies in general, means that virtually every part of every EC state, is at least a potential site for Japanese FDI. The subcontracting strategies of Japanese investors are invariably transnational. Large manufacturers such as Toyota have even promised subcontracts to unsuccessful host bidders, to ensure harmonious relations. A full estimation of such transnational links would be near impossible - however the following tabulation of firms with investments in more than one EC member state indicates that transnational strategies are substantial. This tabulation, extrapolated from JETRO data, is conservative. Keiretsu partners, minority holdings, research and development centres and financial institutions are not included.

¹⁹ HEC Eurasia Institute, *The Japanese in Europe, Vol.1: the impact of Japanese investment strategies*, for the Club de Bruxelles, 1990, p.3.8.

²⁰ *Interview*, Mr. John Doherty, Director, Far East, Industrial Development Authority (IDA) of Ireland, Tokyo, 13 July 1993.

²¹ Ozawa, T. 'Japanese multinationals and 1992' in Burgenmeier, B. and J.L. Mucchielli (eds.) *Multinationals and Europe '92*, Routledge, London, 1991. pp.150-1.

²² Globerman, Steven 'Government Policies Toward Foreign Direct Investment: has a new era dawned?' *Columbia Journal of World Business*, Vol.23, issue 3, 1988. p.41.

TAB.16 Japanese firms with plants in more than one EC member state.

Japanese firms with plants in 2 member states	57
3	18
4	7
5	2
6-10	3

Compiled from JETRO's *10th Survey of European Operations of Japanese Companies in the Manufacturing Sector*, Tokyo 1994. pp.96-170.

This data underestimates the level of transnational activity by Japanese firms in the European Community. Although subcontracting and multi-locational activities can diminish opposition to extra-European investment, there is no evidence that the Japanese government has an effective role in encouraging such a trend. Individual locational decisions - including those for strategic purposes are the prerogative of the firms.

The following sections treat the competence of EC member states regarding FDI matters; divergences in the strategies of member states; the distribution of Japanese FDI in the EC; the dispositions of individual member states towards Japanese FDI, and the role of the Japanese state in EC-Japan FDI relations.

IV.3 MEMBER STATE COMPETENCE AND JAPANESE FDI

In treating the competence of EC member states in Japanese FDI relations, the most important element is 'disposition.' Disposition as used here, includes the historical propensity of a member state to engage in FDI activity, the prevailing state philosophy towards FDI, the regulatory framework which affects FDI decisions and the complex web of bargains, direct incentives, side-deals and political stratagems which states use to promote, protect or deter FDI. Neither regulation *per se*, nor incentives alone are sufficient factors in the analysis of political conditions for FDI. In the sphere of FDI relations with Japan, member states and sub-state regions have a more 'total' FDI armoury than the EC Commission or other

Community institutions.²³ The Commission's exercise of competition policy is one area of Community strength, although due to the confidentiality of inbound investment negotiations, the Commission's investigative powers are limited and almost always *post facto*.

The interests of the integrating unit are different to those of the globalising firm. Firms which emphasise trans-national strategies pose policy challenges for both the EC institutions and member states. The strategic purpose of Japanese investment was outlined in a 1989 UK *House of Lords* report which stated: "The Japanese are not investing in Europe as a favour. Japanese investment is based on sound commercial decisions - in particular, a conviction that profits will be made in the long-term, and on the basis of the concept of a *global market*."²⁴ This conclusion stresses the paramount importance of firms in global FDI movements. However, as the uneven distribution of FDI in the EC clearly illustrates, firm endogenous conditionalities alone cannot provide a sufficient explanation for the geographical distribution of FDI. It is here that the member states, the sub-state regions and the Community institutions play important roles. The Commission and Community strategy provided an important (albeit largely unintended) motive for Japanese firms to invest through anti-dumping measures and the '92 Programme. Liberal states and a range of sub-states eagerly sought the advantages of Japanese FDI.

During the 1980s, the rise in Japanese FDI underwrote the role of states and sub-states within the EC. This was partially a simple geographical reality. Firms coming into the Community, selecting a location needed to pin-point local conditions. In doing so, firms responded to

²³ The difficulty of the EC Commission's position was outlined in a 1993 speech to the Tokyo European Business Community by James Moorhouse MEP: "The EC cannot afford to take a passive stance in its relationship with Japan. Unfortunately, the Commission is in a very difficult position and does not have a very constructive policy towards Japan. This is partly due to the fact that the Council of Ministers has not given the Commission its firm backing in its dealings with Japan." Tokyo, 7 June 1993. Laurens Jan Brinkhorst, Head of the EC Commission delegation in Tokyo commented on government policies towards inbound FDI: "Member states must take into account a Community perspective and Community priorities in this respect." Rotterdam Seminar, 14 October 1985.

²⁴ House of Lords, Select Committee on the European Communities, *Relations between the Community and Japan*, Report, 13th report, Session 1988-89, London 1989, p.25. *Emphasis added*.

disparities - many of which were not political. However, the firms also respond to diversities which are clearly caused by political authorities, and even accentuate them. This in turn is fuelled by the states who, in the 'new era' of FDI, see direct political reward in capturing a share of the more than 200,000 manufacturing jobs which JETRO estimates to have been created by Japanese investment in the decade to 1993.²⁵ The selection of location - and importantly, repeated patterns of locational selection throughout a given period - presents a *de facto* critique of variant political economic conditions within the Community. That the member states of the EC found their external economic policy given enhanced expression through bargains with Japanese firms, was a generic phenomenon. Specific states however, exploited this reality differently.

The UK and the Netherlands have been particularly successful in facilitating external firms. Both enacted financial sector deregulation in the mid-1980s, and vigorously supported bargains with Japanese interests within the European Council and bilaterally. The manner in which member states summon a range of external relations powers can only be the envy of the Commission. Jonathan Morris for example states that: ".. local content levels have been agreed as a *quid pro quo* for financial inducements..²⁶ In this global political economic environment it is unsurprising that Mr. Keld Hammering, Executive Director of the European Business Community council in Tokyo should state: "All the [EC] embassies are not giving up just because trade is an EC competence."²⁷ This is illustrated by the fact that as of 1993 the Commercial section of the French embassy in Tokyo had approximately an equal number of staff as the EC delegation in Japan.²⁸

²⁵ JETRO *The 9th Survey of European Operations of Japanese Companies in the Manufacturing Sector*, Tokyo, 1993.

²⁶ He cites Nissan's agreement with the UK government. Morris, Jonathan 'Japanese foreign manufacturing investment in the EC' in *Japan and the Global Economy*, Jonathan Morris (ed.), Routledge, London, 1991. p.197.

²⁷ *Interview*, Mr. Keld Hammering, Executive Director, EBC council, Tokyo, 11 May 1993.

²⁸ *Interview*, Jean-Pierre Dubois, Commercial Counsellor, French embassy, Tokyo, 21 July 1993.

Japanese officials recognise the role of states in investment decisions; both in the liberalisation of outbound investment conditions by Japan, and the desirability - even the necessity for host states to engage in attraction activities:

...Japanese direct investment overseas has been deregulated under the Foreign Exchange and Foreign Trade Control Law, and it is now the responsibility of the private sector to make decisions in this area. Accordingly, countries wishing to attract investment must improve the general business environment, the economic situation, and make efforts to attract foreign capital.²⁹

Understanding variations in the dispositions of member states and member state regions is an important function for any Japanese firm engaged in locational selection. Wallace and Kline have emphasised that foreign investors are subject "to prevailing laws wherever they do business."³⁰ For Canon Inc., Mr. Eiji Tozosaki stated that local regulations were the most important within the Community.³¹ Mr. Takashi Saegusa, President of Canon Italia SpA supported this view.³² Mr. Yoichi Harada of Honda Motor Co. referred to the fact that "through our production activities in motorcycles we should be able to gather information about the culture on the spot. Culture means history, business practices and common sense."³³ Mr. Susumu Takiguchi of Nomura's London office has written: ".. for us to assume a unified market in which Japanese firms can operate anywhere in Europe in exactly

²⁹ Yoshiki Nagatomo, Representative of JETRO, Brussels, 'Japanese Investments abroad Past Present and Future' *conference paper* JAPANESE BUSINESS STRATEGIES IN EUROPE AND THE EUROPEAN ANSWERS, Universite Catholique de Louvain and the International Advertising Association, Brussels, 22 October 1987. pp.22/23.

³⁰ Wallace, Cynthia Day and John M. Kline *EC 92 and Changing Global Investment Patterns*, Vol. XIV, #10 'Significant Issues Series' Center for Strategic and International Studies, Washington D.C., 1992. p.49. In her statistical methodology DeAnne Julius treats the G-5 for the analysis of inbound and outbound FDI. The EC is however listed as an entity for projected scenarios. *Global Companies and Public Policy*, RIIA-Pinter, London, 1990. pp.3,20,52.

³¹ *Interview*, Eiji Tozosaki, Canon Inc., Tokyo, 15 June 1993.

³² Mr. Saegusa stated that "each government will still be important" after 1992. He listed language and differing histories as important elements within the Community. *Interview*, Milan, 7 April 1992.

³³ *Interview*, Yoichi Harada, Assistant Manager, Public Relations Division, Honda Motor Co. Ltd, Tokyo, 24 May 1993.

the same way would be to assume that we are living in cloud-cuckooland!"³⁴ JETRO found that 65.6% of respondents in its 1993 survey of Japanese manufacturing investors in the EC believed that the completion of the single market "would not be positive nor negative."³⁵

IV.4 DIVERGENCE IN MEMBER STATE STRATEGIES

An important theme in the evolution of the European Community has been the tension between the primacy of *common cause* among member states, and member state relations with externalities. Modern political economic history reveals no single model in European economic philosophy. Rather, since early modern times there have evolved fundamentally divergent political economic approaches between regions. Many of these proto-policies have repeatedly reappeared in the same areas, suggesting that the selection of one approach to the governance of an economy involves far more than rational decision-making.³⁶ Geography, historical experience, society and culture play important roles in the evolution of the political economic predisposition of states. That there is no single European 'model' of political economic management is a fundamental theme in the evolution of EC-Japan relations.³⁷

³⁴ Takiguchi, Susumu 'Europe and Japan: The Anatomy of their relationship' paper presented at the DIALOGUE EUROPE AND JAPAN '94 conference, European University Institute, Fiesole, June 1994.

³⁵ JETRO *9th Survey of European Operations of Japanese Companies in the Manufacturing Sector*, Tokyo, 1993. p.7.

³⁶ This is in contrast to the view of William Nester who states that the 'power imbalance' between Japan and Europe is due to ideology: "Ideology is perhaps the ultimate source of power. The power and fate of a nation or alliance rests ultimately on its ideological foundations. It is ideology which determines how and to what ends a state is organized." *European Power and the Japanese Challenge*, Macmillan, London, 1993. p.166.

³⁷ Michel Albert, Chairman and CEO of Assurances Générales de France (AGF) argues that tensions *between* variants of capitalism have become more evident and more relevant since the demise of communism. "The neo-American model is based on individual success and short-term financial gain; the Rhine model, of German pedigree but with strong Japanese connections, emphasises collective success, consensus and long-term concerns." *Capitalism against Capitalism*, Whurr, London, [1991] 1993. p.18.

Michèle Schmiegelow has summarised the dominant philosophies:

[Colbert] also strove to increase France's share of international commerce and reduce the commercial hegemony of the Dutch by imposing tariffs on imports. These mercantilist sins were vehemently criticized 100 years later by Adam Smith... In the meantime, Britain had replaced both France and the Netherlands as the dominant trading nation and, quite clearly, free trade worked in its favor, both in terms of 'principle' and in terms of 'results'.. Germany, the next challenger from the 1870s to the 1940s, did present a lively Colbertist tradition dating back to Prussia's Frederick the Great. This heritage had been further developed in the 19th century by the mercantilist strategy of Friedrich List's "Zollverein."³⁸

Government strategy within states is neither unchanging nor predictable. However, patterns in the predispositions of member states towards issues such as external trade and investment are clear. These have largely domestic origins and are imbued with legitimacy by virtue of their long standing and the systems of direct democracy in member states. Divisions in the Council of Ministers regarding anti-dumping on Japanese parts for example, do not concern immutable rights or wrongs, but tension between legitimate systems. The enduring question for the EC is whether or not the integration of adjacent state policies - a form of strategic 'economies of scale' - can be as efficient as state decision-making.

Differing economic dispositions of member states are clearly and recurrently visible in the phenomenon of foreign direct investment. Stephen Thomsen notes that "the vast bulk of investment flows in and out of the same set of countries. The UK is the largest recipient in Europe but it is also the largest investor."³⁹ That states such as the UK and the Netherlands, which have a high propensity towards extra-European trade and investment, should seek to defend these interests is not surprising. Since the primary *raison d'être* of the SEA was the enhancement of European competitiveness in the face of U.S. and Japanese firms, the pooling of political economic philosophies as a means of enhancing strength in the global economic system may be questioned. On some issues, liberal states have had more in common with Japan than with other Community members. Although such is countered by the fact that intra-EC trade and investment is substantial; the technological edge in important sectors is to

³⁸ Schmiegelow, Michèle 'Asia's Pragmatic Challenge to Europe: mercantilist, capitalist, corporatist, Confucian or otherwise?' paper EUROPE IN THE ASIA/PACIFIC REGION conference, European University Institute, Fiesole, March 1994. pp.4/5.

³⁹ Thomsen, Stephen *The Financial Times*, letter, 10 March 1993, p.12.

be found in alliances with extra-European partners - particularly those from the U.S. and Japan.

A matrix of member states' dispositions towards Japanese investment can be attempted. Simon Reich finds that "the ways in which Western European governments have dealt with the presence of American MNCs suggests a variety of operative policy responses ranging from pure liberalism to pure protectionism."⁴⁰ James Moorhouse M.E.P. identified "the UK and Denmark at one end, to France, Italy and Spain at the other end.. This will continue to be the trend. Given the diversity of positions the Community has trimmed its sails and accommodated state positions."⁴¹ A *Japan Times* editorial writer in 1990 saw the EC in two camps regarding trade and investment:

In the view of angry Listians, EC free-traders appear to be abandoning Europe's defenses, and therefore inviting Japanese domination of strategic sectors of European manufacturing. Embodied largely by the West German Ministry of Economics and the Cabinet of British Prime Minister Margaret Thatcher, the free-trade camp views the Listians as clever defenders of special interests who are keener on captured markets than on fostering competition.⁴²

The Listians were France⁴³ Italy and to a lesser extent, Spain - all of whom opposed the liberalisation of the European car market. The inclusion of Germany in the same category as Britain is not wholly accurate. As seen from the analysis below, Germany's disposition towards Japan has been broadly based on competitive strength and pragmatism rather than an unquestioning liberalism.

⁴⁰ Reich, Simon 'Roads to follow: regulating direct foreign investment' in *International Organization* 43, 4, Autumn 1989, p.546. He points out that "the divergence in European policy responses stemmed from differences in the dominant national ideological principles of these governments, especially with respect to the degree of access granted to American MNCs and the type of support extended to indigenous firms." p.549.

⁴¹ *Interview*, James Moorhouse, M.E.P., Tokyo, 1 June 1993.

⁴² *The Japan Times*, editorial, 25 July 1990, p.20.

⁴³ *Business Week* presented the following view of state positions: "France's Cresson is readying proposals for EC industrial aid and other Japan-fighting moves. But Britain - where the Japanese have put 40% of their EC investments - will oppose the French. German officials, confident about their staying power vs. Japanese rivals, are against protectionist measures." 3 June 1991, p.17.

The UK and the Netherlands have been Japan's closest political economic partners within the EC in the period under review. Denmark and Ireland tended to support these two states in the European Council, having few market protective interests of their own *vis-à-vis* Japan. Germany was well disposed, but not unequivocally open to FDI from Japan. Luxembourg and Belgium could be considered 'well disposed' - attracting a high proportion of Japanese FDI relative to their size. Portugal and Greece had little interface with Japan. Spain had a co-operative inbound FDI regime, which stipulated joint-ventures to a greater extent than Japanese manufacturers would favour. France was increasingly well-disposed to Japanese investment - particularly after the realities of the SEA became apparent; although a fundamental change in disposition to inbound FDI cannot be confirmed. Italy largely eschewed Japanese FDI.

Bargains between liberal member states and Japan were resented by some member states and frequently, by specific industries. Eberhard von Kuenheim, Chairman of BMW "criticized Toyota Motor Corps. decision to construct an assembly plant in Britain."⁴⁴ Tensions therefore were not always along the lines outlined by Reich and Schmiegelow; however these did largely predominate. Nor were questions of disposition always identifiable by state over sector.

The question of investment subsidies offered by both member states and sub-state regions has been controversial. Often the objections to excessive subsidy offers come from local firms who feel that enticement funds for foreign investors could be spent on domestic competitiveness enhancement.⁴⁵ James C. Abegglen has stated that "the EC should find a

⁴⁴ *Nihon Keizai Shimbun*, 2 May 1989, p.2. *Mainichi Daily News* quoted a European company representative in Tokyo as saying: "Toyota, and the Japanese generally speaking, are taking advantage of the EC weakness. They play European manufacturers and governments against each other, and there is always a weakest link." 1 February 1989. For sectoral and firm diplomacy in attempts to access the Japanese market see Strange, Susan 'European Business in Japan: a policy crossroads?' *Journal of Common Market Studies*, Vol.33, No.1, March 1995. pp.1-25.

⁴⁵ Domestic firms have also argued that subsidies "encourage the proliferation of foreign-owned "screwdriver" plants with low added value, particularly when they are set up in response to actual or threatened trade protection." *The Financial Times*, 10 November 1986, p.26.

standard. It is unseemly and costly competition."⁴⁶ Liberal states however, have been unyielding in their support for Japanese investment. Following the Maastricht Social Chapter opt-out crisis, a British M.P. wrote that: "Britain, he [Prime Minister Major] argued at the time, had to say clear of that sort of burden if it wished to carry on attracting Japanese and other overseas investment."⁴⁷ In 1991, EC Commission President Jacques Delors stated that any country which 'opted out' of the EC Social Chapter would become "a paradise for foreign investment, particularly Japanese investment."⁴⁸ The *perceived* threat to levels of Japanese FDI in the UK was one of the main contributing reasons for UK government opposition to the Social Chapter at Maastricht. There remains therefore, considerable scope for competition between European states for FDI; and for individual, quite divergent policies to govern domestic conditions which impact on EC-Japan relations.

IV.5 THE DISTRIBUTION OF JAPANESE FDI IN THE EUROPEAN COMMUNITY

Scholars and practitioners have commented on the inadequacy of FDI statistics.⁴⁹ Statistics concerning outflows from Japan⁵⁰ do not represent a total profile since Japanese firms can raise capital locally - from Japanese or other financial institutions, reinvest profits, or have

⁴⁶ *Interview*, James C. Abegglen, Chairman, Gemini Consulting (Japan), Tokyo, 13 April 1993.

⁴⁷ David Howell M.P., *The Japan Times*, 17 March 1993.

⁴⁸ *The Financial Times*, 11 December 1991, p.2.

⁴⁹ For example: Jacques Leonard, *summary paper L'INVESTISSEMENT EXTÉRIEUR DIRECT* conference, summary, Waseda University, October 1988. Ed Graham at the JAPANESE DIRECT INVESTMENT IN A UNIFYING EUROPE: IMPACTS ON JAPAN AND THE EUROPEAN COMMUNITY conference, INSEAD, Fontainebleau, June 1992. Susan Strange at the EUROPE IN THE ASIA/PACIFIC REGION conference, European University Institute, Fiesole, March, 1994. *The Economist* states that "Official statistics have also failed to keep up with the rapid expansion of foreign investment. In the past decade, direct investment overseas has grown five times faster than world output and more than three times faster than trade. As a result, crude trade figures are becoming less useful as a guide to economic health." 26 December 1992.

⁵⁰ Compiled by the Japanese Ministry of Finance since 1951.

particular arrangements with their operations in the U.S. and elsewhere. Monitoring the exact impact of Japanese capital flows is also difficult. A DATAR [French regional development agency] official stated: "We have tried to get information about the economic contribution of inward investment in every European country, in terms of output, value added and so on, but there are no reliable figures."⁵¹ Japanese firms investing abroad are required to register investments of \$5,000 or more with the Ministry of Finance. These statistics relating to *new* outflows are the only relatively accurate indicator of investment destination, both globally and within Europe. No accurate statistics regarding reinvestment and other capital sourcing are available and there is every indication that such accounting would be near impossible.

Ministry of Finance statistics indicate a heavily increased outflow of Japanese FDI from the mid-1980s until the early 1990s.

TAB.17 Outflow of Japanese direct investment, 1984-93.

	<u>Total</u>	<u>Europe</u>
1984	10.1 \$bn	1.9
1985	12.2	1.9
1986	22.3	3.4
1987	33.3	6.5
1988	47.0	9.1
1989	67.5	14.8
1990	56.9	14.2
1991	41.6	9.3
1992	34.1	7.0
1993	36.0	7.9

\$US bn. Represents financial and manufacturing investment outflows from Japan, globally and to Europe, 1984-1993. Source: 'Charts and Tables related to Japanese direct investment abroad' International Business Affairs Division, MITI, Tokyo, June 1993. Based upon Japanese Ministry of Finance statistics. Compiled from Charts 1 and 3. Figures for 1993 from Keizai Koho Center, Japan 1994: an international comparison, Tokyo. [Based on Japan Ministry of Finance statistics.]

An analysis of Japanese FDI by the Export-Import Bank of Japan reveals that out of \$352.39bn invested abroad between 1951 and 1991, some \$93.92bn was in manufacturing

⁵¹ Ms. Bougeneaux, quoted by *The Financial Times*, 19 November 1986, p.26.

activity.⁵² Japanese FDI abroad continued to be concentrated in the financial and non-manufacturing sectors during the 1980s, both globally and within the EC. However, the amount of 'non-manufacturing FDI' devoted to manufacturing *support* is difficult to determine, and may increase the 'manufacturing FDI' proportion.

A more complete picture of the distribution of FDI can be gained from a tabulation of total EC inbound investment by *amount*, (including non-manufacturing sectors):

TAB.18 Japanese direct investment to the 'EC 12', 1951-93.

	<u>1951-1992</u>	<u>1993</u>
U.K.	29,134 \$m	2,527
Netherlands	16,222	2,175
Germany	6,574 ⁵³	760
Luxembourg	5,941	44
France	5,429	545
Spain	2,577	207
Belgium	2,222	135
Italy	1,438	188
Ireland	829	469
Portugal	204	57
Greece	102	4
Denmark	fn ⁵⁴	-

\$USm. Represents accumulative Japanese FDI to [future] member states 1951-92, and to member states in 1993. Source: 'Charts and tables related to Japanese direct investment abroad' International Business Affairs Division, MITI, June 1993. Compiled from Table 1. Based upon Japanese Ministry of Finance statistics. Data for Denmark: see footnote 57. Statistics for 1993 courtesy of the Mission of Japan to the EC, Brussels. [See also CHARTS III & IV over.]

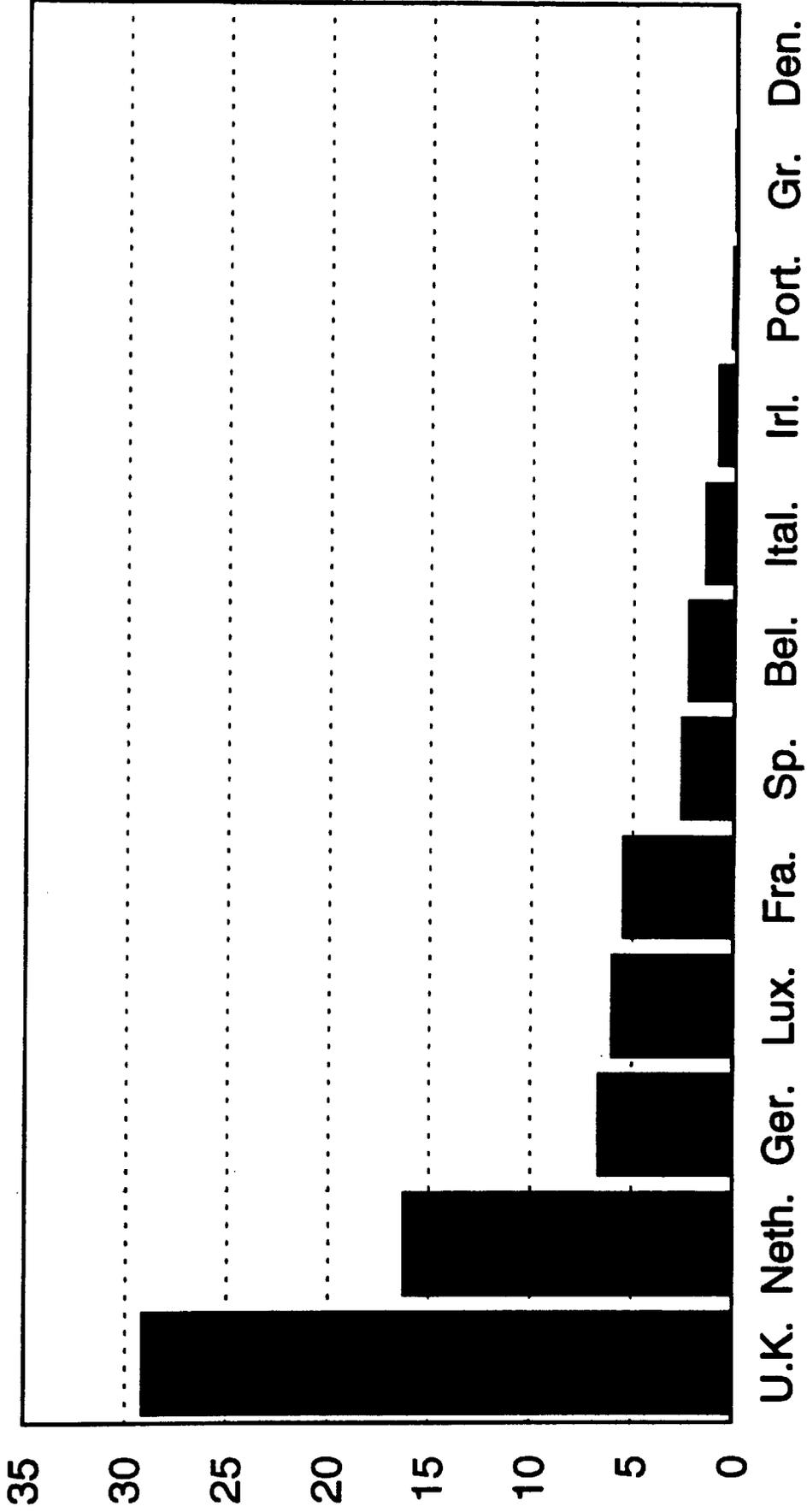
⁵² Export-Import Bank of Japan, with Japanese Ministry of Finance statistics, appendix, p.13.

⁵³ Excluding GDR.

⁵⁴ Central Bank of Denmark statistics for 1984-1992 were obtained courtesy of the Economic and trade section of the Embassy of Japan in Copenhagen. Direct investment from Japan to Denmark in that period totalled 541,000,000 Kr.D. [approx. \$71m. Calculated at period average rate, from IMF *International Financial Statistics Yearbook*, Washington, D.C., 1993. p.313.]

Japanese FDI to the 'EC 12'

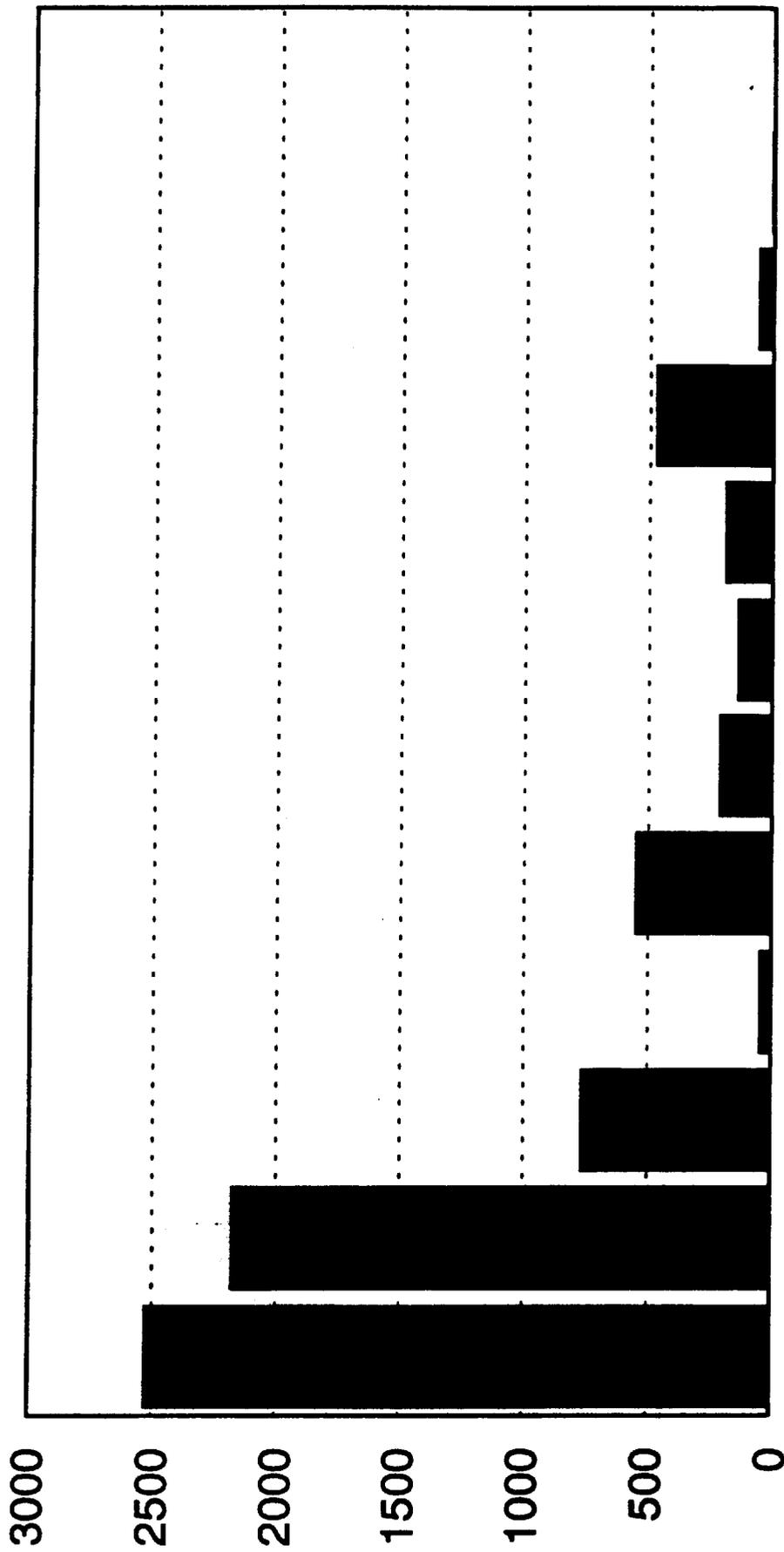
accumulative share by state, 1951-1992



\$US bn. Source: MITI, & Cent. Bank. Den. data ['84-92] from Japanese Emb. Den.

Japanese FDI to the EC in 1993

share by member state



U.K. Neth. Ger. Lux. Fra. Sp. Bel. Ital. Irl. Port. Gr. Den.

\$US bn. Source: Japanese Min. of Finance stats. from Mission of Japan to the EC

The most comprehensive survey of Japanese manufacturing firms in Europe is the annual JETRO (Japan External Trade Organization) *Survey of European Operations of Japanese Companies in the Manufacturing Sector*. The survey targets firms with a 10% or more Japanese interest, and has a relatively high response rate of 60.7%.⁵⁵ In terms of numbers of plants, the following break-down of the 671 plants in the EC was reported for 1993:

TAB.19 Distribution of Japanese manufacturing bases in EC member states.

U.K.	206
France	121
Germany	106
Spain	64
Netherlands	45
Italy	52
Belgium	40
Ireland	31
Portugal	12
Luxembourg	3
Denmark	3
Greece	3

Source: JETRO 10th Survey of European Operations of Japanese Companies in the Manufacturing Sector. Tokyo, 1994. [Excludes R&D bases.]

By sector, these plants were concentrated predominantly in electronic and electrical machinery and parts; chemicals; general machinery; transport and parts and the metal product sector.⁵⁶ The decline in new outflows of Japanese investment capital is visible from the data. The decline in inflows to EC countries was explained in terms of the "completion of the Single European Market and the slump in both European and Japanese economies".⁵⁷ However the long-term volume prospects of FDI raises important theoretical issues, and more fundamental reasons for the decline could be present. The global increase in FDI flows is comparatively new and has spawned a number of works speculating on trade substitution and trade support. Despite the recent nature of the high volume of FDI, the phenomenon of delocation has

⁵⁵ JETRO *9th Survey of European Operations of Japanese Companies in the Manufacturing Sector*, Tokyo, 1993. p.2. This annual series commenced in 1983.

⁵⁶ JETRO, *ibid.* p.2.

⁵⁷ JETRO, *ibid.* p.2.

recently been examined.⁵⁸ An important question which arises from the analysis of Japan-EC FDI flows is whether or not such FDI will be a permanent feature of the relationship, or whether the recent phase of the relationship has been characterised by FDI in a specific set of political economic conditions from the mid-1980s to the early 1990s. In addition to JETRO's interpretation, it is highly significant that all major Japanese financial and manufacturing groups are now represented within the EC. Should EC growth increase and the Japanese economy recover, Asia still represents a counter-pole drawing on Japanese outbound FDI. The JETRO survey found that "The percentages of the companies which were planning to increase investment and employment levels were also lower than at any time in previous surveys."⁵⁹ New stocks of Japanese direct investment decreased in the early 1990s. This was in part due to the presence of most large Japanese firms in the Community by the start of 1993, low growth in the EC and the diversion of FDI to Asian destinations. The overall global rate of FDI also slowed.

The decline in the volume of Japanese FDI to the European Community also highlights the important factor of spatial distribution of investment (particularly by manufacturing FDI). From a Commission perspective, a concern has been whether investments which are intrinsically beneficial for one member state or region could be detrimental to the Community as a whole. Both the Commission and the MITI would have preferred less 'loading' of FDI in specific member states such as the U.K. and the Netherlands. However, there was little either authority could do to affect the spatial distribution of FDI within the EC.⁶⁰ A more even spread in FDI distribution was frequently predicted. But as Fig.2 indicates, such hopes

⁵⁸ The concepts of *delocation* to the home base; and *relocation* to other economic hosts are of growing importance. The latter became important in the Anglo-French 'social dumping' controversy focused on American firms during 1993. Thus far, Japanese firms have not been involved in such relocation controversies. Delocation of financial investment is however a growing reality. See 'A 'slow squeeze' by Japan - investment reversal starves world of funds' *International Herald Tribune*, 23 March 1992, p.1.

⁵⁹ ie. since 1983. JETRO, *9th Survey of European Operations of Japanese Companies in the Manufacturing Sector*, Tokyo, 1993. p.5.

⁶⁰ Neil J. Mitchell has written that "To offset the tendency for individual states to pay too much in the competition with each other to attract foreign investment, policy towards this investment would have to be developed at the federal level." 'Foreign Money & American Politics' (review essay), *Polity*, Vol. XXIV, Number 2, Winter 1991. p.341.

were merely wishful thinking. With the reduction in levels of investment, it can be concluded that *in this phase* of Japanese investment to the EC, firm locational strategies were broadly consistent.

Predictions of a global economy where FDI will expand exponentially are premature. The Japan-EC experience indicates that FDI is still an option which must be viewed with close attention to firm trade strategy, the multiple-level political dispositions of host areas and trade policy.

IV.6 EC MEMBER STATES AND JAPANESE FDI: DISPOSITION, BARGAINS AND REGULATION

This section treats the dispositions of individual member states towards Japanese investment. For the purposes of inbound regulation activity, The Netherlands, Luxembourg, Italy, Ireland, Portugal, Greece and Denmark function as single entities in Tokyo. The U.K., Germany, France, Spain and Belgium have sub-state regional offices which are responsible for attracting investment. All of the member states with sub-state regional representation have co-ordinating roles between their embassies and sub-state regional offices and frequently the embassies in this group also have an involvement in inbound investment decisions. (This is particularly evident in the case of the UK, France and Spain.) Officially-designated regions frequently receive financial assistance for their inbound investment programmes. No general conclusion can be drawn regarding the relative efficiency of FDI attraction activities at state or sub-state levels. The two highest recipient states in the EC operate differing systems. For the most part, this is a function of size. However, the fact that Italy has no sub-state representation in Japan and (for a member of the G-7) a low penetration of FDI may represent a co-relation. Japan itself, another G-7 state, also has an exceedingly low level of inbound investment and her prefectures are not substantially active abroad.

The United Kingdom

Although Portugal, Spain and particularly, The Netherlands had strong historical links with Japan, her closest European ally by the early 20th Century was Great Britain. The post-war era confirmed the United States as the closest external diplomatic and economic partner of

Japan. Links with the United States had been expanding since the Meiji Revolution and the Occupation consolidated Japan as an American ally. Exchanges between Europe and Japan remained at a low ebb until the growing competitive strength of Japanese industry produced mounting deficits with western European states in the 1970s. This factor, European trade policy reaction and the trade and investment dispositions of member states and sub-states, heightened Euro-Japan exchanges. Within this evolution, the U.K. has clearly been the most reliable of allies; both in its co-operative disposition towards firms, and in its political support for Japanese interests at the EC level.

The bilateral political economic cooperation between the UK and Japan⁶¹ has aroused some concern,⁶² particularly in France where it has been suggested by Jacques Calvet of Peugeot and others that the UK is a proxy for Japanese interests. The issue however, is not so much one of liberal states acting as 'aircraft carriers'⁶³ or 'Trojan horses,' but of the extent to which common cause between the member states should supersede bilateral external interests. As discussed above, both the UK and The Netherlands have had a more open disposition to extra-European trade and investment *prior* to the arrival of substantial amounts of Japanese investment in the EC. Their positive disposition represents a continuation of this disposition and the government policies which had long supported it.

UK government policy has had a significant influence on Japan-EC FDI flows. Other factors

⁶¹ The Anglo-Japanese has been treated in more depth than any other Euro-Japanese bilateral relationship. The standard work on the contemporary political economy of this relationship is Roger Strange's *Japanese Manufacturing Investment in Europe: its impact on the UK economy*, London, Routledge, 1993.

⁶² Dunning and Cantwell have noted "current concern among some EC countries that the UK is receiving too high a share of Japanese direct investment in the EC." 'Japanese direct investment in Europe' in Burgenmeier, B. and J.L. Mucchielli (eds.) *Multinationals and Europe '92*, Routledge, London, 1991. p.174. Fujitsu's acquisition of a majority stake in ICL in 1990 caused widespread consternation, despite the fact that the two firms had been cooperating since 1981. ICL was excluded from EC-funded semiconductor projects. In 1992 however, as in the case of the Nissan free movement case, the EC permitted ICL to participate in the Secure European System for Applications in a Multivendor Environment (Sesame). *The Japan Times*, 9 May 1992, p.24.

⁶³ *Business Week*, 3 June 1991, p.21.

which give the UK a favourable disposition for Japanese investors include proximity to Europe's biggest financial centre, a cooperative investment relationship with the U.S., availability and cost of labour, language, and proximity to other EC markets.

Government policy is also crucial. In his analysis of FDI regulation in the automobile sector, Simon Reich designates government policy towards FDI along two variables (after Servan-Schreiber): the degree of access granted by the state to foreign firms, and the type of support provided by the state to domestic firms. For the UK he identifies the type: "unlimited access and nondiscriminatory intervention."⁶⁴ Applied to Japan, this has been combined with open government support for UK-Japanese firm bargains at EC level. On the important issue of free movement of UK Japanese automobile production, Jean-Pierre Lehmann has observed that "the United Kingdom is not only on the side of the Japanese, but indeed championing the cause."⁶⁵ Apart from individual UK sub-state offices in Tokyo which are active in attracting Japanese investment, the Invest in Britain Bureau was set up within the Department of Trade and Industry in 1977 for the purposes of inbound investment attraction generally.⁶⁶

In addition to liberal FDI access, incentives to investors and political support for firm activity on the broader European stage, there is also potential for bilateral economic transactions in

⁶⁴ Reich, Simon 'Roads to Follow: regulating direct foreign investment' in *International Organization* 43, 4, Autumn 1989. p.558.

⁶⁵ Lehmann, Jean-Pierre 'France, Japan, Europe, and industrial competition' in *International Affairs*, Vol. 68, No. 1, January 1992. p.45. Mr. Yoshiaki Gogami, Manager, European & American Operations Group, Nissan Motor Co., Ltd. Tokyo, stated that "Mrs. Thatcher negotiated with the French and Italian governments, and since that time we have no problem." *Interview*, 15 July 1993. *The Mainichi Daily News* reported [7 March 1989] that Prime Minister Thatcher had informed her cabinet that the UK would prosecute France in the Court of Justice of the European Communities, if such automobiles were not allowed access. At interview, Mr. Nobuya Etoh of Toyota Motor Corp. stated: "the main reason why we invested in the UK is that the government welcomed our investment." *Interview*, Tokyo, 28 May 1993. Yoko Sazanami has identified UK government policy as a key element in attracting Japanese investment; 'Determinants of Japanese Foreign Direct Investment: Locational attractiveness of European countries to Japanese multinationals' *Revue économique*, No.4, July, 1992. p.667.

⁶⁶ The DTI is also involved in promoting British investment to Japan, under the 'Priority Japan Campaign' at the Japan Exports Unit. *Interview* with Mr. C.E.A. Ripley, First Secretary, Inward Investment, British Embassy, Tokyo, 23 March 1993.

the form of government-government or government-firm bargains. A recent and apparently unprecedented loan from the Export-Import Bank of Japan for a major infrastructural project in the UK [the Heathrow Express Rail Link] is the kind of untied loan normally offered by a government Bank to a developing country. UK-Japan involvement in such financial arrangements is highly discretionary and does not involve the EC Commission.⁶⁷

Grazia Letto-Gillies has written of the UK position *vis-à-vis* British sovereignty within the EC:

It may be also considered an irony that some political forces should resist more integration within the EC on the grounds that it would lead to loss of sovereignty. In reality the major loss of sovereignty has already occurred in the economic sphere through the power of TNCs (enhanced by the policies often advocated by the same political forces!). One cannot help wondering whether what is being feared in a full European integration is the loss of sovereignty or the strengthening of countervailing power to the TNCs.⁶⁸

This view aims to identify an apparent contradiction in the UK's stance *vis-à-vis* 'integration' and 'globalisation'. However, the UK could equally be said to be opposing further integration⁶⁹ precisely in the belief that it could capture, or at least harness the agenda of Japanese firms in attempting to improve the trade balance or alleviate unemployment. Since Japanese firms have accessed the European Community market anyway, and since UK/Japanese goods have liberal access to that market, (largely due to victory in an internal bargain at EC level) further political integration was questioned as unnecessary. The point made by Letto-Gillies, while not invalid regarding TNCs, does not expose a logical inconsistency in British policy. Like Milward, Letto-Gillies does not indicate at which point sovereignty 'transfers' acquire any kind of critical mass - a general defect in the EC literature discussion of 'sovereignty surrender.'

The Netherlands

During the Tokugawa closure of Japan, which lasted from the mid-17th Century until 1868,

⁶⁷ Export-Import Bank of Japan, *News Release*, NR93-18, Tokyo, 11 November, 1993.

⁶⁸ Letto-Gillies, Grazia, *International Production: trends theories and effects*. Polity, Cambridge, 1992, p.210.

⁶⁹ For example, the opt-out of the Social Chapter of the Maastricht treaty in December 1992.

the Netherlands was the only European power to be given (albeit limited) trading access to Japan. A positive Dutch disposition to extra-European trade and investment has attracted high levels of American and more recently, Japanese investment. The Dutch government, through the Netherlands Foreign Investment Agency, (NFIA) promotes itself as a centrally located, cosmopolitan state which is well-disposed towards external trade and investment.⁷⁰ Mr. C.J. Dirkzwagar, Commercial Councilor at the Dutch embassy in Tokyo stated: "There is no public debate in Holland where you will find people airing sceptical viewpoints on Japanese investment."⁷¹ As was the case with the UK, high-level political economic missions to Japan sought investment during the mid-1980s as Japan turned attention to the EC. On one such mission in 1986 the Dutch transport minister, accompanied by thirty Dutch businessmen promoted the country as the "gateway to Europe."⁷²

Yoko Sazanami has pointed to the important role of deregulation in the Dutch case: "The Netherlands attracted Japanese subsidiary finance companies by financial deregulation since 1986, which provided the liberal framework for inward FDI".⁷³ Dutch political support for Japanese firms has also been conspicuous - the Netherlands strongly opposing the EC move to impose anti-dumping duties on imported component parts for assembly in Japanese plants in the EC [Ch.V.10]. It is likely that The Netherlands will continue to strongly protect its extra-European trade links, despite the general tendency observed by Yui Kimura: "Generally, creation of a common market leads to an application of unified tariffs to imports from non-member countries. This tends to divert trade with efficient non-member countries to less

⁷⁰ Additionally, MIP, a venture capital institution "has worked closely with regional development agencies to attract foreign investment since it was set up by the government in 1982." This is a 57% state-owned enterprise. *The Financial Times*, 10 November 1986, p.26. The EC Commission has cautioned the Dutch government that interest-free loans given in the promotion of FDI projects may constitute "unfair subsidies." *Nikkei Weekly*, 13 April 1992.

⁷¹ *Interview*, Tokyo, 13 July 1993.

⁷² *The Japan Times*, 23 January 1986, p.7.

⁷³ Sazanami, Yoko 'Determinants of Japanese Foreign Direct Investment' *Revue économique* No.4, July, 1992, p.666. *The Daily Yomiuri* reported that "The Netherlands received the biggest amount of Japanese investment in Europe \$2.81 billion, up 325 percent [from the previous year] - due to more lenient tax laws." 5 December 1989. 1986 was also the year of the City of London 'Big Bang'.

efficient member countries."⁷⁴ Mr. Dirkzwagar at the Dutch embassy stated that such a trend could become a cause for 'concern.' In the sphere of FDI, the Dutch government however, has thus far effectively protected its extra-European interests.

Dutch-based multi-national enterprise activity in Japan bears a similarity to Japanese firm activity in Europe, *vis-à-vis* independence from government control. Mr. Dirkzwagar commented that most Dutch investment in Japan comes from large firms: "These companies don't rely on embassy support - they make their own decisions."⁷⁵ The firm culture is thus a further commonality between the Netherlands and Japan.

Luxembourg

The Board of Economic Development in the Luxembourg Ministry of the Economy cites favourable economic conditions for FDI such as "a liberal policy to set up in business and on the transfer of capital and dividends."⁷⁶ In Tokyo, the embassy's "primary mission is to promote Luxembourg as a place to invest in and conduct business."⁷⁷ The embassy promotes this activity through economic missions and seminars through which prospective investors are informed of the climate for investment. For example, officials moved to reassure Japanese investors that the Maastricht Treaty would not imply a Community-wide harmonisation of taxes. A common feature of representations in Japan is to accentuate both the advantages of a particular state's 'access' to the Community (*via* location or political influence) while simultaneously reassuring potential investors that there are clear differences between political regimes.

The size of the Duchy is perhaps the main reason why Luxembourg's embassy in Japan

⁷⁴ Kimura, Yui 'Foreign Direct Investment by Japanese Semiconductor firms in Europe' *conference paper* JAPANESE DIRECT INVESTMENT IN A UNIFYING EUROPE: IMPACTS ON JAPAN AND THE EUROPEAN COMMUNITY, INSEAD Euro-Asia Centre, Fontainebleau, June 1992. p.21.

⁷⁵ *Interview*, 13 July 1993.

⁷⁶ Board of Economic Development *Investment in Luxembourg: management guide*, Luxembourg, 1992. p.13.

⁷⁷ *Mainichi Daily News*, 9 May 1993, S.8.

resembles a regional mission of a larger state. The embassy gives primacy to inbound investment and financial service matters. Mr. Takeo Miyauchi of the Luxembourg Industrial Development Department in Tokyo stated that the size of the bureaucracy was a major advantage: "It is very easy to handle problems with Luxembourg government officials and decisions come very quickly."⁷⁸ He also noted a change away from the traditional financial sector investment which had predominated in Luxembourg-Japan relations. By the end of the 1980s, most major Japanese banking concerns had set up in Luxembourg. The government has attempted to invite investors from other sectors, and has met with success among transportation firms. However, Luxembourg's share of Japanese FDI has remained predominantly in the financial sector.

Denmark

Denmark has experienced a healthy trading relationship with Japan, but did not receive a significant proportion of inbound FDI during the period under review. Denmark does not have major indigenous electronic or transport manufacturing interests and has avoided trade friction with Japan. Ms. Jaspersen at the Danish Embassy in Tokyo stated that "We have a surplus in our trading relationship with Japan.. we don't experience generally speaking, this conflict feeling."⁷⁹ The proportion of new cars from Japan registered in Denmark (which along with Ireland) is the highest in the Community, annually fluctuating around 40%. On a visit to Japan in 1991, the Danish Prime Minister stated that Denmark was "an ardent defender of free trade."⁸⁰ This has been borne out at the EC level. Unlike Luxembourg's more neutral EC-level stance however, Denmark has vigorously supported the 'Atlanticist' approach of the UK and the Netherlands in EC debates concerning Japan.

⁷⁸ *Interview*, Takeo Miyauchi, Manager, Industrial Development Department, Embassy of Luxembourg, Tokyo, 15 July 1993.

⁷⁹ *Interview*, Danish Embassy, Tokyo, 9 July 1993.

⁸⁰ Paul Schluter, press conference at the Nippon Press Club, *Asahi Evening News*, 19 June 1991.

Ireland

Relative to its size, Ireland⁸¹ has received a significant number of (particularly, American) multi-national corporations. The debate regarding the long-term contribution of such firms to the industrial fabric and employment base has frequently been contentious. Despite three decades of total liberalisation in the inbound investment field⁸² Ireland has consistently recorded high levels of unemployment. Although FDI is not a panacea for unemployment; in the transitional Irish economy of the 1960s and 1970s expectations that foreign firms would make a *permanent* contribution to the solution of this problem were high. Delocation became a recurrent feature of FDI in Ireland. Before drawing broad conclusions regarding inbound FDI strategy options and job creation, it is worth noting that in Spain, where government policy has nurtured the highest percentage of Japanese joint-ventures in the EC, high unemployment has also been present.

In the 1980s wave of Japanese investment, Ireland vigorously promoted itself as a destination with a young, educated and abundant labour supply.⁸³ The Industrial Development Authority specifically sought Japanese electronics, software and pharmaceutical firms. The IDA also targeted component parts manufacturers - a reflection of Ireland's proximity to the large primary production investments made by Japanese firms in the UK. The opening of the Dublin Financial Centre in 1991 provided favourable conditions for Japanese financial institutions.

⁸¹ This section treats the Republic of Ireland. Northern Ireland is treated in Ch.III.

⁸² The UNCTC report on trade-related investment measures (TRIMs) found that Ireland was widely known among firms as offering generous locational subsidies. UN, *The Impact of Trade-related Investment Measures on Trade and Development*, New York, 1991.

⁸³ *An Taoiseach*, [The Prime Minister] Charles J. Haughey, visited Japan in April 1989, the first such visit in an official capacity. On a visit to Tokyo in 1993, Charlie McCreevy, Minister for Tourism and Trade listed Ireland's attractiveness criteria as a location for Japanese investment as: a 10% corporate tax rate for manufacturing (guaranteed until 2010), an educated work force, and a low industrial cost structure for labour, energy and telecommunications. *Mainichi Daily News*, 9 May 1993, S.10. In September 1994, *An Táinste* (the Irish Deputy Premier) opened 'Ireland House' in Tokyo. This office consolidates in one facility, the Irish Embassy, IDA Ireland [the investment attraction authority] *An Bord Trachtála* [the trade board], *Bord Fáilte* [tourism promotion] and *FAS* [the training authority].

As with Denmark, the Irish economy is liberally accessible in terms of trade.⁸⁴ Ireland was as supportive of neo-liberal causes in the European Council as Denmark; opposing the extension of anti-dumping measures on component parts and supporting the UK in blocking the introduction of non-binding inbound FDI guidelines desired by the EC Commission. In overall terms, Ireland and Denmark have not attracted a great proportion of Japanese-EC FDI. However, due to their open trading relationship with Japan, these two states support the UK-Dutch alliance on Japanese FDI unequivocally.

Germany

Mr. Eiji Toyosaki of Canon Inc. referred to the "different competitive strength of nations within the EC."⁸⁵ In the case of Germany, it is this competitive strength which is the defining characteristic of its relationship with Japan in the EC context. Although sometimes assumed to be as liberal as the UK and the Netherlands, Germany's *de facto* disposition towards inbound FDI is not unquestioning.⁸⁶ Whereas the UK government was willing to graft Japanese production onto declining industrial sectors, a combination of competitive strength and regulations such as those governing mergers and acquisitions⁸⁷ make investment

⁸⁴ "Our market as far a Japanese products is concerned is totally open." *Interview*, John Doherty, Director - Far East, Industrial Development Authority of Ireland, Tokyo, 13 July 1993.

⁸⁵ *Interview*, Tokyo, 15 June 1993. Jean-Pierre Lehmann writes that "*Competition* is the operative term to describe the response by German government and German industry" [to Japanese competition]. 'France, Japan, Europe, and industrial Competition' in *International Affairs*, Vol.68, Number 1, January 1992.

⁸⁶ Michael Borrus and John Zysman state that "initial German opposition to the [1991] auto quotas reflected the small but highly profitable export position of Mercedes-Benz and BMW in Japan and their confidence in holding position in the European market. The German position then reportedly shifted shortly after a careful evaluation of the Lexus (Toyota) and Infiniti (Nissan) entries in the luxury market." 'Industrial strength and regional response: Japan's impact on European integration' in Gregory F. Treverton (ed.) *The Shape of the New Europe*, Council on Foreign Relations Press, New York, 1992. p.178.

⁸⁷ *The Asahi Evening News* stated that "Germany's close-knit business groups make investing there as difficult for the Japanese as Japan's economic structure does for foreign companies that want to invest here." 19 June 1991. p.7. Japanese firms have however adopted flexible strategies. Mr. Eiji Toyosaki of Canon Inc. stated that his firm's decision to open a cartridge recycling plant in China was a direct consequence of German environmental laws. *Interview*, Tokyo, 15 June 1993.

more complex than in the five states treated above. Günther Rexrodt, Economics Minister has written that "The government of the Federal Republic of Germany has always vigorously maintained this liberal position in Brussels. We are of the opinion that we have been successful as a rule in defending this position - often in the face of very substantial resistance."⁸⁸ However, Germany has not promoted a political economic alliance with Japan within the EC, largely because it does not need to - a function of the power of its own firms within the relationship.⁸⁹

DeAnne Julius describes the German FDI stance as "ostensibly neutral, neither welcoming nor discouraging"⁹⁰ while Simon Reich identifies "unlimited access and discriminatory intervention"⁹¹ regarding, respectively; FDI access and support for domestic industry. Germany was a favoured destination for R & D projects, ranking second only to the UK as of the end of 1993.⁹² Jonathan Morris found that

Advantageous factors [in favour of West Germany for Japanese FDI] included extremely positive views of the German industrial relations system, a favourable response to the levels of skills and education of its workers and its central geographical position within Europe.. The main negative feature associated with locating in West Germany cited by the respondents is the extremely high cost of labour and, in the southern German states.. labour shortages.⁹³

The question of whether Japanese FDI would become spread more evenly throughout the

⁸⁸ *Mainichi Daily News*, 9 May 1993, S.22.

⁸⁹ BMW is the leading automobile import in Japan. An exception to this proposition was the manner in which Chancellor Kohl appeared to down-play the EC-Japan trade deficit during a visit to Tokyo in 1993. This came as the EC delegation in Japan was warning that the deficit was a 'time bomb.'

⁹⁰ Julius, DeAnne *Global Companies and Public Policy*, RIIA/Pinter, London, 1990. p.48.

⁹¹ Reich bases his finding on the (largely American) West German inbound investment experience in the automobile sector. Reich, Simon 'Roads to Follow: regulating direct foreign investment' in *International Organization* 43, 4, Autumn 1989. p.562.

⁹² JETRO, *The 9th Survey of European Operations of Japanese Companies in the Manufacturing Sector*, Tokyo, 1993. p.3.

⁹³ Morris, Jonathan 'Japanese foreign manufacturing investment in the EC' in Morris, Jonathan (ed.) *Japan and the Global Economy*, Jonathan Morris (ed.) Routledge, London, 1991. p.199.

Community came to focus on Germany following the events of 1989/90. The expectation that (due to opportunities in Eastern Europe and the expanded German market) Japanese investors would lessen their preference for the UK have not materialised to the extent expected by Kobori,⁹⁴ Bain⁹⁵ and Motono.⁹⁶ The view of B. Nino Kumar has proven more realistic:

Taking into account that firms with such oligopolistic assets are, by definition, relatively few, and that the fundamental objective of Japanese firms is to defend their export markets in West Germany, we can draw the conclusion that Japanese *manufacturing* direct investments in this country are likely to remain limited in the future.⁹⁷

The Toyota and Honda decisions to locate in the UK, following Nissan rather than diversifying Japanese investment across the Community was crucial. The establishment of a 'flock pattern' in the behavior of Japanese firms entering the Community, confirmed that bi-lateral political economic bargains with liberal states were stronger than the geographical pull of locating in central European destinations.⁹⁸

⁹⁴ Shinzo Kobori, Deputy Director of economic research at C.Itoh & Co., *Japan Economic Journal*, 7 April 1990. p.1.

⁹⁵ G.Bain, 'European Business and the influence of Japan,' *Journal of the British Chamber of Commerce in Japan*, Vol.5, No.4, 1991. p.5.

⁹⁶ Moriyuki Motono, former of Japan to France, 'The Japanese Business Community's Perception of 1992' *paper* FOURTH ANNUAL EC-JAPAN CONFERENCE OF JOURNALISTS, Brighton, 20 September 1990. p.9.

⁹⁷ Kumar, B. Nino 'Japanese direct investments in West Germany' in Morris, Jonathan (ed.) *Japan and the Global Economy*, Routledge, London, 1991. p.221. This view is supported by Azusa Oshima, general manager of the Bank of Tokyo's USSR and East Europe department. *Japan Economic Journal*, 7 April 1990. p.1. As of 1993 "Because Japan and Germany are in the midst of severe recessions and because what used to be East Germany lacks some basic infrastructure, Japanese leaders have little expectation of enormous advances in direct investment immediately." *Nikkei Weekly*, 8 March 1993, p.3. Germany's use of merger and acquisition regulations has (like Japan herself) limited non-greenfield FDI.

⁹⁸ Japanese firms were aware of the political sensitivity of these locational decisions: "A day before the decision [by Toyota to locate in Derbyshire] was made public, Toyota's chairman faxed the Tokyo office of DATAR, the French industrial development agency, a copy of a letter expressing his regrets that Toyota had rejected plant sites in France. The letter included a promise that the company would encourage Toyota parts suppliers to open facilities there instead." *Asahi Evening News*, 5 December 1989, p.5.

France

France has had a long tradition of government economic intervention.⁹⁹ Among Japanese investors, and particularly since the 'Poitiers Affair' in 1982, France has been viewed as a protectionist state.¹⁰⁰ One authority classifies France's disposition to FDI in the auto sector as permitting "limited access".¹⁰¹ However, France underwent a gradual change in its disposition towards inbound FDI due to the constitutional limits on Commission action in the realm of FDI, and the success of liberal member states in alliances with Japanese firms.

The change was not total - indeed the Cresson premiership briefly reversed its course - however France's disposition towards inbound FDI was more open towards Japanese firms in the mid-1990s than the early 1980s. An important difference between France and Italy (the other 'resistant' state) was the presence of French sub-state regional offices in Tokyo, encouraging and facilitating Japanese FDI. DeAnne Julius states that "until about 1985, inward FDI was positively discouraged both by the conservative government of Giscard d'Estaing and under the various incarnations of the Mitterrand presidency. This official attitude was reversed in 1985 [1986] by Prime Minister Chirac.."¹⁰²

⁹⁹ See Stopford, John M. 'European Practices and Policies,' Ch.4 of Robinson, Richard D. (ed.) *Direct Foreign Investment: costs and benefits*, Robinson, Richard D. (ed.) Praeger, New York, 1987. p.73. Michèle Schmiegelow has written that: "Colbert carried out a comprehensive program of economic reconstruction that helped make France the dominant European power of that time... Somehow, his record sounds like a summary of the debates on "competitiveness" of various members of today's G7," 'Asia's Pragmatic Challenge to Europe: mercantilist, capitalist, corporatist, Confucian or otherwise?' *paper* EUROPE IN THE ASIA/PACIFIC REGION conference, European University Institute, Fiesole, March 1994. p.4.

¹⁰⁰ Moriyuki Motono has stated that "it has to be admitted that, in the Japanese business circles, France is generally considered to be a "difficult" country to invest in.." 'The Japanese Business Community's Perception of 1992' *paper* FOURTH ANNUAL EC-JAPAN CONFERENCE OF JOURNALISTS, Brighton, 20 September 1990, p.9. Jean-Pierre Lehmann notes that "economic policy in France has been and remains ideologically oriented and highly politicized." 'France, Japan, Europe, and industrial competition' *International Affairs*, Vol.68, Number 1, 1992. p.39.

¹⁰¹ Reich, Simon 'Roads to Follow: regulating direct foreign investment' in *International Organization* 43, 4, Autumn 1989, p.553.

¹⁰² Julius, DeAnne *Global Companies and Public Policy*, RIIA/Pinter, London, 1990. p.48. President Mitterrand discussed Japan-French FDI favourably with Prime Minister Nakasone at the G-7 in 1987. Kyodo News Service, 10 June 1987.

A further incentive to the change in policy was the settlement of the Nissan Bluebird case in 1989, which brought the true meaning of free movement principles home to many French officials [Ch.V.6]. Also the GATT ruling against anti-dumping on parts appeared to give the *imprimatur* to EC neo-liberalism and the Fujitsu/ICL deal of 1990 highlighted that corporate alliances were not bound by EC territory. Japanese investment in France was three times greater between 1988 and 1992 than the period 1951-1987.¹⁰³ National and local governments (sometimes reluctantly) accepted the view that France was missing job creation opportunities while UK/Japanese products were accessing the French market.¹⁰⁴ Meanwhile Nissan,¹⁰⁵ Toyota¹⁰⁶ and Honda¹⁰⁷ all stressed the increasing levels of local content in their UK produced automobiles. Although the French and Italian governments had no legal basis to keep such UK produced automobiles out of their markets, Japanese producers adopted

¹⁰³ JETRO/*The Japan Times*, 14 July 1993. Although FDI was by no means completely liberalised. Takashimaya was blocked by the government from buying a stake in Leroy which was co-owner of the prestigious Burgundy Romanee-Conti vinyard. *Mainichi Daily News*, 18 September 1988, p.7.

¹⁰⁴ *The Asahi Evening News*, wrote that "Suddenly, governments like those of France and Italy, which once tended to view foreign investment with disdain, have discovered that the integration of the European market obliges them to chase after Japanese investment with the same shameless zeal as their American cousins." 5 December 1989, p.5. This was more true of France than Italy, in large part due to the aforementioned flexible French investment-seeking structure in Tokyo. Mr. Michio Sasamori, Manager, European Business Development Dept., Hitachi, Ltd., Tokyo, said that "The French government and investment authorities felt they had to do the same [as those in the UK and the Netherlands]." *Interview*, Tokyo, 30 June 1993. Roger Fauroux stated that "it is better to have Japanese photocopiers made in France than imported from Japan." *The Financial Times*, 7 February 1990, p.6.

¹⁰⁵ Nissan claimed throughout the Bluebird controversy that its local content was increasing, but that the firm should not be pressed on such increases by EC or national timetables. The UK government supported this stance.

¹⁰⁶ Toyota planned to reach a local content level of 70% by late 1993 in order to make smoother its exports to other parts of Europe. In the early stages of its UK operation the company largely supplied the UK, German and Nordic markets. A Toyota official stated that the increase in local content would make arguments against UK-Toyotas being imported to France and Italy, groundless. *The Japan Times*, 8 June 1993, p.12.

¹⁰⁷ *Interview* with Yoichi Harada, Honda Motor Co., Tokyo, 1993. As of 1993 he pointed out, local content in UK production was at 80%. The equivalent for Ohio-built Honda Accords was 75% local content. *Los Angeles Times* supplement in the *Daily Yomui*, 22 May 1993, p.10(a).

a soft approach to these markets until local content increased.¹⁰⁸

In Tokyo M. Jean-Pierre Dubois stated that the French embassy assists French companies through the French chamber of commerce and also has regular contact with ministries. Inbound investment had been liberalised and the embassy was organising investment seminars. A European investment policy would be difficult to administer since "inward investment is a very confidential matter." Regarding a co-ordinated European policy to promote market access in Japan he stated that "We have a lot of co-ordinated activities to improve the penetration of European goods in Japan but nevertheless I have the feeling that each member state is also working with its own priorities."¹⁰⁹ French government policy towards Japanese FDI remains part of France's overall stance on trade and industrial policy. Although this policy during the second Mitterrand presidency became more moderate; France vigorously promotes its own vision of external economic relations at Community level which contains strong elements of its own historical dispositions.

Italy

Italy's disposition towards Japanese FDI remained broadly consistent throughout the period 1985-93, with no dramatic increase in her share of accumulated Japanese FDI. By the end of 1993 this G-7 state had attracted a greater amount of Japanese FDI than Ireland, but less than Belgium. Japanese products had achieved a low penetration of the Italian market. The scheduled liberalisation of the EC automobile market in 1999 is expected to be an important watershed in Japanese import penetration. It is possible that Italy will press for the 1991 'elements of consensus' to be renegotiated. Even in 1992, with Japanese producers claiming high local content ratios for European production, Giovanni Agnelli stated: "We will have to

¹⁰⁸ According to JETRO's *9th Survey of European Operations of Japanese Companies in the Manufacturing Sector*, Tokyo, 1993: "76.1% of all Japanese manufacturers operating in Europe have achieved local contents of more than 50% in this area. This figure shows a steady increase, 2.9 points up from 73.2% at the time of the previous survey." p.6. An increasing number of Japanese marques are assembled within the EC. The Association of European Automobile Makers reports that in 17 European states [EU, Norway and Switzerland] 13% of Japanese cars were assembled in Europe in 1991; 15% in 1992; 25% in 1993 and 32% in 1994. *International Herald Tribune*, 29 June 1995.

¹⁰⁹ *Interview*, Jean-Pierre Dubois, Commercial Counselor, French Embassy, Tokyo, 21 July 1993.

see if this is going to be total production or if it will be part assembly."¹¹⁰

There is no regional Italian representation in Tokyo - itself a strong indicator of predisposition to Japanese investment. Mr. Antonio Verde of the Italian Embassy in Tokyo stated: "We do not have regional representations. The structure of the Italian presence in Japan is organized by the economic and commercial office at the embassy."¹¹¹ The Italian Chamber of Commerce cooperates with the European Business Council and the Italian Trade Commission organises trade fairs. Particularly with the decline in overall levels of new FDI from Japan to the EC, there is no indication that Italy will increase its share of this investment.

Spain

Spain has given preference to joint-ventures in Japanese investment. According to the JETRO 1993 survey, such ventures had a higher than average number of employees.¹¹² Camilo Barcia, Ambassador of Spain to Japan stated: "...the EC would like to see more investment in real complex manufacturing activities and see more research and development centers being set up in Europe."¹¹³ Spain's clear preference for joint ventures represents an important state prerogative in inbound investment regulation.

Belgium, Portugal and Greece

Belgium has a much lower proportion of Japanese investment than the Netherlands. Mr. Horikoshi of the Ogaki Kyoritsu Bank (Europe) S.A. in Brussels, suggests that this may be due to three regional representations dealing with inbound investment.¹¹⁴ However, the

¹¹⁰ Sen. Giovanni Agnelli, Conferenze Jean Monnet, European University Institute, Fiesole. 5 November 1992.

¹¹¹ *Interview*, Mr. Antonio Verde, Second Secretary (Commercial) Italian embassy, Tokyo, 16 July 1993.

¹¹² JETRO, *The 9th Survey of European Operations of Japanese Companies in the Manufacturing Sector*, Tokyo, 1993. pp.11/12.

¹¹³ *Speech* to EC-Keidanren Forum, 14 November 1988.

¹¹⁴ *Interview*, Brussels, 22 July 1992. The Irish IDA, Danish and Luxembourg embassies in Tokyo all reported advantages of centralised inbound investment decision-making. This would suggest that small states should centralise inbound investment activities.

amount of Japanese FDI is not negligible comparative to Belgium's size. Additionally, Belgium is the centre for many Japanese 'antennae' offices which are concentrated in Brussels. Japanese FDI in Portugal has existed at a low level. Mr. Rui Boavista Marques stated that "We see Portugal as a good location for a second production plant in the EC."¹¹⁵ This is similar to the strategy of Ireland, which emphasises its proximity to primary manufacturing producers in the UK. Portugal has also attracted a small number of Japanese firms who were originally based in Brazil and who were interested in gaining a European foothold. Mr. Marques made that point that feasibility studies conducted by Japanese firms, even where the investment had gone elsewhere, were a valuable source of upgrading information for the host region. While Greece has welcomed Japanese investment, the central task of its representation in Japan is to promote exports and Greece as a tourist destination.¹¹⁶

IV.7 THE JAPANESE STATE IN EC-JAPAN FDI RELATIONS

In the decades since the 1960s, Japan has gradually relaxed its controls on out-bound investment. Presently, only notification to the Ministry of Finance is required; sums less than \$5,000 being exempt. During the 1980s and early 1990s, a number of government initiatives to facilitate inbound FDI were launched.¹¹⁷ The efficiency of these has been doubted by the European Business Council and some European business executives.¹¹⁸ More significant

¹¹⁵ *Interview*, Rui Boavista Marques, Manager, Investment Dept., Investimentos, Comércio e Turismo de Portugal, Tokyo, 8 July 1993.

¹¹⁶ *Mainichi Daily News*, 9 May 1993, S.11.

¹¹⁷ MITI set up a section for the promotion of inbound FDI in 1984. Julius, DeAnne *Global Companies and Public Policy*, Pinter, London, 1990. p.57. In June, 1993, MITI launched FIND [Foreign Investment in Japan Development, Inc.] a centre in Tokyo to assist foreign companies wishing to invest in Japan.

¹¹⁸ The Kyodo News Service reported in 1987: "Despite MITI minister Tamura's advice to EC firms to invest in Japan, Umberto Agnelli, Chairman of Fiat Auto S.P.A... said his firm encountered vigorous Japanese opposition to its investment scheme here [in Japan] in 1962-63. He said his meetings with Japanese bankers in the past two years have made him extremely sceptical about making a full-fledged commitment into the Japanese market."

however is the inability of government to significantly effect the volume and timing of FDI.

The role of the Ministry of International Trade and Industry has changed *vis-à-vis* industry in Japan. Chalmers Johnson accords a central role to the MITI in the development of modern Japan.¹¹⁹ Daniel Okimoto places industrial policy in the context of the strength of the Japanese private sector and macroeconomic policies.¹²⁰ Kumaraswamy Velupillai argues that the role of MITI has been much exaggerated.¹²¹

Mr. Yoichi Harada of Honda Motor Co. indicated at interview that the Japanese government had not approved of Honda's initial plans to invest abroad in the 1970s. In more recent times however, the government had been favourable to outbound FDI.¹²² With increased FDI, firms such as Honda have become responsible for their own information gathering abroad. Large Japanese firms maintain 'antennae' offices in Brussels for the purpose of such information gathering. The MITI, in recognition of this inevitability has issued non-binding guidelines for Japanese firms investing abroad. The neomercantilist view of Japan espoused by William Nester is thus inaccurate.¹²³

This empirical evidence would suggest that the Johnson thesis is correct for the period which it refers to, *viz.* 1925-1975. However, the evolution of the world economy - particularly the

Kyodo News Service, 4 December 1987.

¹¹⁹ Johnson, Chalmers *MITI and the Japanese Miracle: the growth of industrial policy, 1925-1975*. Stanford University Press, [1982] 1990.

¹²⁰ Okimoto, Daniel I. *Between MITI and the Market*, Stanford University Press, 1989.

¹²¹ *Forthcoming*.

¹²² *Interview*, Yoichi Harada, Assistant manager, Public Relation Division, Honda Motor Co., Ltd. Tokyo, 24 May 1993.

¹²³ Nester writes: "Japan's development strategy is neither liberal nor socialist but combines the most progressive aspects of market-led and state-led capitalism. Japan's cultural values, of the group over the individual and cooperation over competition, obviously give the Japanese an important advantage in organizing and running a complex modern economy. Japan is the quintessential neomercantilist state..." Nester, William R. *European Power and the Japanese Challenge*, Macmillan, London, 1993. p.175.

empowerment of Japanese firms in the global market - requires an evolutionary and flexible evaluation of the role of the MITI. This thesis finds a continued role for the MITI in the period 1985-93, but with firms - rather than the Ministry - playing a lead role in external commercial relations.

The Japanese government has reacted to 'deficit diplomacy' from the EC Commission by encouraging firms to invest abroad.¹²⁴ Such encouragement cannot be considered a serious incentive in firms' decisions to invest abroad in an age of greatly enhanced firm information-gathering capabilities and the liberalisation of capital flows. However the bureaucracy is also conscious of problems which might arise with firms investing abroad and "not coming back."¹²⁵ Such concerns are also present within industry itself. A Long-term Credit Bank of Japan survey in July 1987 found that outbound investment "could have an increasingly adverse effect on domestic investment and employment".¹²⁶

Finally, the Japanese government failed to influence the state distribution of FDI within the European Community. One industry locational specialist stated that "In the case of Japan, there is a sense of gently political pressure from MITI on Japanese companies not to favour Britain as much as in the past."¹²⁷ However, as the statistical representation above shows; in the EC-Japan 'era of investment' there was no significant trend away from liberal locations.

CONCLUSION

The presence of foreign firms poses a greater challenge to *coordination* within an integrating political regime, than it does to the authority of the state itself. The preceding treatment of

¹²⁴ MITI encouraged the Japanese photocopier sector to "increase its overseas production to ease trade friction." *Mainichi Daily News*, 3 June 1987, p.7.

¹²⁵ *Interview*, Yuji Hosoya, Deputy Director, International Business Affairs Division, Industrial Policy Bureau, MITI, Tokyo. 16 June 1993.

¹²⁶ *The Japan Times*, 19 September 1987. p.5.

¹²⁷ David Rees as quoted in *The Financial Times*, 9 March 1993. p.15.

EC member states' policies toward EC-Japan foreign direct investment reveals a considerable divergence between member states' perspectives over how to enhance EC economic welfare. States remain greatly influenced by their historical regulatory dispositions towards external investment. France's preference for 'statist' intervention and the UK's preference for total openness to Japanese FDI, were both policies based on the judgements of legitimate political authorities. Change in dispositions of non-liberal member states was greater than that in liberal states, who capitalised on the rise in FDI flows at an early stage, reinforcing historical propensities. The prevailing liberal evolution of the single market, in so far as policy towards FDI was concerned, was driven by bargains between Japanese firms and liberal states, and acted as a catalyst to reluctantly (although belatedly in terms of gains) moderate the prior French and Spanish dispositions. Italy was largely resistant to EC-wide liberal change in this regard.

In their relations with one of the dynamic forces of global *economic* integration (foreign direct investment) EC member states played a central role in EC policy formulation and in setting the constitutional limits of certain EC competencies. The alliance of Japanese firms and liberal Community states (and sub-states) regarding FDI matters, was one of the pivotal determinants in putting the Single Market Programme on a liberal trajectory. The shift from trade to *trade plus investment* in the global political economy - led by large Japanese firms, implied a central role for European states due to the demarcation of trade/investment competence within the EC. Additionally, whilst the Commission negotiated trade agreements, states retained trade promotion. Options for EC institutional reaction were curtailed due to the economic 'membership' status of Japanese firms - a result of FDI bargains with liberal states. The Commission repeatedly called for more conformity regarding inbound FDI attraction incentives. At the close of the period, the Council (The UK and Ireland) blocked Commission attempts to even have non-binding guidelines for FDI brought under Community competence. The dispositions of several member states (and sub-states) undermined the 'internal' logic of the new western European market space. Simultaneously an unprecedented era of multi-leveled EC-Japan co-operation was facilitated by Japanese FDI. *Economic* integration adopted to the bargaining channels of the *political economic* integrating unit to further spread global economic integration. The following chapter examines the extent to which economic integration supersedes and even undermines regional political integration.

CHAPTER V EC INSTITUTIONS AND JAPANESE INVESTMENT

INTRODUCTION

Foreign direct investment is a firm-originating phenomenon with important systemic consequences. This thesis focuses on the implications of Japanese foreign direct investment for the European Community, and analyses European integration as revealed in its reaction to Japanese firms, 1985-93. This chapter focuses on EC institutional-level actions and reactions towards increased FDI from Japan.¹

Foreign direct investment involves negotiations between TNCs and host territorial authorities. The preceding analysis shows that such bargaining is multi-leveled - even within states. The increased volume of FDI draws attention to the trans-state strategies of firms, underlining that FDI and trade (although frequently influenced by host conditions) are essentially firm originating phenomena.

The structure of the EC, and the demarcation between trade and investment policy in European Commission legal competence are important conditional elements in EC-Japan affairs. Trade and trade policy constitute a prelude and context for investment by Japanese firms. The application of EC trade policy in the period was largely *reactive*; the Single European Market programme an *active* measure. The evolution of the Single European Market programme and the Commission's attempts to regulate Japanese FDI were closely intertwined. Japanese and other external firms played a direct political role in the evolution of the market in a neo-liberal direction. Due to their competitive position, Japanese firms were among the first to test the applicability of the Freedom of Movement principle to exogenous firms (1988/89), which strongly influenced France's position on FDI. The Commission attempted to regulate the component sourcing of Japanese firms within the EC territory by an extension of anti-dumping rules in 1987, which drew a GATT ruling in favour

¹ 'EC level' connotes the Commission of the European Communities, the Council, COREPER [the committee of permanent representatives in the Council of the EC] and the European Parliament.

of Japan in 1990. Attempts to reinterpret the Community's rules of origin seriously divided the Council in 1989. The limited Commission competence in the sphere of FDI regulation had direct implications for the exercise of trade policy.

The lack of FDI regulatory powers can be traced to the era of the preeminence of trade policy, when global FDI volume was much lower than in the 1980s. The Commission's attempts to strengthen its position in this regard was challenged not only by liberal states, but by the alliances between liberal states, sub-states and global capital and production. Negotiating European FDI access in Japan emerged as one area in which the Commission enhanced its powers.

V.2 THEMES

Japanese political elites and firms have experienced varying degrees of understanding and confusion regarding the evolution of the Common Market and its nominal successors. The Japanese government expressed concern regarding access to European markets following the Treaty of Rome. However such anxiety eased following the collapse of Britain's first accession attempt. In an interview in 1992, Mr. Masae Harashima, Manager at Price Waterhouse in Brussels said: "The Japanese are beginning to understand what the EC can do and what the EC cannot do."²

Through the 1980s, and in particular following their investment experience in the U.S., Japanese firms became more adept at information gathering on their own account - effectively reducing the role of the Japanese Ministry of International Trade and Industry (MITI) in their international strategies. The political analysis of EC-Japan relations thus cannot be limited to EC Commission-MITI dialogues. As indicated by Mr. Harashima, firms are aware of where regulation rests and are aware of where and when to deal with different levels of political authority, whether the Commission of the EC, member states, sub-state regions or

² *Interview* with Mr. Masae Harashima, Manager, Price Waterhouse, Brussels, 20 August 1992.

municipalities.

EC-Japan relations since 1985 have been radically transformed by the growth of investment, which renders obsolete an approach to international relations founded completely on inter-state relations. Investment has introduced Japanese firms and European regions to the forefront of the relationship. Theories of European integration are useful in focusing attention on medium and long-term trends within the EC. In this analysis, no single theory of integration is found to be sufficient. The conclusion will examine the extent of integration, and the extent to which political integration may be superseded by global economic integration.

Functionalism, which implies an almost 'natural' progression towards integration, emphasises economic forces and the ways in which they must be, largely reactively, managed by governments and international organisations. Neo-functionalism, which as a theory is closer to explaining the evolution of the EC, places greater emphasis on political decision-making in the process of integration. In the EC-Japan relationship since 1985, neither of these theories neatly apply. There is no evidence that a common EC stance towards Japan is evolving automatically. The evolution of a *communautaire* competence in EC external trade policy has been continuous since the 1960s. This has been slow however, and was hampered from within the EC itself by the member states. Such a dynamic is prominently highlighted in inter-governmental explanations of the development of the Community. In the era of the Single European Act the trend towards a more unified EC approach to relations with Japan, has been challenged from an external source - firms which are capable of investing within the EC. Although Japan may have appeared to have been an initial 'external federating' force in prompting the competitiveness enhancing strategy manifest in the SEA; the actual evolution of the Single European Market has not had a federating effect.

An important feature of relations between the EC and Japan is the extent to which they are dominated by matters of economic diplomacy. On the Japanese side, there has been a consistent attempt to broaden the European agenda to include issues of a 'purely' political nature. The Commission's agenda with Japan primarily concerns issues of economic concern.

The 'high/low'³ distinction is methodologically useful in the analysis of the *strategies* and *positions* of the Commission and the Japanese ministries. The political nature of international economic activity has become more acute in the age of FDI. Robert Gilpin has written that "the phasing out of declining industries and creating of new growth sectors have powerful political effects."⁴ In this context, economic activity and regulation have played a major causal role in the constitutional evolution of the EC through the 1980s, occupying an important place in the 'high' political agenda.

Foreign direct investment has a tendency to *internalise* an external relationship - if relations between two states predominantly consist of economic affairs. That is, dealings with a predominantly exporting power, become transformed into a relationship of internal regulation when FDI becomes a major factor. There is thus a *geographical* shift in the locus of the relationship. Japanese firms maintained a far greater degree of collective behaviour than their European counterparts in the period 1985-93. The response of Japanese manufacturing firms - to trade measures such as anti-dumping, or SEA attempts to enhance competitiveness, were broadly in unison. However in the case of European firms - harmony between them has frequently broken down in the face of individual corporate alliances with technologically more competitive external firms.⁵

Corporate alliances are thus a vital aspect not only of international business, but of international relations. The nature of alliances in their impact on political authority has a significant geographic aspect. Thus far, Japanese firms have been better able to use the 'alliance geography' to their advantage - largely due to their capacity for outbound investment and the difficulties encountered by foreign firms in investing within Japan.

EC-Japan relations can therefore be seen in the context of two forces of integration: political or *de jure* integration in western Europe; and the global, economic or *de facto* integration of

³ See Ch.II

⁴ Gilpin, Robert with Jean M. Gilpin, *The Political Economy of International Relations*, Princeton University Press, 1987, p.32.

⁵ As exemplified by the breakdown of CECOM, the European photocopier pressure group.

Japanese firms. In this paradigm there are two competing political 'geographies.' One based on twelve member states (1985-93) the other with few, if any boundaries.

V.3 STRUCTURE OF THE EC: RELATIONS WITH JAPAN

Trade and investment dynamics are inextricably linked. External trade policy - along with the Common Agricultural Policy - is the most evolved legal competence of the EC. The experience of the Commission in attempting to harness state positions in the realm of 'Japan policy' was an important prelude to the advent of Japanese FDI in the Community. Commission action to enhance competitiveness through the Single European Market was prompted by a perceived lack of competitiveness *vis-à-vis* the U.S. and Japan.

Since the late 1980's, large Japanese firms have established monitoring offices in Brussels. These 'antennae' missions constitute an important parallel to the official-level contact between the Commission, (DGI and other DGs in Brussels, the Tokyo Delegation) and the Japanese government (MITI, the Ministry of Foreign Affairs and other ministries, and the Japanese delegation in Brussels). On the EC side, relations with Japan are handled primarily by DGI⁶ with the Council, COREPER, the 113 Committee⁷ and other committees such as that on rules

⁶ In mid-1993 DGI was reorganised in recognition of the Maastricht Treaty framework and the enhanced position of EPC/CFSP [European Political Cooperation/Common Foreign and Security Policy]. Under the new structure DGI dealt with external trade matters, as previously - whilst DGIa was in charge of non-commercial external relations. The demarcation was adjusted once more in October 1994 with the Brittan/Van den Broek portfolio carve-up. Hans van den Broek was given responsibility for both political *and* economic relations with central and eastern Europe, while Leon Brittan retained overall multilateral trade responsibility. (*The Financial Times*, 31 October 1994, p.2.)

⁷ This Committee is named for the Treaty of Rome article on the Common Commercial Policy. The 113 Committee is constituted of member-state officials and assists the Commission with coordination of external commercial policy. Rothacher, Albrecht *Economic Diplomacy between the European Community and Japan 1959-1981*. Gower, Aldershot, 1983. pp.26-27.

of origin also playing important roles.⁸ With steeply rising levels of Japanese direct investment during the late 1980s, the Competition (DGIV), Industrial Affairs (DGIII) and Single Market (DGXV) Directorates General became more directly involved in EC-Japan affairs. In addition to the formal structure of diplomacy, Commission officials and their Japanese counterparts meet at the WTO⁹, the G-7 and other international conventions. However the discussions in the margins of these assemblies tend towards the general, whilst Commission-MITI bilaterals treat specific issues. Additionally, the European Parliament and the Japanese Diet hold consultative inter-parliamentary conferences annually. Although this forum would appear to be ideal for bi-lateral exchange involving new constitutional players, the discussions tend towards the global and futuristic; for example giving issues such as UN reform approximately the same amount of agenda time as EC-Japan trade relations at the 1993 conference.¹⁰

In addition to these contacts, the Commission maintains a delegation in Tokyo, which is considered to be its second-most important external delegation after Washington DC.¹¹ Prior to 1973, EEC matters were handled through the Belgian embassy in Tokyo. The Head of Delegation only attained the rank of Ambassador with the assumption of the post by Ambassador Leng in 1990. The daily business of the delegation involves matters of co-ordination between member states, and communications with diverse Japanese ministries. On matters of high priority, negotiations are frequently conducted by Brussels-based Commission specialists. Such is the case for example with DGIII officials and the annual negotiations in the framework of the 1991 EC-Japan automobile *elements of consensus*. In times of particularly important negotiations, Commissioners may be present in Tokyo to support

⁸ The most comprehensive account is by Simon Nuttall: 'Foreign Policy Making in European-Japanese Relations: EC approaches' in Von Heynitz, A. and H. Maull (eds.) *European-Japanese Relations: the next phase*, conference proceedings, Stiftung Wissenschaft und Politik, Ebenhausen. November, 1989.

⁹ GATT prior to 1st January 1995.

¹⁰ EC-Japan Inter-parliamentary Conference, Diet Building, Tokyo, 31st May/1st June 1993. Author's notes.

¹¹ Former heads of the EC delegation in Tokyo include one ex-Prime Minister (Van Agt) and one ex-Minister (Brinkhorst).

negotiating officials.¹²

The difficulty of the task of member state co-ordination has been complicated with the advent of increased FDI, unevenly spread through the EC since 1985. Member state councilors at the embassies in Tokyo regularly meet their Commission counterparts at the delegation to discuss matters of mutual concern (usually by sector). An example of such is the Agricultural Councillors of the 12 who would meet the delegation councillor to discuss common matters. These meetings however, are largely consensual and 'front line' cooperation frequently exceeds that at the level of Council. The task of coherently orchestrating EC member state positions is one which falls more within the functional remit of the higher levels of DGI in Brussels, and consultations between the member states.¹³

The EC-Japan agenda overlaps with the competence of the EC Commission to a high degree in trade, but not in international investment matters. Trade policy and investment policy are not executed at the same level of political authority as the EC is constituted. The term 'policy' is problematic when applied to investment matters since the EC Commission approach to investing firms is not enshrined in a stated 'investment policy' but is disfracted through the competence of many Directorates General. The Commission does not have a legal mandate to lay down such a policy, as is the case with external trade matters. Further, the disposition of the Commission underwent considerable change during the period under

¹² Commission Vice President Bangemann's visit overlapped with high level negotiations in March 1993.

¹³ The role of the delegation has been criticised by those who feel that attempts at coordination are inefficient. James Bourlet, then at Keio University, argued that EEC uniform trade policy had failed the member states and that the high profile of Commission criticism of Japanese market access had exacerbated the trade deficit by "frightening many European businesses away from the Japanese market or away from making the necessarily high marketing investment and commitment here." *The Times*, 11 August 1986. This illustrates the difficult role of the delegation in Tokyo, which is simultaneously criticised for not applying enough pressure to alleviate such problems. The build-up to the 1992 Programme enhanced the profile of the Community and its institutions. Some however remain sceptical that this reconstitution will lead to greater power in the international arena. One such is James C. Abegglen, Chairman of Gemini Consulting (Japan): "I don't think the EC has a credible negotiating position here - that may be changing, but I don't think so." *Interview*, 13 April 1993.

review. There are two principal reasons for this, directly relevant to EC-Japan relations.

Firstly, the Single European Market 'blueprint' evolved in a neo-liberal direction; and secondly, Japanese firms, by allying themselves with liberal states and a plethora of sub-states, had a direct impact on the evolution of the market and the ability of the Commission to respond to FDI. In the case of Japanese FDI, there existed a strong causal link between Commission initiatives and the decisions of Japanese firms to invest. In the implementation of an FDI 'policy' however, the Commission has a minor and indirect role - one which was partially limited by Japanese firms themselves.

Japanese direct investment in the Community existed at a low level before the 1980s.¹⁴ The Commission's enhanced external trade powers - were used in part, and largely unintentionally, to drive Japanese firms into bargains with the member states and member state regions. This could be said to constitute a form of 'counter-neo-functionalism' whereby an EC orchestrated initiative actually accentuated bi-lateral relations with an external commercial power. More plausible however is that the advent of high volume global FDI facilitated such bargains.

The EC Commission in its relationship with Japan, relied on the development of a *de jure* trade competence through the 1970s and early 1980s. This development was succeeded by the *de facto* reality of investment - a form of economic integration, which posed a challenge to the structural, territorial, *de jure* approach to integration. While the Commission's relationship with Japan relied on structure and legality, the 'front-line' realities outside of the legal competence - such as the sudden advent of Japanese FDI involved strong roles for the member states and sub-states.

At a time when trade policy and investment policy are being intertwined within member

¹⁴ Mark Mason provides a thorough overview in 'Historical perspectives on Japanese direct investment in Europe', in Mason, Mark and Dennis Encarnation (eds.) *Does Ownership Matter?* Clarendon Press, Oxford, 1994. Chapter 1.

states¹⁵ the lack of a formal Commission investment policy could represent a limit to integration in the formerly leading integrative sphere of external commercial policy. As will be argued below, there is even the possibility that the lack of a Commission policy on FDI could lead to the unravelling of the Commission's trade competence with Japan.

V.4 Trade and trade policy: prelude and context for FDI and FDI response

"Foreign trade is a war in which each party seeks to extract wealth from the other."¹⁶ This oft-quoted line of Honda Toshiaki serves as a reminder that the stakes in international commercial transactions have long been recognised and contested. In recent times, this axiom has been applied to EC-Japan trade deficits, investment imbalances and market access conditionalities. Tensions over such issues have frequently been expressed in Commission statements which have stressed the gains which Japan and Japanese firms have made under the liberal international economic system.¹⁷ The Commission has contrasted such liberalism with the relative closedness of the Japanese domestic market. At the delegation in Tokyo,

¹⁵ At interview, Mr. Rui Boavista Marques, Manager, Investment Department, *Investimentos, Comercio e Turismo de Portugal* (ICEP), said that previously his office had only dealt with trade matters, but now ICEP assumes responsibility for inbound and outbound investment, tourism and trade. This flexible measure is in response to the late 1980s boom in Japanese FDI. *Interview*, Tokyo, 8 July 1993. The Irish inbound investment authority (The IDA) and the Irish trade board (*An Bord Trachtála*) consolidated their offices in Tokyo in September 1994.

¹⁶ Honda Toshiaki (1744-1821) quoted by Endymion Wilkinson, *Japan Versus the West, image and reality*, Penguin, 1990, p.160.

¹⁷ For example Vice-President Andreissen speaking in Tokyo in 1989: "Japan has become by now a major economic, financial and technical power. This dramatic transformation has only been possible because Japan was able to take full advantage of the free world trading system established after the war - in other words, its prosperity is based to a large extent on the openness of markets with a high purchasing power." *Speech* at the Foreign Correspondents' Club, Tokyo, 6 October, 1989. *EC News*, PR 15/89. Emile Noël, Honorary Secretary General of the EC Commission stressed conditions for access to the Japanese market: "...outside Japan - and perhaps in the country too - it is felt that only a reform of the Japanese distribution system to make it more like that of other OECD countries can lead to a more balanced structure for Japanese foreign trade, closer to that of its chief partners." *Speech* at the Foreign Correspondents Club, Tokyo, 6 November 1989, *EC News*, PR 18/89, p.9.

Ambassador Jean-Pierre Leng identified "an evident misperception and mistrust overshadowing the EC-Japan relationship and impeding its deeper development."¹⁸ It is not surprising that the Commission dwelt upon trade difficulties when indeed trade has been its primary external concern; and when economic affairs constitute the bulk of the EC relationship with Japan. However, the shift in firm strategy from trade to *trade plus investment*, particularly in the second half of the 1980s, led to a greater overall cooperative regime between the EC and Japan. To the extent that political authorities were important to the evolution of this regime, the states and sub-states were to the fore. FDI, the biggest force for *de facto* EC-Japan co-operation therefore has occurred largely outside of the reach of the Commission.¹⁹

The EC-Japan trade deficit, and increased Japanese investment in the EC, are two of the most important features of EC-Japan relations in recent decades. The trade imbalance between Japan and the EC, which had become politically sensitive in the Community by the end of the 1970s, was caused more by the dynamic expansion of the Japanese economy than the relative stagnation of EC economies; although both factors are important. A Keidanren²⁰ position paper of March 1993 refers to a "comparative advantage [which] lies with Japan for product groups with particularly large markets, such as motor vehicles and electronics, and with the EC for product groups such as special purpose machine tools, chemicals and luxury goods, which have relatively smaller markets."²¹ The sectors of consumer electronics and automobiles are the two most contested between the Commission and Japan. Consumer electronics have been at the centre of the arguments regarding trade policy and its extension

¹⁸ *Japan Times*, 26 September 1990.

¹⁹ The Japanese government continues to foster links with both the Commission and the member states: "Japan remains unsure of whether to limit its contact to the supranational institutions (the European Commission) or to retain strong bilateral links with individual member states." *The Politics of European-Japanese Relations in the mid-1990s*, conference report by Penny Henson, University of Reading, 1995. p.6.

²⁰ Japan Federation of Economic Organizations which represents about 1,000 Japanese firms.

²¹ Keidanren 'Future Relations Between Japan and the EC' *position paper*, Tokyo, March 1993. p.3.

into attempted local content regulation of parts (V.10 below) and rules of origin (V.11); while the automobile industry was occasion for Japanese testing of the principle of free circulation of goods to external firms (V.6) and the major EC-Japan automobile agreement of 1991 (V.12).

Japanese officials such as Ambassador Tomohiko Kobayashi, have placed the trade deficit in the context of other forms of exchange; the employment benefits of FDI - essentially the recycling of the trade-generated surplus - and greatly increased Japanese tourism in EC member states.²² The Commission stressed throughout the period that it was not occasional deficits *per se* which were of concern, so much as a structural, annual deficit with Japan.²³ However, the negative nature of deficits has been sharply contested. Paul Krugman has asserted that "...in both theory and practice a trade surplus may be a sign of national weakness, a deficit a sign of strength."²⁴ For the EC Commission and to varying degrees, EC member state governments, the recurrent trade deficit with Japan is essentially a negative phenomenon; and the *concept* of trade deficit has long since entered the political arena as anathema. It is this reality - even though it may be a reality of *perception* - which has remained in the European political agenda of EC-Japan relations since the late 1970s.

One of the contested areas of the negative impact of deficits debate, is the alleged relationship between deficits and unemployment. This link is one which EC Commission officials consistently have alluded to or openly claimed, and one which Japanese officials have persistently denied. The European Parliament has also addressed the matter. James Moorhouse, an MEP who produced two substantial reports on EC-Japan affairs (1986, 1993) stated at the 1993 EP/Diet inter-parliamentary meeting: "While on the one hand the economic pundits say that this is a matter of little concern; those of us in politics are very concerned

²² Kobayashi, Tomohiko 'Tokyo looks for closer ties with a stronger Europe' *The Financial Times*, 3 July 1992. p.2.

²³ Horst G. Krenzler, DGI, Director General External Relations, EC Commission, *news conference*, EC delegation, Tokyo, 20 April 1990.

²⁴ 'Competitiveness: A Dangerous Obsession' in *Foreign Affairs*, March/April 1994, p.31. James C. Abegglen concurs: "Bi-lateral deficits are not necessarily bad." *Interview*, Tokyo, 13 April 1993.

about the impact [of the deficit] on employment in Europe."²⁵ On the Japanese side, the matter of deficits and unemployment is sensitive, and Japanese officials and firms have been keen to stress the job-creating dimension of FDI. Interviewed in April 1993, Mr. Teruhiko Mano²⁶ who led a Keidanren mission to Brussels and authored an influential report on EC-Japan economic matters; vigorously denied any link between the trade deficit and unemployment in Europe and made representations to this effect directly to President Delors.²⁷ Nevertheless, concern about the trade deficit was the priority on the EC side. In the words of Shigeru Horikoshi, adviser, at a Japanese commercial bank in Brussels in 1992: "governments interfere when there is a problem. And of course there is a problem with the trade imbalance."²⁸ Since external trade policy has been within the legal competence of the EC Commission, this has been the most visible area of EC representational activity in EC-Japan relations.

The situation regarding trade policy differs substantially from that which prevails in the realm of inbound FDI 'policy' - where competence is retained by the states. Japanese firms and the Japanese government played a role in the bargaining which sustained the limited EC-level competence in inbound FDI matters. Before turning to that evolution, it is firstly necessary to look at the specific exercise of trade policy towards Japan in the years leading up to the surge of FDI.

²⁵ James Moorhouse, Euro-MP for London South & Surrey East, speaking at the 14th EP/Japan inter-parliamentary meeting, Diet Building, Tokyo, 1 June 1993. Author's notes. EC ambassador in Tokyo, Jean-Pierre Leng concurred: "It is impossible to conceive that in a very serious crisis in Europe, especially with high unemployment that there will not be a backlash against Japanese trade." *Press conference*, EC delegation, Tokyo, 17 June 1993. Dr. Malcolm Trevor, Director of the EC-Japan Centre for Industrial Cooperation, said that the deficit "was becoming very dangerous." *Interview*, 31 March 1993.

²⁶ Advisor to the President of the Bank of Tokyo.

²⁷ *Interview*, Mr. Teruhiko Mano, Tokyo, 7 April 1993. This position is shared by a Japanese Ministry of Finance official, Masaki Omura. Discussion at Canon Foundation/European University Institute conference, Fiesole, June 1994.

²⁸ *Interview*, Shigeru Horikoshi, adviser, Ogaki Kyoritsu Bank (Europe), Brussels, 22 July 1992.

V.5 ANTI-DUMPING: LEGAL INSTRUMENT AS REACTIVE TRADE POLICY

In 1948 anti-dumping measures were agreed by GATT to be a legitimate means of protecting 'free trade.' Firms are deemed to be dumping if it can be demonstrated that they are selling in an external market at prices lower than their domestic market. The EC's anti-dumping law (which has undergone several revisions) dates from 1968.²⁹ Although the U.S. has used anti-dumping measures³⁰ the main thrust of Japan policy has involved both explicit and implicit critiques of the endogenous features of Japanese markets and society. An example of such a policy is the Structural Impediments Initiative (SII). By contrast, the EC Commission has, in trade policy, been largely reactive and has relied on measures such as anti-dumping duties.³¹ The instrument of anti-dumping became even more important in EC-Japan affairs with the controversial EC decision to extend its usage to cover component parts.

The Commission also increased its export promotion drive in the 1980s. The Export Promotion Programme for Japan and the EC-Japan Centre for Industrial Co-operation³² were established to attempt to redress the massive imbalance in trade between the Community and Japan. Throughout the 1970s and 1980s Japanese goods became increasingly visible in the European market, but up until the mid-1980s Japanese investment in the EC was comparatively low. Two major EC developments were influenced by external competition from Japan - the evolution of the Single Market Programme and the increased use of anti-dumping measures. Japan was not the only spur to these developments. However, Japanese

²⁹ Van Bael, Ivo and Jean-François Bellis *Anti-Dumping and other Trade Protection Laws of the EEC*, 2nd ed. CCH editions, Bicester, 1990. p.23.

³⁰ Simon Reich writes: "The issue of America's uncompetitiveness is often reduced to congressional accusations of dumping being leveled against foreign producers who, it is claimed, are cheating at some mythical "rules of the game" - a tactic designed to intimidate both foreign firms and their governments in order to encourage the firms to shift part of their manufacturing production to the United States. In this context, "foreign" is often the euphemism for Japanese." 'Roads to Follow: regulating direct foreign investment,' in *International Organization*, 43, 4, Autumn 1989. p.545.

³¹ Mr. Peter Doyle, Press Secretary, EC Commission delegation, Washington D.C., stressed this aspect of the EC approach. *Presentation*, E.U.I., October 1991.

³² Founded in 1979 and 1987 respectively.

firms, by increasing market share, exposed the low level of European competitiveness. As Robert Keohane and Stanley Hoffmann have written: "decisive moves toward the Single European Act were delayed until the perception of crisis was widespread."³³ However, the Commission cannot be faulted for the degree of *reaction* in its policy towards Japan, since it had been advocating an *active* unified EC approach from the early 1960s when it was jealously denied a negotiating mandate by the Council.³⁴

Anti-dumping was not the only measure which could provide protection for European industries. However, since anti-dumping (a Community competence) was increasingly applied in the 1980s, it became the most important aspect of the EC's response to Japanese expansion into European markets. Strictly defined, anti-dumping is a legal instrument. In this period however, it was used as an instrument of EC trade policy. Anti-dumping has not been used against Japanese firms alone, nor disproportionately to Japan's trade volume.³⁵ Japanese firms *are* however among the few anti-dumping defendants to be in a position to significantly effect the EC and EC regulation, through foreign direct investment. The increased and broadened use of anti-dumping actions led to the growing *internalisation* of Japan's relationship with Europe; a development which has greatly increased the complexity of EC-Japan relations.

One sector in which the anti-dumping policy was fully played out was that of photocopiers. At the beginning of the 1980s there were nine indigenous photocopier manufacturers in the Community. Ten years later, only Rank Xerox (UK) and Oce (The Netherlands) were fully

³³ Keohane, Robert O. and Stanley Hoffmann, 'Institutional Change in Europe in the 1980s', in R.O. Keohane and S. Hoffmann (eds.), *The New European Community: decision-making and institutional change*, Westview Press, Boulder, 1991. p.23. The principal architect of the Single European Act, Jacques Delors stated: "We have to move fast, or Europe will become an archaeological site where the Americans and Japanese will come to dig over defunct ways of life", *The Sunday Times Magazine*, 15 September 1991, p.26.

³⁴ Rothacher, Albrecht, *Economic Diplomacy between the European Community and Japan, 1959-1981*, Gower, Aldershot, 1983. Chapter 4.

³⁵ Yoshitomi, Masaru and the Sumitomo-Life Research Institute, *Japanese Direct Investment in Europe*, Vol. II of the Joint Project on Japanese Investment in Europe, Avebury, Aldershot, 1991, p.32.

independent or non-reliant on Japanese manufacturers. Even these had distribution links with Japanese manufacturers by the early 1990s. European manufacturers of photocopiers reported in 1985 that the Japanese share of the ECU1bn. EC market had increased from 50% in 1980 to 85% in 1985.³⁶ A group of European firms formed the Committee of European Copier Manufacturers (CECOM) in March, 1985, "with the sole purpose"³⁷ of pressuring the EC Commission to investigate the possibility of dumping by Japanese manufacturers on the European market. The five CECOM firms, Rank Xerox (UK), Olivetti (Italy), Oce (The Netherlands), Develop (West Germany) and Tetras (France); "by making a joint approach to Brussels, increased their credibility by arguing from a common position instead of appearing as individual companies each trying to protect its private commercial interest."³⁸ The EC firms in this group presented the Commission with pricing information which could be used in determining whether or not Japanese photocopier manufacturers were in fact engaged in dumping.³⁹ If the industry complaint were substantial, the Commission would find it difficult not to take action. Such information as is reviewed by the Anti-Dumping Directorate in DGI is of a 'commercially confidential nature.'⁴⁰

While the percentage share of the European photocopier market held by European firms was only 15% at the time CECOM presented its case to the Commission, according to Rank Xerox a successful dumping action would "result in regaining opportunities for the remaining European manufacturers."⁴¹ Trade lobbying became an important part of commercial strategy for European firms whose market share was diminished by Japanese competition.

³⁶ *Financial Times*, 2 August 1985, p.4.

³⁷ *Interview*, David Whibley, legal department, Rank Xerox (UK), 31 March 1992.

³⁸ Philip, Alan Butt, 'Pressure Groups in the EC and Informal Institutional Arrangements', in Beuter, Rita and Panos Tsakaloyannis (eds.), *Experiences in Regional Cooperation*, E.I.P.A., Maastricht, 1987. p.83. Also, Lodge, Juliet 'EC policymaking: institutional considerations' in Lodge, Juliet (ed.) *The European Community and the Challenge of the Future*, Pinter, London, 1989. p.52.

³⁹ *The Financial Times*, 2 June 1986, p.23.

⁴⁰ Fielding, Sir Leslie, letter to *The Financial Times*, 19 June 1986, p.23.

⁴¹ Bake, James, letter to *The Financial Times*, 10 June 1986, p.23.

Since the anti-dumping instrument is exercised by the EC, European firms frequently look to Brussels rather than their home government when formulating a strategy to seek protection. Very often, as was the case with the UK and the Netherlands, such firms are bypassing unsympathetic national governments in the pursuit of protection.

The calculation in anti-dumping investigations is complex. In determining whether or not dumping is taking place, the Commission can use 'constructed' prices. The reconstruction of the cost chain back to the Japanese manufacturer, and the way in which such reconstructed prices are compared have been challenged.⁴² One analysis finds that "Japanese pricing reverses western practice."⁴³ Whereby Japanese firms begin with a targeted market share, and trim costs of manufacture in order to compete effectively for that share. European firms tend to add up costs to determine entry price. With a great deal of interpretation available, such a process becomes inevitably political. The ultimate decision on whether or not to proceed with the imposition of anti-dumping duties on Japanese imports, is made by the Council, after the Commission's recommendation which is prepared with the knowledge of the member states' permanent representatives in Brussels. The Commission's investigation is made within DGI.⁴⁴

In August 1986 the Japanese firms investigated in response to CECOM accusations were declared to be dumping photocopiers and fined up to 15.8% in duties, increased to 20% in February of the following year.⁴⁵ Advocates of anti-dumping point out that such measures prevent the further erosion of European firms' market share and provide opportunities to

⁴² For example Messerlin, Patrick A. and Noguchi Yoshiyuki 'The EC Antidumping and Anticircumvention Regulations: a costly yet futile exercise, the case of photocopiers' *draft working paper*, Paris, 1991; and Curzon-Price, G. and V. 'Follies in European trade and relations with Japan' in *The World Economy*, Vol.10, No.2, 1987. pp.155-176.

⁴³ *The Economist*, 4 April 1992, p.20

⁴⁴ DeAnne Julius has questioned the structural demarcation of EC institutional activity in this area; "the burden of proof and enforcement in such cases should rest with competition policy, not with trade or FDI policy." *Global Companies and Public Policy: The growing challenge of foreign direct investment*, RIIA, Pinter, London, 1990, p.99.

⁴⁵ *The Financial Times*, 26 August 1986, p.1, and 24 February 1987, p.6.

increase that share. On the other hand, a 1989 UK House of Lords report on EC-Japan relations, concluded that although protection was sometimes needed "some industries have been given 'illegal' protection, in a haphazard fashion, under the cover of anti-dumping rules and voluntary restraint agreements."⁴⁶ Opponents of anti-dumping point out that such duties are against the European consumer interest by increasing the unit price of the 'dumped' item. The application of protection may also compromise EC efforts in Japanese 'market access' negotiations. In the 1970s, the arguments for greater European access to the Japanese market were weighty. Japan was exporting to the EC, unaccompanied by major investment, and her own market was more inaccessible than in the early 1990s.

Anti-dumping actions can have an adverse affect on firms which act solely as distributors of Japanese products. Many of these are of long standing within the EC. The Joint Chairman of Gestetner Holdings, a UK distributor of Japanese photocopiers has even gone so far as to suggest that firms which pressure the Commission into anti-dumping investigations are simply being litigious in pursuing individual firm goals.⁴⁷

In 1987, while surveying the legal instruments available to the EC's external trade directorate, Marco Bronckers stated that "Japan has opted for quiet though persistent diplomacy. Yet, as a matter of law, nothing in the GATT precludes Japan from formally disputing important restrictions on its products in the future."⁴⁸ In an interview with the President of Canon Italia SpA, the point was borne out: economic problems tended to become political, and MITI requests Japanese companies abroad to "harmonize the international relationship."⁴⁹ Japanese

⁴⁶ House of Lords Select Committee on the European Communities, *Relations between the Community and Japan* [13th Report, session 1988-89], *Report*, p.26.

⁴⁷ In the view of Jonathan Gestetner, "yesterday's patent suit is today's anti-dumping action." Letter to *The Financial Times*, 4 June 1986, p.25.

⁴⁸ Bronckers, Marco C.E.J., 'A legal analysis of protectionist measures affecting Japanese imports into the European Community - revisited', p.92, in J.H.J. Bourgeois et al (eds.), *Protectionism and the European Community: import relief measures taken by the European Economic Community and the member states, and the legal remedies available to private parties*, 2nd ed., Kluwer, Deventer, 1987.

⁴⁹ *Interview* with Mr. Takashi Saegusa, President, Canon Italia SpA, Milan, 7 April 1992.

criticism of anti-dumping in the mid-1980s focused on the constructed market price used by the Commission and a perceived 'political' element in the application of anti-dumping rules. Bronckers' 1987 assessment that Japan could have recourse to GATT was prophetic. As discussed below, Japan won an important GATT panel ruling against the EC on the issue of the extension of anti-dumping measures to cover components used in Japanese plants within the EC. (V.10 below)

With some anti-dumping investigations, the threat of duties is withdrawn following Japanese firm 'undertakings' to adjust prices. Where it is obvious however that an investigation will lead to duties being imposed, a Japanese short-term response in the photocopier sector was to stock up on photocopier units in advance of the imposition of duties. However, the main consequence of anti-dumping for Japanese firms was increased FDI. Pat Choate, analysing Japanese lobbying efforts in Washington, stresses the policy-influencing efforts of Japanese firms and their lobbying agents.⁵⁰ The main ambition of Japanese representatives in Brussels was not so much to influence EC policy directly, but rather to gather information for use in firm (location, relocation or exit) strategies. Firms with large resources and complex trans-national interests, devoted greater effort to avoiding, or preparing for unfavorable conditions in national and international jurisdictions. Such resources are impressive; placing regulatory organizations in a reactive position when trying to 'contain' their activities.

In the late 1980s Hitachi⁵¹, Fujitsu, Victor, Mitsubishi Electric⁵² and other Japanese firms set up representative offices in Brussels. This strategy was partly motivated by the need for information relating to the 1992 programme. It was also aimed at assessing the impact of EC regulations, standards and competition policy on firm activity - including what we may call 'new zone' regulatory activity of the Commission in areas such as the extension of anti-dumping to component parts and the reinterpretation of rules of origin. According to Higashi

⁵⁰ Choate, Pat, *Agents of Influence*, Knopf, New York, 1990.

⁵¹ *Interview* with Mr. Michio Sasamori, Manager, Hitachi European Business Development Dept., Overseas Operations Promotion Office. Tokyo, 30 June 1993. "We gather information and try to have good relations with the Community." The company has other such offices in Washington DC and Los Angeles.

⁵² *The Japan Economic Journal*, 19 August 1989, p.7.

and Lauter "MITI is encouraging companies to set up 'antenna offices'.... in Brussels to follow the various developments more closely."⁵³ This is indicative of the changing role of MITI in the EC-Japan relationship. In former decades, MITI was the primary collector of such information, making it available to firms. By the late 1980s, the emphasis was on firm-based information gathering, with MITI encouragement.

Lack of consensus between member states on issues of common commercial concern towards Japan are likely to arise in the EC anti-dumping committee, the rules of origin committee, COREPER, or the Council. The position of national governments on anti-dumping is largely determined by the prevailing view of industrial and commercial policy in individual member states.⁵⁴ By virtue of its presence in five countries, CECOM, the European photocopier manufacturers' group, was in a position to gauge the possible *pro* or *contra* stance of individual states to its proposed strategy of persuading the Commission to impose anti-dumping on its Japanese competitors.

Anti-dumping is not the sole means by which the EC can regulate imports. In 1983 the Japanese government agreed to negotiate voluntary export agreements on a Community-wide basis.⁵⁵ The 1991 automobile agreement is one such agreement, resulting in voluntary 'monitoring' by the Japanese. Voluntary restraint, or 'gentleman's agreements' also take place between European and Japanese industries and industrial associations. Some measures have been affected by the Single Market Programme. Seamus O'Cléireacáin, has pointed out that other measures, such as the Article 115 safeguard clause which grants exceptions to free circulation of external goods within the Community to protect certain state markets, "should be expected to disappear eventually in a complete internal market."⁵⁶

⁵³ Higashi, Chikara and G.Peter Lauter, *The Internationalization of the Japanese Economy*, Kluwer, Boston, 1990, p.341.

⁵⁴ See IV.4 above.

⁵⁵ Taylor, Robert, *China, Japan and the European Community*, Athlone Press, London, 1990, p.86.

⁵⁶ O'Cléireacáin, Seamus, 'Europe 1992 and Gaps in the EC's Common Commercial Policy', in *The Journal of Common Market Studies*, Vol. XXVIII, No.3, March 1990, p.203. In the UK, the Monopolies and Mergers Commission recommended the ending of VERAs and

Interviewed in 1992 Mr. Christopher Norall, a lawyer in Brussels said "The intellectual climate has changed away from anti-dumping. As a device to keep out imports it didn't work. The logic of economic high-tech survival, especially in hi-tech is multinational [firm] cooperation."⁵⁷ The disintegration of CECOM, the photocopier lobby group, under the weight of such firm-firm cooperation, is one example of how private trans-national relations provided an alternative to the exercise of broad international 'industrial' policy in the form of anti-dumping, confirming Norall's general view. This has been partially recognised at the highest levels of the Commission: "Anti-dumping is a short run response, but to really improve competitiveness you need a much stronger restructuring strategy."⁵⁸ The most important effect of bringing the technically legal instrument of anti-dumping to the fore of EC external policy was to bring the 'Japan issue' closer to home. This occurred by virtue of a massive increase in Japanese FDI in Europe during the period under review. The role of the Japanese firm as primary manifestation of Japan, emerged as a central theme in the relationship between Japan and the EC.

In 'the age of investment' in EC-Japan relations, the EC Commission formulated a new approach in trade policy. This is the Trade Assessment Mechanism (TAM) which is a joint exercise between the Commission and Japanese ministries, to study medium and long-term trade imbalances between Japan and the Community. This cross-sectoral study aims to identify specific problem sectors and arrive at mutually-agreed initiatives for change. The TAM has been described thus: "The approach is analytic and non-confrontational, and designed to lead to improved market access by mutual agreement."⁵⁹ In Tokyo, the

the UK government even suggested that the UK quota under the umbrella 1991 EC-wide auto VERA, may be unilaterally abandoned before the expiry date of 1999.

⁵⁷ *Interview*, Mr. Christopher Norall Esq., *Forrester, Norall and Sutton*, Brussels, 16 July 1992.

⁵⁸ *Interview*, Alexis Jacquemin, *Cellule de Prospective*, EC Commission, Brussels, 23 July 1992.

⁵⁹ *EC News*, PR 16/93, Tokyo, 20 April 1993.

Commission now regularly rejects the "ritual exchange"⁶⁰ between Japanese and EC officials that European exporters were not trying hard enough. Ambassador Leng in Tokyo said of the TAM in mid-1993: "We cannot stay in the analysis stage forever. We have to move from analysis to the selection of products... and then to the solution."⁶¹

This approach is quite different from that of the U.S. towards Japan. Firstly, the Commission in the 1990s has repeatedly stated that it opposes sectoral numerical targets. This has particularly been the case since the Commission's vociferous opposition to the U.S.-Japan semi-conductor agreement.⁶² The EC's approach in the early 1990s encourages the Japanese government to increase domestic growth in order to stimulate imports; the TAM serves to tackle areas of specific difficulty and the EC persistently asks for greater consideration in large government procurement projects.

Theoretically, the stabilising role of the Japanese ministries ought to favour the EC Commission's approach to Japan over that of the United States. The EC Commission, through the TAM is involved in an on-going exercise with MITI and others, which is - at least on the surface - a co-operative exercise. The U.S. approach, advocated by Special Trade Representative Kantor and others, is directed more towards cabinet-level actors and demands a specific political intervention in market sectors. This tends to result in communiqués which are subject to vigorously different interpretations. Such occurred at the US-Japan bilateral meeting immediately before the 1993 G-7 meeting in Tokyo, with both sides having varying interpretations of what 'objective criteria' actually meant.⁶³

The EC trade strategy towards Japan has thus moved from the more confrontational climate

⁶⁰ Horst G. Krenzler, Director General External Relations, DGI, *press conference*, EC delegation, Tokyo, 20 April 1993.

⁶¹ Ambassador Jean-Pierre Leng, *press conference*, EC delegation Tokyo, 17 June 1993.

⁶² The extension of was confirmed in July 1994.

⁶³ Roger C. Altman, Deputy Secretary of the Treasury in the Clinton administration reflected on U.S. negotiating experiences with Japan thus: "When agreements were finally reached, they were often vaguely worded and subject to conflicting interpretations." 'Why Pressure Tokyo?', *Foreign Affairs*, May/June 1994, p.3.

of 1983-1989 to a more co-operative approach, which is largely founded in the realities of increased investment from Japan to the EC since the mid-1980s.⁶⁴ Throughout this transition, the Commission was largely in an *ad hoc* reactive position. Japanese firms played an active role with the European states and sub-states playing the role of eager interlocutors.

One area in which the states are strongest actors, but in which the Commission has taken a recent but limited initiative is trade promotion. The EC Commission's export promotion programme (EXPROM) provides "training, market information and commercial promotion"⁶⁵ for EC firms in Japan. The Executive Training Programme gives young European executives work experience and training in Japan. The sectors which were of particular interest were those in which the EC had experienced difficulties in accessing the Japanese market, such as processed foods, leather and textiles. That the states play the strongest role in export promotion is reflected at Community level, by the tendency for the Council to trim the Commission EXPROM expenditure request in the Community budget. The European Parliament consistently supports the Commission in this regard.

More recently, the Commission and the member states have turned their support activities towards Asia in general: "We as a community need to raise the consciousness of industry regarding the opportunities in the area."⁶⁶ In mid-1994 the Commission, with strong support of the German Presidency⁶⁷ issued a new communication, *Towards a New Asia Strategy*⁶⁸

⁶⁴ The transition was summed up by Akira Kudo thus: "The economic relationship between Japan and the EC is in transition from commercial conflicts to industrial and technological cooperation." 'Industrial and technological cooperation between Japan and the EC' in *University Research on European Integration*, EC Commission, Luxembourg, 1987, Entry #2668.

⁶⁵ Horst Krenzler, Director General for External Relations, DGI gave a full exposition at the *Club de Bruxelles* conference 'Tackling the Japanese Market' Club de Bruxelles, Palais des Congress, Brussels, 8 November, 1991. Summary of the debates, pp.5-6.

⁶⁶ Simon Nuttall, Director, DGI, quoted in 'Europe in the Asia/Pacific Region: involvements, challenges, policy roles' *conference report*, European University Institute, Fiesole, 1994. p.19.

⁶⁷ *International Herald Tribune*, 7 July 1994, p.4

reflecting a growing European awareness of the strategic importance of Asia in general.

V.6 THE ROLE OF JAPANESE FIRMS IN THE EVOLUTION OF THE EUROPEAN SINGLE MARKET

Through the late 1980s and early 1990s, there was considerable flux in what was meant by a Single European Market; what it was intended to achieve; how it would actually be constituted and above all: what the prevailing political economic philosophy would be. From its conception, different member states and industrialists had different visions of what the market would be like. The *dirigiste* view was that 'state-like' intervention could be transferred to Community level. To neo-liberals, the market was an important opportunity for the expansion of Atlantic-style capitalism.

In a finely balanced neo-realist/neo-functionalist analysis of the evolution of the '1992 Initiative', David Cameron concludes (narrowly) that the Community "will remain a Community of states" - thus giving more emphasis to inter-governmental explanations.⁶⁹ Attempts to combine such differing theoretical explanations in EC scholarship have however been less than satisfactory. It is difficult to envisage the Community evolving in both intergovernmental and federal directions and it cannot be overlooked that theoretical mixing has emerged in a period of uncertainty concerning the EC's constitutional destination. This research project stresses the distinction between economic integration and political integration as a useful conceptual matrix to understanding the evolution of the European single market in the era of globalisation. It is argued that the evolution of the relationship between the politically-inspired single market and the organic global market, has important implications for the European Community.

⁶⁸ Commission of the EC, Communication from the Commission to the Council, COM (94) 314, Brussels, 1994.

⁶⁹ Cameron, David R. 'The 1992 Initiative: Causes and consequences' in Alberta M. Sbragia (ed.) *Euro-Politics: institutions and policy-making in the "new" European Community*, The Brookings Institution, Washington, D.C., 1992. p.74.

The analysis of Grahl and Teague which stressed differences and evolutions in the market philosophy is accurate: "1992 can be given a neo-mercantilist interpretation, popular in France and to some extent even in Germany, as well as the neo-liberal interpretation which is preferred by the British government."⁷⁰ Although Charles Oman of the OECD has suggested that "Single Market Europe was a response to Anglo-Saxon deregulation"⁷¹ it is more likely that the UK and the Netherlands constituted an aggressive force for such deregulation *after* the initial bargaining, as fault lines developed over such issues as Japanese inward investment.

The contest for control of the 'blueprint' of the Single European Market is an important context to the evolution of EC-Japan investment relations in the period from 1985 to 1993. In particular, it is important not to view the SEA and the '1992 initiative' as static, rules-based realities. The intertwined history of the development of the single market programme and Commission reaction to Japanese firm globalisation illustrates an evolution from Commission scepticism concerning Japanese FDI towards a more open stance. The evolution was driven not so much (although certainly influenced) by the *dirigiste*/neo-liberal debate - as by the larger question of the ability of public authorities to regulate firm globalisation. In the case of the SEA and the 1992 Programme, the Commission was active. With regard to 'new zone' attempts to regulate FDI, the Commission was not only reactive, but was largely thwarted by firms in its attempts to respond to extra-jurisdictional developments in the commercial realm. Jonathan Story has stressed that the Single Market Programme was intended to "restrict member states' protectionist propensities and to open up intra-EC

⁷⁰ Grahl, John & Paul Teague, *1992 - The Big Market*, Lawrence & Wishart, London, 1990. p.172. The openness of the EC to inbound investment was stressed by Mr. C.E.A. Ripley, First Secretary, Inward Investment, British Embassy, Tokyo. *Interview*, 23 March 1993. Neil Fligstein points to the Japanese role on this issue thus: "The Japanese threat was once more taken up at the Copenhagen Summit. It was argued that the best way to deal with the Japanese was to increase European competitiveness. And the argument that was developing to do that, was the neo-liberal view of opening markets to more competition." 'The Cultural Construction of Political Action: the case of the European Community's single unitary market program' *paper* at the Annual Meeting of the American Sociological Association, Miami, Florida, 1993.

⁷¹ At the Stockholm School of Economics' (European Institute of Japanese Studies) DÉFI JAPAONAIS conference, June 1994.

markets, as the precondition to strengthening its negotiating position against non-members".⁷² This assessment pinpoints the Commission's assumptions of scale-efficiency and its somewhat simplistic concepts of European/non-European market participation.⁷³ The failure of the Commission to establish itself as the 'gatekeeper' of market participation [V.9, V.10, V.11 below] undermined the political integrative 'dividend' from the Single Market Programme.

A comprehensive statement of Commission views on inward FDI at the end of the period under review, was given by Sir Leon Brittan in his Jean Monnet Regional Lecture in March 1993:

Japanese investment in Europe gets a lot of attention. The Commission welcomes it. Increased direct investment in both directions is good for jobs, good for reducing trade imbalances and trade frictions, good for our cultural understanding of each other. We encourage Japanese and all other inward investors to integrate fully in the European economy, by locating research, development, marketing and management here alongside the manufacturing, sales and service functions... So the EC needs foreign investors and must treat them well. We [the Commission] control investment subsidies in Europe on the same basis, whether they are offered to Japanese, American or domestic promoters... The Commission cannot and must not tell businessmen where to set up... We do want to reduce state aids progressively and to reduce competitive subsidy offers among member states all chasing the same business. But we have no desire to spread FDI around the Community according to some bureaucratic vision of what is equitable or expedient.⁷⁴

This is a clear and comprehensive statement of the EC Commission position on inbound FDI at the *close* of the period under review. Such a position encapsulates the neo-liberal outcome of the protracted 'dirigiste' versus 'neo-liberal' debate, which was contested from the inception of the SEA until the early 1990s. The Commission did not always hold so liberal a position towards Japanese FDI. The period was marked by a neo-liberal unfolding and *de*

⁷² Story, Jonathan 'Europe in the global state and market system' in Jonathan Story (ed.) *The New Europe: politics, government and economy since 1945*, Blackwell, 1993. p.52.

⁷³ Stephen Young and Neil Hood write that "in the discussions and implementation of the Single Market, virtually no reference was made to TNCs, the assumption apparently being that international production and trade were undertaken by uni-national firms." 'Inward Investment policy in the European Community in the 1990s' in *Transnational Corporations*, Vol.2, No.2, August, 1993. p.43.

⁷⁴ Sir Leon Brittan, , 'Shaping a framework for global trade: the challenge for the European Community,' *Jean Monnet Regional Lecture*, Hallgarth Hall, Darlington, 19 March 1993. *EC Rapide*, ref: Speech/93/30, text, p.6-7.

facto, limitations on the options of the Commission for response to changes in global production and finance.

Speaking at the Sixth EC-Japan Symposium on industrial co-operation in Tokyo in 1987 Umberto Agnelli outlined a position which, in the early stages of the contest regarding the shape of the single market, represented a common view in France, Italy and even within the European Commission. In some ways, Agnelli's position represents not so much a strict *dirigiste* line, but rather a *communitaire-consistent* logic which claimed that gains from internal political bargains on matters of economic coordination and reconstitution should be reaped more by Europeans than others. It was this "natural institutional priority" which global capital and productive mobility undermined over the ensuing six years:

Before long the EEC will become a single European market. And that offers growth opportunities for us all. However it must be clearly understood that the single European market is primarily designed for the benefit and development of the European productive system. It would be an illusion and above all a grave mistake to believe that the single market could be exploited to the detriment of this obvious *natural institutional priority*. The fact that the EEC has opted for free trade does not mean it will ever fail to protect European interests. That after all is the principle you [Japanese] yourselves wanted respected back in the sixties when our car industry could have posed a serious threat to the development of yours.⁷⁵

In the mid-1980s the Commission's position was not wholly different from Agnelli's. The view of Sir Leon Brittan (1993) should not be understood in the context of a completely voluntarily - arrived at position. Industrialists such as Agnelli and Jacques Calvet (and Rank Xerox in lobbying for anti-dumping suits) attempted to establish a rationale for the exclusive administration of EC competitiveness stimulants to 'European' firms, precisely at a time when FDI was beginning to undermine the geographical enforceability of such preferential competitiveness enhancement.

The impression of 'Fortress Europe' which existed in Japan during the late 1980s appears

⁷⁵ Emphasis added. Umberto Agnelli, SIXTH EC-JAPAN SYMPOSIUM ON INDUSTRIAL CO-OPERATION, *speech*, Tokyo, 4 December 1987.

only to have subsided in the recent past.⁷⁶ However, Japanese industrialists did expect the removal of internal barriers to be accompanied by a 'hardening' of the external frontier.⁷⁷ The options for EC institutional reaction were curtailed due to the growing 'insider status' of Japanese firms and their bargains with liberal member states and a myriad of sub-states.⁷⁸

In the mid-1980s the EC Commission suggested rapid approval for directives which would bring the Single Market into immediate effect in certain areas. This proposal was opposed by the French in Council since this "would benefit products from producers outside the EC as much as those from within."⁷⁹ Yet such an outcome was a logical implication of the Single Market Programme which could not deny external firms' rights as enunciated in the Treaty of Rome. The EC Commission was in a difficult position *vis-à-vis* the evolution of Community strategy. While recognising the need to make the Community "more attractive for inward investment in the industrial sector" Laurens Jan Brinkhorst, Head of the Commission Delegation in Tokyo in the mid-1980s, also referred to the need for

a greater convergence of government policies towards inward investment. Conditions for inward investment and the extent of technology transfer to and from third countries

⁷⁶ Takehiko Nishiyama, Ambassador of Japan to the European Communities stated in a 1990 speech at the Royal Institute of International Affairs: "A recent opinion survey conducted among Japanese business leaders indicates that Japanese anxiety over fortress Europe has been somewhat assuaged but it seems to be still too early to say "goodbye to fortress Europe." 'Goodbye to Fortress Europe? Current concerns: a Japanese viewpoint,' p.1. A similar wave of concern arose in Japan in the early 1960s regarding the Common Market. By 1991 one news magazine declared: "Europe's fearsome fortress is beginning to look like Swiss cheese." *Business Week*, 'The Battle for Europe', 3 June 1991, p.16.

⁷⁷ One such was Kenjiro Ishikawa of the Mitsubishi Research Institute: "Because one of the motives behind the integration is to guard and support domestic industries, such as autos and electronics, Japan is likely to be forced into a difficult position." *Japan Times*, 22 October 1990, p.24.

⁷⁸ Yannopolous has written: "When non-tariff barriers are eliminated in the internal transactions of the customs union, there is no directly equivalent instrument to use in the common external commercial policy." 'Foreign Direct Investment and European Integration: The Evidence from the Formative Years of the European Community,' *Journal of Common Market Studies*, Vol. XXVIII, No.3, 1990, p.255.

⁷⁹ Fligstein, Neil, *The Cultural Construction of Political Action: The Case of the European Community's Single Unitary Market Program* paper ANNUAL MEETING OF THE AMERICAN SOCIOLOGICAL ASSOCIATION, Miami, Florida, 1993. p.29.

must be actively studied. Member states must take into account a Community perspective and Community priorities in this respect.⁸⁰

The only strong EC-level investment regulation which could be termed 'inward investment policy' is the post-facto investigations which the Commission is authorised to conduct if it suspects that state or regional aids have had an anti-competitive effect. Both Sony (Berlin) and Toyota (Derbyshire) have been investigated in this regard.⁸¹ This power is not reserved exclusively for external firms; European firms have been investigated and have been ordered to pay supplemental amounts when they have been deemed to have underpaid for sites. From a Commission perspective, eliminating all investment host 'inequities' would be desirable. But this is impractical if not impossible. Differing levels of taxation in the Community⁸² are likely to remain, while infrastructural spending and other incentives are frequently difficult to link to specific Japanese investment projects.

It is thus evident that the Commission - although also opting for a 'liberal' stance for positive reasons, found it exceptionally difficult to implement any alternative. The emerging design of the Single European Market was subject to the outcomes of *ad hoc* skirmishing and a somewhat belated realisation by the Commission that (in principle) Japanese firms had an exceedingly strong legal case to participate in the market once inward FDI had been permitted

⁸⁰ Laurens Jan Brinkhorst, Head of Delegation of the Commission of the European Communities in Japan, ROTTERDAM SEMINAR, 14 October 1985. *Text*, p.4. Emphasis in original.

⁸¹ This recourse is largely intended to discourage national authorities, regions and municipalities from offering subsidies which could be deemed 'distortive.' As David Whibley pointed out; "Derbyshire is not an underdeveloped area." *Interview*, Rank Xerox legal department, Marlowe, 31 March 1992. The number of cases investigated has been small, and the actual penalties are not severe - the main intent being preemptive discouragement. Both Japanese firms and the localities with which they are bargaining are negatively disposed towards Commission involvement. *Nikkei Weekly* quoted a Japanese industry source in the Sony/Berlin case thus: "Getting approval for projects in Germany is a drawn-out process in any case, and there are still residual administrative complications as a result of unification.. The last thing you need on top of this is an investigation by the European Commission." 12 October 1992, p.11 'Japanese firms alarmed over Sony HQ snag in Berlin.'

⁸² Vigorously defended by Jacques Santer while *premier* of Luxembourg.

at all.⁸³

Further, Japanese FDI decisions were influenced by EC trade policy and constitutional change in the first instance. Most notable among these policies was the increase in the use of anti-dumping actions as a policy option against Japanese firms in the mid-1980s. The Single European Act itself created an additional incentive for Japanese firms to invest.⁸⁴ The Commission resolved to establish the 'four freedoms' of movement for people, services, goods and capital; with a view to reducing the costs of internal transactions and enhancing the EC's competitive position with the U.S. and Japan.⁸⁵ The free movement of goods was quickly tested by external firms. This issue arose most visibly in the context of the Nissan Bluebird local content confrontation between the UK and France. In this instance, Japanese involvement did not so much change the shape of the market - the free circulation of goods was a fundamental 'freedom.' Rather, a Japanese firm with a high degree of international competitiveness, was the first major external investor to test and affirm Treaty of Rome

⁸³ Laura D'Andrea Tyson has pointed out the 'case-by-case basis' on which the Community treats decisions on the participation of non-EC firms in Community R&D programmes. *Paper*, JAPANESE DIRECT INVESTMENT IN A UNIFYING EUROPE: IMPACTS ON JAPAN AND THE EUROPEAN COMMUNITY conference, INSEAD, Euro-Asia Centre, Fontainebleau, 26 June 1992.

⁸⁴ Mitsuo Matsushita has written that "...the year 1992 seems to be a political manifesto rather than the year in which the integration is finally completed." 'A Japanese View of the European Integration of 1992' in Oppermann T. and J. Molsberger (eds.) *A New GATT for the Nineties and Europe '92*, Nomos, Baden-Baden, 1991, p.291.

⁸⁵ Wallace and Kline compare the U.S. with the EC in many respects. Wallace, Cynthia Day and John M. Kline *EC 92 and Changing Global Investment Patterns*. Vol. XIV, #10 Significant Issues Series, Center for Strategic and International Studies, Washington, D.C., 1992. Here however, U.S. states are compared with EC sub-states, and the U.S. with EC member states. Although the EC has little in common with NAFTA, such a comparison is more accurate than the convenient U.S./EC comparison. The implications of FDI attraction competitions are radically different between the U.S. and the EC. Inter-state tension in the U.S. over FDI 'loading' does not involve potential international conflict of interest. The federal system is not only more mature - but internal demographic movements have direct competitiveness effects. Freedom of movement of persons is an integral *de facto* facet of U.S. competitiveness; whilst in the EC, the 'four freedoms' constitute a *de jure* attempt to enhance competitiveness. In the U.S. such a circulation of persons can counter-balance FDI 'loading'. As such, the U.S. can be compared with EC member-states whose 'anti-loading' strategies are effective.

provisions as resuscitated in the 1992 Programme. In so doing, Japan's involvement through foreign direct investment, served to underscore clearly a principle which does not seem to have been fully thought through by the Commission or the French and Italian governments. The affirmation of freedom of circulation which Nissan sought from the Commission, was exceedingly slow in forthcoming. The Nissan investment of 1986 was a landmark in western Europe; vigorously sought by the UK government and looked upon suspiciously by European producers in this important and sensitive European industry. The French government and auto industry was at this time sceptical about Japanese investment in France, but was unable to affect Japanese investment in other member states since the Commission could not enunciate EC-wide inward investment policy.

In 1988 the French government announced that Nissan automobiles imported from the UK should contain 80% EC-sourced content. The British government stated that it was itself interested in increasing local content levels but was opposed to regulating investing firms on product sourcing decisions. Local content requirements were not stipulated by the Commission for products made by Japanese owned or controlled firms within the EC. By the time of the coming into effect of the 1992 Programme, the only significant local content requirements on Japanese firms were negotiated with individual member states. One of the hallmarks of the Nissan dispute was the long delay in there being any resolution. The Commission delegation in Tokyo was persistently asked for the Commission's position but could only say that the matter was under consideration in Brussels and European capitals. The Commission was placed in the position of persuading France to concede that Nissan Bluebirds should be allowed entry to its market. An EC Commission press release of 18 April 1989 stated:

In reply to a request by Vice-president Bangemann, the French authorities have indicated that the administrative measures required to ensure free access to the French market for Nissan UK Bluebird vehicles, starting at the end of 1988, have been taken. The French Government has confirmed that these imports from the UK will not affect the traditional imports of Nissan vehicles from Japan. Vice-President Bangemann has informed the British government about the insurance given by the French authorities.⁸⁶

The Commission had been placed in the position of supporting the logic of its own market

⁸⁶ EC Commission press release, IP (89) 257, Brussels, 18 April 1989.

programme on behalf of the UK government and Nissan. The French government was reluctant to concede the principle, but found itself arguing against the very logic of the Market Programme to which it had subscribed. The Nissan case clearly indicated that the evolution of the market was not solely determined by endogenous factors and decisions.

The Commission statement on the Nissan issue highlights that the *de facto* interpretation, course of application and impact of agreements, depends on the extent to which they are imbued with real power in the system. The case of access to the mainland European markets of UK Nissans illustrates that dynamics in such cases were not solely limited to *de jure* provisions. The evolution of the single market was subject to the gauntlet of conflicting interpretations throughout.

The confirmation that French authorities would not link free movement to 'traditional' Japanese imports was important, and is returned to below in the context of Commission attempts to extend trade policy into the investment sphere, where the advent of local production exposed the limited legal competence of the Commission in the rapidly interlinking global equation of trade and investment.

Leon Brittan's view appears to underestimate almost flippantly, the issue of inter-state tensions over locational and relocational decisions by MNEs. Most states in the Community have some element of the 'bureaucratic vision' of FDI guidance which Brittan refers to. This is primarily to defuse excess tension between regions. The 'safeguards' against investment 'loading' in particular regions within the larger member states do not appear to be transferrable to the Community level. Such a transfer would require the Commission to issue centralised guidelines to member states regarding one of their most sensitive political economic functions: the creation of an environment for employment and growth through inviting external FDI with a view to enhancing economic welfare. Such enhancement was the most important concern of the SEA. The evolution of the relationship between the Commission and the member states was directly effected by the involvement of external firms - which bargained with the liberal member states, leading to a neo-liberal outcome in the

contest for the blue-print of the market.⁸⁷ The relationship between sub-state regions and states on one hand; and states and the EC-level institutions on the other was strikingly different. There is little which could be done to institute a consistency through EC levels of political authority in this regard. Regardless of the internal justifications for such a difference - the implications for external relations remain.

Exogenous actors cannot be excluded in the analysis of the evolution the debate on the Single Market.⁸⁸ The original Treaty of Rome bargain was liberal, but this effectively meant liberal for American firms. The revitalised application of the bargain in the form of the Single Market Programme was applicable also to Japanese firms. The position of Agnelli was consistent with the implicit assumption in the SEA that there existed a nurturable relationship between EC territory and competitiveness. This basic logic of the economic dividend of integration was undermined by FDI (economic integration) - which provided a new avenue for EC-Japan cooperation and also provided states and sub-states with an alternative to centralised EC competitiveness enhancement strategies.

V.7 INTEGRATION AS A MAGNET FOR FDI

The Single Market Programme caught the imagination of Japanese business leaders, even if the exact implications of the programme were often viewed with caution or even suspicion. The newfound market momentum gave the EC a higher profile in Japan than had been the case for decades. Earlier scholarship has addressed the specific issue of whether or not a customs union/integrating bloc acts as a *magnet* for FDI. The question of the 'magnetic'

⁸⁷ A 1994 UK government White Paper 'Competitiveness: Helping business to win' underlines a continued liberal perception of the European single market. In its discussion of the European dimension, the paper states that the government will work towards "trade policy based on fair and open markets" and "encouraging privatisation and liberalisation". Summary, DTI, London, 1994. p.2.

⁸⁸ Robert Gilpin and Simon Reich have recognised the U.S. role in the shaping of favourable conditions for external firms in the Treaty of Rome. Reich, Simon 'Roads to Follow: regulating direct foreign investment,' *International Organization*, 43, 4 Autumn 1989, p.547 and Robert Gilpin who is cited.

effect of customs unions or single markets on inward FDI, raises the question: Do FDI and its implicit host bargains pose positive, negative or no apparent *political* consequences for the process of regional political integration itself?

George Yannopoulos⁸⁹ cautioned against the conclusion that there existed a clear diversion of American investment towards the integrating bloc in the early years of the Common Market. His work identifies pre-existing trends, and the coincidence of other developments which "were raising the locational advantages of the Member States of the EC (eg. the follow-up of German reconstruction)." The econometric approaches to the debate were by no means conclusive. Yannopoulos found that "the formation of the European customs union in the later 1950s coincided with a substantial increase in the foreign direct investment flows to the six original members of the EC."⁹⁰

Thomsen and Woolcock have pointed to the region-building capacity of intra-European investment.⁹¹ Although external firms *could* behave in a manner which might enhance the cohesion of the bloc, regional differences imply variations in the modes of production, business practices, consumer taste, communications and the local strategy of Japanese firms. Japanese investments in the EC are part of overall outbound investment strategies by Japanese firms. These firms are flexible within the Community and continue to carefully research market evolution on the EC's eastern flank. Whilst Japanese firms frequently have 'EC headquarters' (Amsterdam and London are favoured locations) these are responsible for operations in Europe as a whole. It would be false to assume that once within the Community, Japanese firms recognise the EC frontier as the limit of their commercial ambitions. The geographical space of firm activities is different from that of the territorial

⁸⁹ Yannopoulos, George 'Foreign Direct Investment and European Integration: the evidence from the formative years of the European Community' in the *Journal of Common Market Studies*, 1990, pp.236-7. In his contribution to Mayes, David (ed.) *The External Implications of European Integration* (Harvester Wheatsheaf, New York, 1993) Yannopoulos extended his analysis to the European single market programme.

⁹⁰ *ibid.* p.256-7

⁹¹ Thomsen, Stephen and Stephen Woolcock *Direct Investment and European Integration*, Pinter for RIIA, London, 1993.

space of the EC. Such firm activities occupy an economic space which is potentially global. From Common Market to the 1992 programme, politically-created blocs have had varying levels of influence on firm decisions to invest. The factor of reaction to EC trade policy appears to be the stronger of the two principal EC-generated policy influences on Japanese FDI strategies. Trans-national priorities in the building of integrated communities are markedly different from the transnational aims of the external firms attracted to them.

V.8 THE ADVENT OF JAPANESE FOREIGN DIRECT INVESTMENT IN THE EC

In the past some authors stressed the reluctance of Japanese firms to internationalise production.⁹² For the purposes of examining the *matrix* for investment, such a proposition at least draws attention to the importance of host political authorities in creating conditionalities for such decisions. The EC Commission's trade responses for example, had an important impact on Japanese firm decisions to invest in the Community.⁹³ Trade and trade policy are important determinants of foreign direct investment. The phenomenon of Japan's underlying trade strength is the most important source of heightened exchange between Japan and the European Community. The legal trade competence of the Commission is one of the most manifest motors of the strengthening of EC-level executive authority. The use of this authority in external trade matters had a significant impact on the investment strategies of Japanese firms. Trade and trade policy are thus important pretexts for Japanese FDI in the European Community.

As outlined above, the EC Commission received lobbying representations from the European photocopier sector to act against alleged Japanese dumping. In forming the CECOM lobbying group, such manufacturers assumed that trade would continue as the dominant form of

⁹² Trevor, Malcom *Japan's Reluctant Multinationals*, Pinter, London, 1983.

⁹³ Yoko Sazanami reports the findings of R.A. Belderbos, that "most of Japanese manufacturing investment in the EC has been a response to trade frictions." Belderbos, R.A. 'On the Advance of Japanese Electronics Multinationals in the EC: companies, trends and trade policy', *paper*, EIGHTH CONFERENCE OF THE EURO-ASIA MANAGEMENT STUDIES ASSOCIATION, October 1991.

industrial exchange between the EC and Japan. The central role of FDI however, quickly became apparent; as a strategy in response to EC trade policy and as a trade supporting option within firm strategy.

The advent of international alliances between Japanese firms and European counterparts weakened the bond between European industry and the Commission. In the case of greenfield sites, the Euro-Japanese co-operative axis is between states, sub-state units and Japanese firms. The term 'internal market' was proven to be less than accurate - since many of these European entities chose intercontinental bargains to enhance their welfare. This in turn guaranteed commercial participation for Japanese firms.

Following the upsurge in Japanese investment in the mid-late 1980s, CECOM membership was reduced. The West German firm, Develop was acquired by Minolta; Tetras of France was taken over by Canon, and Olivetti sold its photocopier production to Konishiroku and went on to form a 51% held partnership with Canon to produce new copier and other lines. Canon, with a plant in West Germany was the only firm with a pre-1985 production presence in the Community. By the end of the 1980s every major Japanese photocopier manufacturer was producing within the EC.⁹⁴

V.9 EC RESPONSE TO JAPANESE FDI: THE LIMITS OF REGULATION

Japanese foreign direct investment in the EC has increased due to a number of factors, including: the success of Japanese firms in international trade; the globalisation strategies of these firms; the political economic reaction to Japanese trade success; and the politically-driven evolution of western European market design. The role of the European Community

⁹⁴ Canon additionally tripled to 7,000 photocopiers per month its existing German output. Matsushita started production in West Germany in 1986 and Konishiroku followed suit. Ricoh expanded its UK component operation in Telford to include copier assembly and announced plans for a French plant in 1987. Sharp, with grants from the Welsh Office, set up a photocopier production unit in Wrexham the same year. *The Financial Times*, 26 September 1986, p.7; 13 March 1986, p.8; 1 April 1987, p.4; 29 August 1986, p.6; 7 November 1986, p.4 and 9 June 1987, p.8.

institutions as an important actor in the Japan-EC FDI dynamic is here examined with a view to determining the impact of Japanese FDI on the constitutional evolution of the European Community in the period under review. The focus is not so much the motivations and causality of FDI as the impact which FDI - a form of *economic* integration - has upon attempts by the Commission of the EC to promote *politically* integrative competitiveness enhancement.

The issue of advantages and disadvantages of FDI on host (usually state) territory, dominated the debate in the late 1960s and early 1970s.⁹⁵ While it is interesting to compare the European response to increased American FDI in Europe in the 1960s with increased Japanese FDI in the 1980s and '90s, there is a fundamental disjunction in such a comparison in so far as the importance of the EC 'regime' has greatly increased since that time, and global FDI levels have greatly increased. Importantly, the UK did not enter the Community until 1973. Some aspects of the earlier debate on FDI regulation continued into the mid/late 1980s among member states and at the European level. Advocates of anti-dumping and anti-circumvention measures claimed that the kind of jobs created by Japanese FDI were low-skilled and did not contribute high value added to European industry.⁹⁶ The European Commission cannot be said to have had a grand scheme to 'trap' Japanese FDI within the Community. Had this been the case, the Commission could likely have pre-empted the GATT's objections to its anti-dumping on parts initiative at a much earlier stage. The move into uncharted regulatory territory on parts anti-dumping, local content and rules of origin took place on an *ad hoc* basis.

In the Community opinion has been divided as to whether or not Japanese FDI is good for

⁹⁵ Some of the literature in this realm could be classified as 'alarmist' or even sees FDI in an 'imperialist' paradigm. Recently, a neo-Marxist approach to Japanese investment in Asia has been used by Robert Steven in *Japan's New Imperialism*, Macmillan, London, 1990.

⁹⁶ In the theoretical economic literature, Kar-Yiu Wong finds that *quid pro quo* FDI "may not improve the expected employment and may be detrimental to the economy" of host countries. 'Optimal Threat of Trade Restriction and *Quid Pro Quo* Foreign Investment,' in *Economics and Politics*, Vol.1, No.3, November 1989.

host economies.⁹⁷ The opposition to Japanese manufacturing plants in Europe echoed many of the arguments against unrestrained Japanese imports. In some respects, the EC faced a re-run of the early 1980s pressure to increase anti-dumping actions. By the late 1980s however, the picture was more complex. Any attempt to regulate Japanese operations in the EC would have required a wider armoury of legal instruments than dealing with a strictly 'exogenous Japan.' It would also have required a far greater coordination between Commission Directorates-General. The record shows frequent disagreement over what exactly a 'European interest' was, at what point such becomes critically jeopardised, and how best to respond. The EC Commission and its individual DGs, firms, sectors, states and sub-states had their own, often conflicting views on these issues.

A Keidanren position paper in March 1993 acknowledged the growth in FDI generated co-operation between Japan and the EC.⁹⁸ From an EC Commission perspective this change could be described as a transition from *ad hoc* attempts at regulation to a position of sceptical cooperation.

The EC institutional reaction to Japanese FDI, and the evolution of the Single Market Programme were closely intertwined. The central proposition advanced here is that Japanese firms had an important impact on the evolution of the extent to which the Community could exclusively control the economic dividend from what was initially a political bargain between the member states in 1985-86. By ultimately gaining equal access to this market (French

⁹⁷ A House of Lords 1989 report concluded that "there may come a time when Japanese investment in the Community in certain key sectors becomes a cause for concern, and its level should certainly be monitored. But at current levels, it would be perverse to discourage such investment," House of Lords Select Committee on the European Communities, *Relations Between the Community and Japan*, 13th Report, session 1988-89, report, p.25. A Keidanren mission to Europe in 1991 was informed of opposition not only to Japanese exports but also to production in Europe. *The Economist*, 4 April 1992, p.19.

⁹⁸ The paper states: "It cannot be denied, of course, that relations between Japan and Europe have never been as close as those between Japan and the United States or between Europe and the United States. In the second half of the 1980s, however, Japanese business began an active program of investment in Europe, and both the EC Commission and its member countries began to adopt a more positive, forward-looking approach to Japan and the Japanese market." Keidanren (Japan Federation of Economic Organizations) *position paper*, March 1993 'Future Relations between Japan and the EC' pp.1/2.

government, 1988; GATT, 1990) Japanese firms played a political economic role in the evolution of the EC itself.

In the late 1980s DGI and some 'continental' states considered a number of responses to FDI and global firm activity. These measures could be referred to as 'new zone'⁹⁹ instruments insofar as they were not unambiguously within the armoury of the Commission in the manner of trade policy instruments. These measures essentially failed in their intended application as controls of Japanese FDI. This policy direction lasted from c.1986 to 1990. The 'new zone' strategy unfolded parallel to the growing liberalism of the single market itself.

Whilst the EC Commission does not have a mandate to formulate FDI policy, it does have some influence in this domain. Before examining the new areas of jurisdiction which the Commission sought to enter, it is necessary to recount those instruments with which the Commission can regulate inbound FDI. A number of different instruments, such as trade policy (indirectly), industrial policy (DGIII) competition policy (DGIV mandate to investigate state subsidies) and international standardisation, comprise a diffused Commission influence in inbound FDI matters. Such 'instruments' have usually not been designed with a view to Japanese firms or even FDI - but regulation of commerce in general.

In addition to these policy spheres, *guidelines* rather than strict regulation became the hallmarks of Commission strategy regarding the activities of Japanese and other external firms. In Tokyo, the European Commission Assistant trade Director outlined the Commission position: "This is not a question of law, but the growing sentiment in the Community is that Japanese investment should be better integrated in our economy".¹⁰⁰ However, in the period

⁹⁹ This term has no official currency. Erich Gundlach and Peter Nunnenkamp use the phrase 'innovative protectionist measures' in their paper 'The European Union in the Era of globalisation', Kiel Institute of World Economics *Working Paper* No.650. p.23. The term 'protectionist' is however problematic. Some of the measures could be legitimate (literally) if dumping is actually taking place. 'Protectionist' thus has a completely political connotation - not applicable where GATT endorsed anti-dumping measures are warranted.

¹⁰⁰ Joseph Loeff quoted, *Mainichi Daily News*, 8 February 1989. As Competition Commissioner in the mid-1980s Peter Sutherland called for "a change in emphasis in the patter of Japanese direct investment in the EC, toward research and development and away from knockdown assembly of Japanese parts." *Mainichi Daily News*, 27 May 1986, p.5. Such

of rapidly increasing Japanese FDI, the Commission did attempt to extend its authority *beyond* the aforementioned policy instruments. 'New zone' instruments were frequently prompted in response to Japanese firms. This was not as a result of the decision to target Japan in particular; rather a consequence of the fact that Japanese firms were in the technological and financial 'front line' and were first to pose a challenge to the territoriality of the EC single market and the policy instruments governing that market. Aside from the powers outlined above, the Commission did attempt to extend its authority over inbound FDI matters in a more direct way.

The issues, interpretations and actors which decided the course and neo-liberal outcome of the SEA were many and diverse. However, because of their advanced and visible technological momentum, Japanese firms and EC-Japan relations moved to centre stage in the evolution of the market and FDI regulatory responses. In a three-year period (1987-1990) the validity of the distinction between 'endogenous and exogenous' relative to a neo-liberal market was tested in a short burst of commercial, regulatory, legal, and quasi-legal activity. With the advent of FDI, the Commission was faced with a series of regulatory choices *vis-à-vis* increased FDI. As seen above, the Commission did not have the option of enunciating a unitary code on FDI. Rather it could, and did, exercise its authority through existing competencies. Secondly, it tentatively moved into areas of regulation in which it sought to extend its authority to deal with the real and perceived challenges of Japanese manufacturing systems within the EC territory. The following analysis of the evolution of Commission strategy in these areas illustrates how the measures of anti-dumping on component parts and rules of origin were contested between the member states, the Commission, Japanese firms and the Japanese government.

The most pertinent questions of EC regulatory power vs. firm power; and economic integration vs. political integration, were vigorously contested. In some ways these contests were the culmination of the pressure of Japanese competitiveness as expressed in successive trade deficits with the EEC from the 1970s. When the major issues were settled; largely in

a positive development is occurring in the 1990s. Hitachi for example, has commenced advanced research in Cambridge and Dublin.

favour of Japanese interests with the strong support of liberal European states, the prevailing economic philosophy of the Community was in no doubt, and the participation of initially exogenous actors was guaranteed. The resolution also marks the beginning (in some European states and firms, the reluctant beginning) of the much-heralded cooperation which had been repeatedly called for. When such cooperation came, it was driven by the integrative power of multi-national firms and the outreach of states and sub-states.

V.10 COMMISSION POWER AND JAPANESE PRODUCTION: THE REGULATION OF COMPONENT SOURCING AND LOCAL CONTENT

The most controversial of the new jurisdictional measures undertaken by the Commission was the extension of the anti-dumping authority of the EC to cover the importation of component parts by Japanese firms for assembly in their EC production facilities. By undertaking to extend the application of a trade policy instrument - heretofore used for EC imports - to cover investment production, the Commission was attempting an important extension of its powers. This represented an extension of regulatory power over a central manifestation of global *economic* integration, the mobility of production.¹⁰¹ The debate on foreign ownership of production is not new, and the merits and demerits of foreign ownership are not a primary concern here. Rather, the focus is the constitutional ability of the Commission to form policy in the face of such a challenge; and the relative and changing powers of the EC institutions, member states and sub-states in the European political constellation.

The EC Commission's motivation in trying to exert regulatory authority over inbound FDI largely related to concerns that such production was intended to circumvent trade measures. Secondly, hastily introduced production was said to be of low value-added. Japanese firms which set up production facilities within the EC in the wake of trade policy action against

¹⁰¹ *The Economist* has recently commented on the shifting focus from trade to investment rules: "... the new trade rules, though impressive compared with what went before, already look old-fashioned. They will have to be extended to deal with barriers to market access rather than conventional barriers to trade. In particular, there will have to be agreements on how countries treat **international investment flows** and on **competition policies**. [Emphasis in original] 'A disquieting new agenda for trade,' 16 July 1994, p.64.

them were accused of using 'screwdriver' operations in which European workers were said to do little except assemble imported parts. The 1987 change in the EC anti-dumping code permitted, under certain conditions, the imposition of anti-dumping duties on imported parts.¹⁰² Under the newly extended anti-dumping rules, a firm which had already been found guilty of dumping, which had moved into the Community or substantially increased production after the imposition of anti-dumping duties, and which was found to be dumping parts from its plants in Japan would now be subject to new duties on those parts. 40% of product value would have to be sourced locally. The Commission explicitly recognised in such an extension of powers, that FDI by Japanese firms had followed the initial anti-dumping actions on imports from Japan - thus acknowledging a causal link between anti-dumping and FDI.

In late 1987 the Commission commenced investigations into the parts operations of Japanese electronic typewriter and weighing machines firms with assembly operations within the EC.¹⁰³ The Commission itself, in both DGIII and DGI, monitors such developments as anti-circumvention; but normally does not act until it receives an industry complaint.¹⁰⁴ In reality the process is an intermeshing of the European lobbies, expert committees and lawyers involved in such issues - out of which a 'European' response to anti-circumvention emerges.

The extension of EC powers caused serious concern in Japan. The MITI announced that "EC

¹⁰² Council of Ministers, regulation 1761/87, OJ L 167/9. 22 June 1987. The regulation was slightly modified in July 1988.

¹⁰³ EC *Spokesman's Service*, IP (87) 368. Brussels, 1 September 1987. The service reported: "The investigations have been opened following representations from Community industry which alleges that after the imposition of the anti-dumping duties on the imported products, certain exporters set up assembly operations in the Community of a very basic kind, in which components originating in Japan are put together with only a small proportion of the parts originating elsewhere. The added value is said to be marginal."

¹⁰⁴ In early 1988, CECOM, the European photocopier manufacturers' association (by now reduced in membership due to alliances with Japanese firms) complained to the Commission that Japanese firms were circumventing anti-dumping duties by assembling predominantly imported parts in their European plants.

ministers are requested to consider the proposed new rules most carefully"¹⁰⁵ and threatened to take the matter to the GATT. Akio Morita, Chairman of SONY, and Japan's most internationally-prominent industrial figure was at this time Vice-Chairman of the Keidanren [Japan Federation of Economic Organizations]. In the latter capacity, he wrote to the EC Commission four months before the enactment of the new anti-dumping measure:

We believe that such a proposal, if adopted, would not only greatly hinder direct investments from Japan in the EEC Region but also would infringe GATT rules . . . if adopted, the proposed legislation would create a serious inequity, in that anti-dumping duties could be levied with respect to the parts and components imported by a Japanese firm for incorporation in products which it makes in the EC, whereas no duties would be imposed on the same parts and components from Japan when imported by an unrelated European company which performed simple assembly operations on them.¹⁰⁶

This last point was confirmed in the photocopier sector - European firms (including those pressing for further litigation against Japanese imports and imported parts) could in principle, import as many Japanese component parts as they wished. Morita also voiced a persistent complaint from the Japanese firm side which was that the high percentage of imported component parts represented a stage in the investment when Japanese firms were learning about local conditions and evaluating local suppliers. This had been the experience with Japanese firms in the U.S. Morita concluded by referring to the extension of anti-dumping as "an economically distortive legislative measure" - a statement which dramatically (if unintentionally) reflected the tension between *de jure* regional integration and global economic integration.

Japanese firms vigorously opposed the local content provisions on the grounds that there existed legitimate problems of quality and cost involved in changing component suppliers. The President of Canon Italia SpA stated that component sourcing decisions should be based on considerations of "best quality and cost combinations"¹⁰⁷ and regular supply; if a

¹⁰⁵ *Daily Yomiuri*, 12 February 1987.

¹⁰⁶ Akio Morita, Vice Chairman, Keidanren, Chairman SONY, to President of the Commission, 5 March 1987. Other Japanese industry groups also made representations to the EC Commission on the matter, *Japan Times*, 5 March 1987, p.6.

¹⁰⁷ *Interview*, Milan, 7 April 1992.

Japanese firm wished to import components it should be allowed to do so from whatever source, based on commercial judgement. Ricoh (which was to be at the centre of a major EC-Japan row on rules of origin in 1989) also reported difficulties with the EC approach on local content, saying that "many parts such as electronics are not available in the UK."¹⁰⁸

In its assault on the Commission proposals, the Japanese Keidanren, with the active support of Toshiba, Canon and others, openly lobbied in Brussels¹⁰⁹ and succeeded in having the acceptable European local content threshold fixed at 40%.¹¹⁰ The extension of anti-dumping measures led to increased local sourcing by Japanese firms wishing to avoid new anti-dumping charges. Toshiba, Matsushita and Konica gave the Commission undertakings that they would increase local content levels.¹¹¹ In October 1988, the Japanese government requested that the GATT rule on the disputed extension of anti-dumping to component parts. This was the first time that Japan had requested a GATT ruling in relations with the EC, and was seen as a shift from bi-lateral to multi-lateral problem solving.¹¹² Sadayuki Hayashi, Head of the Economic Affairs Bureau of the Ministry of Foreign Affairs in Japan summed up the Japanese position: "Japan regards these arbitrary measures as hindering investment."¹¹³ The EC Commission defended its action in an article by the European Commissioner for External Relations which stated:

As the world's largest exporter, as well as its largest importer, the European Community has a vital interest in maintaining a liberal system of international trade. But liberal trade is only possible, in practice, if industries can be sure that they are adequately defended against unfair trade practices. *This is why anti-dumping has become an important feature of the Community's trade policy* and why the number of major decisions taken recently has attracted such attention... The Community's main concern [in revising its anti-dumping powers], however, was to guard against the flagrant circumvention of anti-dumping duties while ensuring that the provisions did

¹⁰⁸ Minoru Akiya, quoted in *The Financial Times*, 11 February 1987, p.1.

¹⁰⁹ An unusual departure for Japanese firms which have almost exclusively focused on information gathering; illustrating the stakes in this case.

¹¹⁰ *The Japan Economic Journal*, 19 August 1989, p.1.

¹¹¹ *The Financial Times*, 29 September 1988, p.6.

¹¹² *Japan Times*, 8 October 1988.

¹¹³ *Asahi Evening News*, 23 November 1989, p.4.

not deter genuine inward investment.¹¹⁴

This is one of the few, if only, occasions in which anti-dumping is referred to as part of *the Community's trade policy* which technically it is not - being a legal instrument. However, Commissioner de Clercq was accurately reflecting the reality of experience: anti-dumping had become an instrument of reactive trade policy.

On May 16 1990 a GATT panel found for Japan against the EC in the matter of anti-dumping on component parts.¹¹⁵ The failure of the extension of anti-dumping at the GATT marked a turning point towards co-operation in EC-Japan relations. The GATT ruling reflected the growing importance of FDI and the serious difficulty which an integrating political authority had in dealing with such increased flows. This differed from the experience of the states, whose 'total' experience with inbound FDI included a complex mixture of attraction incentives, bi-lateral *ad hoc* deals, and regulation. The main political role and dividend from Japanese FDI accrued to the state. By the inception of the '92 Programme¹¹⁶ the insider

¹¹⁴ Willy de Clercq, European Commissioner for External Relations, *Financial Times*, 21 November 1988. Emphasis added.

¹¹⁵ *GATT Activities 1990* reported: "The panel reached three central conclusions. First, it found the duties to be internal charges. Since the EC Regulations subjected imported parts and materials to such internal charges in excess of those applied to domestic products, they were contrary to Article III. Second, the panel found that the undertakings to inhibit the use of Japanese parts and materials - in order that the proceedings under the regulation be suspended - implied treatment to imported products less favourable than that accorded to like products of national origin and were, therefore, also inconsistent with Article III. The third conclusion concerned the validity of Article XX(d) in this case. The panel saw the Article as allowing deviation from GATT obligations to prevent enterprises evading obligations imposed upon them consistently with the General Agreement - for instance, the evasion of an import duty. The provision did not permit contracting parties to prevent actions by enterprises designed to prevent an obligation coming into existence - for instance the importation of a substitutable product not subject to duty or the transfer of production to the duty-levying country. Since neither the EC's anti-circumvention duties nor the undertakings served to prevent the evasion of the obligation to pay anti-dumping duties, they were not covered by Article XX(d)." Geneva, 1991. pp.56-57.

¹¹⁶ ie. 1 January 1993.

status of Japanese firms had been clearly established.¹¹⁷ A Keidanren position paper of March 1993 stated:

The integration of the European market will provide a solid platform for the widescale, relatively unfettered development of business activities. It should also serve to prevent the emergence of a "fortress Europe," which may contribute to the stable development of the world economy. For these reasons, the Japanese business community stands firmly behind the integration of the European market.¹¹⁸

V.11 COMMISSION POWER AND JAPANESE PRODUCTION: RULES OF ORIGIN

In the instance of the extension of Commission anti-dumping powers with new local content provisions (1987), the British government had only reluctantly agreed to the measure in Council. In the case of rules of origin (1989), the Council was deeply divided and the measure was passed by vote with the noted opposition of the British and West German governments who were supported by the Netherlands, Denmark and Ireland. The struggle for the 'blueprint' of the market was now (and with the GATT decision in May 1990) coming to a climax. Japanese firms, driven by technological advance, competitiveness-induced deficits, and FDI were at the cusp of these developments as the US had been to the fore in the 1960s. Along with the anti-dumping component parts extension, and the Nissan case (1988/89); the issue of rules of origin was the third important site in the contest by Japanese firms to share in the benefits of the EC market.

With the advent of increased FDI, concerns over the quality of such FDI, and the ability of Japanese firms to circumvent EC measures by exporting to the EC from plants in third

¹¹⁷ In an interview Mr. Teruhiko Mano of the Bank of Tokyo stated: "We do not fear protectionism, we now have production within the EC." *Interview*, Tokyo, 7 April 1993. Mr. Christopher Norall, a Brussels-based lawyer commented on the overall trend away from regulation towards guidelines: "Because of '92, more measures against the Japanese are being phased out." Interview, Christopher Norall, *Forrester, Norall and Sutton*, Brussels, 16 July 1992.

¹¹⁸ Keidanren position paper, March 1993 'Future Relations Between Japan and the EC' p.2.

countries, the EC reinterpreted its 1968 definitions concerning the origin of imported goods¹¹⁹; a definition which pre-dated high-volume global FDI. Following the decision of Japanese firms - notably Ricoh¹²⁰ - to increase imports from US plants, the EC Commission sought the support of the Council to reinterpret the rules of origin. The reinterpretation of a 1968 regulation would permit the Commission - by introducing a tighter definition of where the technological value-added of the imported product took place - to deem products manufactured in the U.S. and elsewhere as Japanese. This can be seen as a Commission attempt to reestablish a more traditional trade 'geography' in the face of global financial and productive changes which were rendering such a logic obsolete.

The conflict between Japanese firms and the Commission revealed important differences among member states towards increased regulation of Japanese production. Secondly, the move into this area by the Commission, illustrated that it was not so much FDI financial flows *per se* which were now at issue - but rather the control of international production itself.

The locus for the division between the states was the Rules of Origin Committee, a group of national experts which meets under Commission chairmanship. The Commission wished to define Ricoh's US output as Japanese by defining the country of origin as the place where the last sophisticated work, not assembly, took place. The Council, unable to agree, sent the proposal back to the Commission, with those countries opposing the measure unable to form a blocking minority. The Commission's definition passed into being with a written protest from Britain and West Germany. Denmark, the Republic of Ireland and the Netherlands supported these two states in Council.¹²¹

¹¹⁹ Regulation (EEC) No.802/68 of the Council of 27 June 1968. *Official Journal of the European Communities*, 28 June 1968, No. L 148/1.

¹²⁰ Ricoh's photocopier imports from the U.S. were not subject to the 20% anti-dumping duty imposed on Ricoh's imports from Japan. Ricoh claimed that the increased output from California to Europe was due to 'product specialisation and division of labour, not circumvention.' *The Financial Times*, 7 February 1989, p.4. The Commission denied that it was targeting a single firm; "the regulation is obviously designed to have a more general application than that." *Europe*, Brussels, 10 February 1989.

¹²¹ *The Financial Times*, 26 May 1989, p.2.

Following the Commission's action, Ricoh expanded local production in Europe, opening a plant in France where industry minister Roger Fauroux commented that "it is better to have Japanese photocopiers made in France than imported from Japan."¹²² In this manner, both the Nissan and case and the 'encouragement' towards more economically integrated production between Japan and the EC can be seen to have 'encouraged' non-liberal states into alliances. While the French government was changing its rhetoric and its policy on Japanese FDI, the UK and the Netherlands who had actively facilitated Japanese FDI for over a decade had already won more than half the gains between them. The Japanese FDI boom would only last another 3 years.

By 1989/90 the Commission's attitude to the emerging market was unequivocally liberal. This was clearly reflected in the EC Commission's Tokyo delegation statements to Japanese industry. Speaking at the Sumitomo Marine and Fire Insurance Company in Osaka in 1989, Michael Lake, the head of Press and Information at the Tokyo delegation stated that "It is not in the EC's own interests that our internal liberalisation should be accompanied by protectionism, as so many ill-informed sceptics predict."¹²³ Just how liberal the Commission's stance had become is illustrated by comparing this remark with Prime Minister Thatcher's speech on 20th of September 1988, stating that "It would be betrayal if, while breaking down constraints on trade in order to create the Single Market, the Community were to erect greater external protection. We must ensure that our approach to world trade is consistent with the liberalisation we preach at home."¹²⁴ The confluence of these views illustrates the victory of the British view, which had by the early 1990s become the standard Commission line. The political economic bargain between the UK and Japan on inward FDI had a direct and clearly evident impact on the change in the Commission's approach to

¹²² *The Financial Times*, 7 February 1990, p.6

¹²³ *Speech* to staff of Sumitomo Marine and Fire Insurance Co, Ltd, Osaka, February 20, 1989. Published as 'A Dynamic Market for Japan,' in *Speaking of Japan*, August 1989, p.19. James Moorhouse MEP confirmed this line in a speech to the European Business Community [EBC], Tokyo, 7 June 1993: "The drive towards an internal market within the EC has been matched by a determination to carry the same philosophy into our external trade relations." *text*, p.6.

¹²⁴ Thatcher's statement is quoted by Michihiko Kunihiro 'The External implications of 1992. I: a Japanese view' *The World Today*, vol. 45, no.2, Feb. 1989, p.31.

Japanese FDI.

V.12 LIMITATIONS OF COMMISSION FDI POWERS: IMPLICATIONS FOR EC TRADE POLICY

While trade and investment strategies are inextricable for firms; it is also in the interest of political executives to have coherent policies on investment as well as trade matters. The EC Commission felt compelled to respond to changes in the global political economy manifested by FDI. However, TNCs and their allies within the Community made the extension of Commission competence problematic. In the European Community, the disjunction between trade and FDI policy is complicated by the power of states over the rights of access for Japanese firms. But the states themselves are experiencing a disjunction - *de jure* trade policy having been given over to the Commission while states control most of the FDI policy 'instruments' plus, importantly, trade *promotion*. During 1993 a Commission proposal was circulated which would have created a formal exchange of non-binding guidelines on inbound FDI. Two governments, the UK and the Republic of Ireland effectively blocked the measure.¹²⁵

In the age of firm globalisation, it would appear that the bicycle theory of 'thus far and no further' in the extension of trade policy to FDI policy by the Commission, does indeed apply. For example, if firm alliances can circumvent VER's, and if external firms can not only produce within the EC, but import from third countries as well: then trade policy itself is directly challenged. In the preceding section, the analysis focused on the (constitutional)

¹²⁵ Both the EC and APEC have failed to establish at regional level, any binding codes. The World Economic Forum, *Europe/East Asia Summit Programme for Action* of October 1994 stated: "Although the need for this [commonly agreed standards] is more acute in East Asia than in Europe, the European Union too would need to review its policies and practices in this domain. This process should include establishment of a comprehensive legal framework offering the crucial elements of predictability and transparency for foreign investors, and to address the issues of investment protection provisions and formal dispute settlement procedures.. In the same vein, European and East Asian governments need to undertake a systematic review to ensure the full transparency of national policies, regulations and administrative frameworks concerning FDI, the standardization of accounting and reporting systems." pt.2.B. p.3.

difficulties of using trade instruments in FDI matters. For the most part, EC 'new zone' instruments failed in the face of Japanese firm activities and claims (GATT, 1990). Globalisation not only creates tension between the constituent parts of the politically integrating entity; but threatens to unravel effective trade policy as well.¹²⁶

In the exercise of some aspects of its external trade policy, the EC Commission (with the cautious consent of the Japanese government) has taken into account production within the EC in the negotiation of what are essentially trade restraint agreements. This is in the interest of the Commission, but strictly not within its mandate. The association between EC trade policy and FDI 'regulation' is therefore not so much a *de jure* preserve of the Commission, as a link which is subtly maintained with the consent of the MITI and the member states. Before examining the most important sector in which this is evident (automobiles), the discussion can be placed in a broader context.

The GATT addressed the issue of TRIMs (Trade Related Investment Measures) in the Uruguay Round. The EC, Japan and the US requested that the GATT include guidance on such measures, including local content requirements, export requirements and import-substitution requirements.¹²⁷ A recent UN report states that many such measures are redundant "in the sense of simply accelerating the plans of firms to develop local suppliers and enter export markets."¹²⁸ On the inclusion of TRIM regulations in the GATT, the

¹²⁶ In October 1994, the GATT/WTO transition brought forth questions regarding EC representation at the new body. Both France and Spain indicated that they would prefer to represent themselves directly to the new body on certain issues [such as non-merchandise trade]. Germany proposed a compromise in which member states could represent directly on issues where a common stance was not found. Belgium blocked this proposal to defend the Commission's competence. *International Herald Tribune*, 3 October 1994, p.9. Global commercial forces and the appropriate regulatory response to such forces continued to raise questions as to the efficiency of a regional response in the most evolved EC competence. In November 1994 the French permanent representatives office in Brussels announced itself "satisfied" with a European Court of Justice ruling denying the Commission an extension of trade powers to cover non-merchandise areas such as financial services. *ibid.* 16 November 1994, p.15.

¹²⁷ UNCTC, *The Impact of Trade-related Investment measures on Trade and Development*, UN, New York, 1991. p.2.

¹²⁸ *ibid.* p.3.

UNCTC report however cautioned that "the effort could be counterproductive if it simply moved conditional incentive packets from published regulations to negotiation behind closed doors."¹²⁹ The Uruguay Round concluded in December 1993, made a cautious start with the issue of TRIMs:

The agreement recognizes that certain investment measures restrict and distort trade... To this end, an illustrative list of TRIMs agreed to be inconsistent with these articles [III & XI] is appended to the agreement. The list includes measures which require particular levels of local procurement by an enterprise ("local content requirements") or which restrict the volume or value of imports such an enterprise can purchase or use to an amount related to the level of products it exports ("trade balancing requirements").¹³⁰

The agreement also scheduled a staggered phase-out of TRIMs - two years for developed countries to seven years for least-developed countries. A form of *ad hoc* 'TRIM' trade/investment policy has been in evidence at the level of EC action towards Japanese firms during the past decade. This however appears to be significantly receding in the face of state and sub-state bargains with Japanese firms, and the internal-external liberalisation of the EC market to those firms which have the capability to invest.

A proposal by Ronald Dore suggests a structured solution to the problem of the diminution of industries under trade threat from more competitive external firms. Dore's proposal, *Investment Inviting Import Quantity Restrictions* (IIIQRs) envisages a ceiling on the level of certain imports after which local manufacturing would effectively be the only means for the external firm to expand market share. Thus the domestic industry (if not specific firms within the industry) would have an opportunity to survive.¹³¹ Dore's view, rather like that of

¹²⁹ *ibid.* p.10. The report calls for the "establishment of a multilateral framework of norms and standards on foreign direct investment, which would doubtless be a stabilising force in the dynamic but volatile area of investor-government relations. The result could be a mutually advantageous ceasefire in the drift towards investment wars, in which TRIMs today play only a minor part." *ibid.* p.10.

¹³⁰ *GATT Newsletter Focus*, No.104, December 1993, p.8-9.

¹³¹ Dore, Ronald 'Rethinking Free Trade' in Morgan, Roger et al. *New Diplomacy in the Post-cold war World*, Macmillan, London, 1993. Saucier points to the divergent interests of governments and firms in Europe over the issue of inward FDI priorities: "Expansion of the Japanese market share may be considered as more acceptable by governments, although probably not by competing European firms, if it is acquired by FDI rather than by exports,

Robert Reich¹³² focuses on the presence and quality of employment and the education and training of the local work-force rather than the national origin of the firm. A problem with Dore's scheme has been identified by Hans Maull who envisaged a situation whereby investments presently bound for less developed countries, would be re-directed towards more developed investment sites in the US and Europe.¹³³ In other words, Dore's scheme could well accelerate the hierarchical trend in the global political economy identified by Stephen Hymer, who envisaged a concentration of such activity *among* developed states.¹³⁴ In light of the increasing attractiveness of unsaturated markets in South East Asia, the US and the EC would have no prior claim on surplus investment capital 'returning' to their economies. This is the 'organic' tendency of capital and investment which the IIIQR proposal would seek to stem. Further, such a policy could only be exercised at a central (EC Commission) level. The IIIQRs would be invoked in response to the impact of external trade trends. However, once Japanese firms reacted to such an EC-level policy (as they did with anti-dumping) the politically sensitive *location* of IIIQR-induced investments would be entirely out of the Commission's hands. This is precisely what occurred with the application of anti-dumping measures against Japan in the 1980s.

and commercial pressure is likely to remain a strong motive for investment strategies as opposed to direct trade strategies." Saucier, P. 'New conditions for competition between Japanese and European firms' in Burgenmeier, B. and J.L. Mucchielli (eds.) *Multinationals and Europe 1992*, Routledge, London, 1991. p.130. This is borne out by a Rank Xerox official who reported an unsympathetic hearing from the British government. The Government position *viz-à-viz* Japan was different from that of the firm.

¹³² Reich, Robert B. 'Who is Us?', *Harvard Business Review*, January/February, 1990, p.53-64.

¹³³ Reported in 'Europe and Japan: cooperation and conflict,' *conference proceedings*, European University Institute, Fiesole, 1992, p.13. See also critiques by Stephen Thomsen and Geoffrey Wood, *Financial Times*, 13 July 1992, p.9.

¹³⁴ Stephen Hymer 'International Politics and International Economics: a radical approach' in Frieden, Jeffrey A. and David A. Lake *International Political Economy: perspectives on global Power and wealth*. [Cited by Stephen Gill and David Law, *The Global Political Economy*, Harvester Wheatsheaf, New York, 1988, p.65.] John Stopford has used a similar logic: "The growing *concentration* of investment flows within the 'triad' markets of the USA, Europe and Japan - for quite understandable competitive reasons - affects the international division of labour and makes it more difficult for latecomer countries to break into the charmed circle of development." in Morgan et al, *op.cit.* p.179. *Emphasis added.*

While the extension of anti-dumping into FDI regulation is visible in the consumer electronics sector; the linkage between trade voluntary export restraint and 'investment production restraint' is more observable in the automobile sector. The 1991 automobile agreement between the Community and Japan (Commission and the MITI) is an important milestone since national import quotas are to be phased out (assuming no revision or superseding agreement) by 1999. Meanwhile, the 'elements of consensus' provide for a negotiated fluctuation in the quotas for those countries which are subject to them.¹³⁵

In the run-up to the agreement, the Japanese government and Japanese industry were vigorously opposed to the linking of Japanese production in the EC to imports in the voluntary quotas. Kenjiro Ishikawa of the Mitsubishi Research Institute wrote in October 1990:

In the rush to draft a policy on auto imports from Japan, Brussels has thus far been bowing to pressure from protectionists and hardliners. They want the existing restrictions on imports from Japan to be made a part of the 1992 setup, and they also want the output from the Japanese plants in Europe to be counted as imports.¹³⁶

As with the other jurisdictional arguments, much was at stake. Japanese industry realised that insider status disarmed the Commission's responses, while the Commission recognised the full implications of a neo-liberal marketplace without centralised FDI regulation. The final text did not include EC production in the quotas, however the *de facto* implementation of the agreement did include such a link. The *Japan Economic Review* reported satisfaction of the Japanese side:

What was obviously significant to many Japanese automobile makers exporting their products to the EC region concerning the new Japan-EC agreement was the fact that the agreement referred only to the automobile exports from Japan to the EC region, but not to any exports of Japanese motor vehicles produced in the US or other countries outside Japan.¹³⁷

But the non-mention of transplants, and the official position that transplants were not to be formally discussed between the Commission and the MITI, masked the *de facto* necessity to consider local production as well as traditional imports. Following the 1993 round of talks,

¹³⁵ France, Italy, Portugal, Spain and the United Kingdom.

¹³⁶ *The Japan Times*, 22 October 1990.

¹³⁷ *The Japan Economic Review*, September 15, 1991. p.8.

negotiator Robert Verrue of DGIII stated in response to a question concerning transplants: "The Community figures concern exports from Japan to each of the five individual markets... but we take all possible factors into account." The Commission did not have any "firm quantified transplant assumption"¹³⁸ regarding transplants. Such a quantified position would not be permissible under the terms of the 1991 Agreement. However the Commission and the MITI were taking local production into account under other 'possible factors.' At a Press conference in Tokyo, Martin Bangemann made a point in defence of the new, slightly reduced Japanese quota that if transplants were added to Japanese imports there had been a total increase in the Japanese market share.¹³⁹ MITI and the Commission are involved in an annual evaluation of the projected short-term European car market and an apportioning exercise on what the Japanese total share should be. MITI then divides up the Japanese quota with the manufacturers in Japan. The Commission's response to Japanese production within the Community, which occurs with the collaboration of the Japanese government in a legally grey area of Commission competence, can be seen as a bi-laterally agreed acknowledgement that trade and investment are inextricable. The exercise of EC competence in this area is conducted *via* co-operative understanding with the MITI.¹⁴⁰ The agreement expires in 1999.

¹³⁸ Robert Verrue, DGIII, *press conference* Tokyo 1 April 1993.

¹³⁹ Martin Bangemann, EC Commission Vice-President, Industrial Affairs, *press conference*, Tokyo, 2 April 1993.

¹⁴⁰ The regulation of FDI in this agreement is vague. Mark Mason writes that the agreement "apparently restricts both exports and foreign direct investment". 'Elements of Consensus: Europe's response to the Japanese automotive challenge', *Journal of Common Market Studies*, Vol.31, No.4, December 1994. p.450. Any restraint on Japanese production is more by 'gentleman's agreement' than the Commission's authority over FDI matters. The lack of specific provisions is increasingly evident in major market access accords. These are now vigorously contested from the close of negotiations. A spectacular example occurred after the 1993 Tokyo G-7 preliminary between the U.S. and Japan, concerning the meaning of 'quantitative indicators'. The U.S.-Japan automobile and auto-parts agreement of 28 June 1995 was followed by a series of conflicting interpretations, most incisively captured by a Japanese official's comment that unilateral U.S. forecasts were "beyond the scope and responsibility of government." *International Herald Tribune*, 3 July 1995. p.10.

V.13 EC POLICY ON FDI ACCESS TO JAPAN AND FDI PROMOTION

The appreciation that direct investment is becoming as important as international trade is at the heart of Commission policy towards Japan. This is particularly due to the perception that one of the most effective ways of dealing with the trade deficit is to tackle the investment imbalance between Japan and the Community [Ch.II].

Commission Vice President Andriessen outlined Commission policy in 1990:

I believe that the Japanese Government has a special responsibility to encourage foreign investment and I welcome the effort it is making now. We are doing our share. For example, the EC Delegation in Tokyo has established a network of 12 regional EC associations with access to the top echelons of local government, banking and business organisations, women's circles, academia and the media. These regions profess a strong interest in having European companies based in their territory.¹⁴¹

The low propensity of the Japanese economy towards inbound investment has been noted.¹⁴² For the period before 1985, this did not present a particular concern for the U.S. or the EC. However, with massively increased outbound FDI flows from Japan (trade supporting, trade policy responsive and market seeking) the Commission and the U.S. government have begun to target conditions for investment in Japan. By 1993, the Commission was still substantially dissatisfied with progress in this regard. So too was the EBC (European Business Community) - the combined European chambers of commerce in Tokyo. On his visit to Tokyo in April 1993, Commission Vice-President Bangemann again pressed the issue.¹⁴³ Although, a relatively new strategic area for the European Commission, in the context of overall trade access to Asia, the role of investment support for European firms is becoming a fertile area for Commission initiative.

¹⁴¹ Frans H.J.J. Andriessen, Vice-President of the Commission of the European Communities. EC-JAPAN JOURNALISTS CONFERENCE, Brighton, 20 September 1990.

¹⁴² See deAnne Julius, and more recently, *The Economist*, 16 July 1994 p.64.

¹⁴³ EC Background Note, Tokyo Delegation, BN 6/93 8 April 1993.

V.14 JAPAN'S EC POLICY

Given the preponderance of difficult economic diplomacy issues in the relationship between the EC and Japan: and at inter-agency level - between the Commission and MITI/MOF/MFA - it is perhaps not surprising that the Japanese government and bureaucracy has an open preference for 'high' politics.¹⁴⁴ Communiques, overtures, and general policy statements tend to stress cooperation and Japan's leading role in ODA. However, economic diplomacy in the EC-Japan relationship has acquired the dynamics and urgencies of traditional high political affairs. It is unsurprising that any government would chose not to dwell on aspects of its external relations in which it is persistently criticised as unfair or permitting a system of unfairness.¹⁴⁵ In EC-Japan affairs however, Japanese firms are to the fore.¹⁴⁶

The civil service in Japan has provided a high degree of continuity in the formulation of national objectives. From 1955 until 1993 the country was governed by the Liberal Democratic Party, with a rapid turnover of Prime Ministers. The limitations of this office have been noted.¹⁴⁷ Cross-ministerial LDP committees also played an important role in consensus forming up to 1993. The Japanese Ministry of Foreign Affairs not only conducted foreign policy but acted as a co-ordinator between the other groups which contribute to the formulation of foreign relations' initiatives. These include the LDP, non-MFA ministries (notably MITI and the MOF), commercial and industrial organisations and individual leaders of industry and commerce. Diet members frequently travel abroad on research missions. Japanese interests are also represented by professional lobbyists and law firms in other

¹⁴⁴ See discussion of the terms 'high' and 'low' politics in Ch.II.

¹⁴⁵ For example, Jean Pierre Leng: "For a real and fundamental improvement in the climate of the bilateral relationship to take place, Japan will have to take the necessary steps to bring its economic structures and trade system into harmony with those of its partners." *The Japan Times*, 9 May 1990.

¹⁴⁶ Mr. Yuji Hosoya, Deputy Director, International Business Affairs Division, Industrial Policy Bureau, MITI, stated with regard to Japanese firms' activities in Europe: "We don't have any targeting policy - its completely up to the Japanese companies." *Interview*, 16 June 1993.

¹⁴⁷ Van Wolferen, Karel 'The Japan Problem re-visited,' *Foreign Affairs*, Fall 1990, vol.69, no.4.

countries. This is particularly true in the United States and to a lesser extent in Brussels. The Japan Foundation promotes Japanese culture abroad; and Japan was the largest donor of foreign aid to developing countries by the early 1990s. The variety of groups and individuals which forge the foreign relations positions of Japan has not impeded the efficient formulation and implementation of policies in the important area of trade and economic affairs. However, with regard to salient issues such as the Gulf War, Japan has experienced difficulty in formulating and implementing clear policies.

In Brussels, the Japanese mission deals mostly with DGI of the Commission. Specialization is a strong feature and commercial issues are treated on a sectoral basis, with different officials treating different policy areas. Japanese companies received support and information, particularly in relation to the 1992 single market programme. Officials from MITI and other ministries are present in the important Japanese embassies, consulates and delegations. The higher priority accorded to European relations in the period was experienced in government (in response to bi-lateral U.S. pressure) as well as firm relations.

Motono Moriyuki, chairman of a Japanese government committee on relations with Europe stressed the necessity for Japan to "seek more understanding in Asia and Europe in order to rebalance its relations"¹⁴⁸ in light of frictions in the Japanese-US alliance. However, with the decline in new stocks of FDI, the economic opportunities in Asia, and receding US-Japan tension, Europe was assuming a lower priority in Japan's external relations by the mid-1990s.

The 'wedge between the member states' thesis is well known in dealings with third parties.¹⁴⁹ However, it is not, as suggested by William Nester, an overriding theme of the

¹⁴⁸ *The Irish Times*, 19 November 1990, Japan supplement, p.4. [report FOURTH EC-JAPAN JOURNALISTS' conference, Brighton, 1990.]

¹⁴⁹ Keld Hammering of the European Business Community Council stated in an interview: "The Japanese government is extremely clever at playing off one country and one business against another." *Interview*, Tokyo, 11 May 1993. *The New York Times* reported: "Michael B. Smith, who served as deputy trade representative in the Reagan Administration said Japanese diplomats were eager 'to find inconsistencies in the positions of different U.S. agencies and to drive a wedge in there.'" 24 November 1989, A.12. This is also an issue in relations between the U.S. states and Japanese firms.

Japanese approach to the EC. In fact, as the experience of firms has shown, the realization among Japanese firms by the early 1990s was that the 1992 programme presented a sound commercial opportunity. Mr. Teruhiko Mano, who led a Keidanren mission to Brussels even commented when asked about the UK opt-out of the Social Chapter in the Maastricht Treaty: "It [the Social Chapter] is a good way to investment - labour harmony is very important."¹⁵⁰

CONCLUSION

The SEA competitiveness enhancement strategy was challenged by three developments. First was the 1980s global boom in FDI and the resultant presence of multiple cross-ownerships which have come to characterise international production. Secondly, the willingness of liberal member states to side with Japan in political economic bargains created an active counterforce against the assumed bond between territoriality and competitiveness. Thirdly, European firms themselves frequently chose extra-European partners to enhance their competitiveness. Such alliances with extra-European firms may even be the key to an enhancement of European competitiveness. In which case the very concept of 'competitiveness' in terms of EC *versus* Japan, is in doubt.¹⁵¹ In terms of trade policy, and the *de facto* restrictions on inbound investment regulation, globalisation - a form of *economic* integration - poses dilemmas for *political* integration. In the European context, this has been represented most clearly in EC-Japan relations.

As Cynthia Day Wallace and John M. Kline have noted

.. governments have had problems linking the presumed national identity of a corporation with the actual distribution of business benefits that are of interest to governments. This change leads to major problems in assessing benefits and

¹⁵⁰ Interview, Tokyo, 7 April 1993.

¹⁵¹ Bourke, Thomas 'EC-Japan Relations, 1985-1993: The Political Impact of Foreign Direct Investment on European Integration in the Liberal Market Era' in *The Shape of the New Europe*, proceedings Columbia University, New York, April, 1994, p.85. Paul Krugman has questioned the usefulness of the concept of Competitiveness in 'Competitiveness, a dangerous obsession,' Foreign Affairs, Spring, 1994.

implementing government programs that are based on territorially defined goals.¹⁵²

In the case of the EC, this has been more the case at the 'EC level' than at state level. At interview, Mr. Alexis Jacquemin of the EC Commission *Cellule de Prospective* stated; "Local content will be diluted by alliances. That is the reality of the business world."¹⁵³

Having chosen the market as the stimulant for enhancing the collective welfare of the EC, and having exposed the 'design' of that market to an open contest between conflicting economic philosophies, the role of an integrated EC approach to competitiveness stimulation and the role of a centralised authority in such matters has been challenged by external actors and their political economic alliances. This evolution overlaps precisely with a period of immense growth in global investment and the inauguration, negotiation and conclusion of the Uruguay Round, wherein states such as Japan pursued their agendas directly at global level.

The tension between regional and global levels of economic activity and regulation was discussed by Grahl and Teague. Writing in late 1989, these authors stated: "The 1992 programme seems particularly to undermine the Community's industrial identity since it promotes European unification by methods that actually advance this process of globalisation."¹⁵⁴ The authors' identification of this aspect of the conflict between political and economic integration was perceptive, particularly at a point when the GATT had yet to decide on the Japan-EC anti-dumping complaint.

¹⁵² Wallace, Cynthia Day and John M. Kline *EC 92 and Changing Global Investment Patterns*. Vol. XIV, #10 Significant Issues Series, Center for Strategic and International Studies, Washington, D.C., 1992. pp.18/19. In a similar vein Seamus O'Cléireacáin writes: "Transnational alliances, and direct foreign investment, blur the national identity of corporate identities. They also make life more difficult for interventionist policy makers not convinced of the benefits of trade liberalisation. Policy makers accustomed to a world in which they could identify and support 'national champions' increasingly find that national champions have foreign alliances." 'EC policies towards Japan: implications for US-EC relations' in George N. Yannopoulos (ed.) *Europe and America, 1992: US-EC economic relations and the single European market*. Manchester University Press, 1991. p.82.

¹⁵³ *Interview*, Brussels, 23 July 1992. A similar phenomenon was beginning to occur with EC voluntary export restraints, which could be circumvented by firm-firm bargains such as that between Toyota and Volkswagen. *Asahi Evening News*, 24 June 1987.

¹⁵⁴ Grahl, John and Paul Teague *1992 - The Big Market*, Lawrence & Wishart, London, 1990. p.142.

As with Agnelli's view, the SEA approach - and the Cecchini analysis - assumed that there would be a global competitiveness dividend from the combining of EC firms - and state policies. We might refer to this as 'internal Darwinism.' But for European firms to improve their real levels of competitiveness, a measure of 'external Darwinism' was essential. Again, for those who, like Thatcher saw that internal and external liberalisation went hand in hand - there was little contradiction. Also logical was the *dirigiste* interpretation of the market programme which demanded external barriers to accompany internal liberalisation. But for the Commission, the advent of globalisation of production placed a query over its very ability to have any competitiveness enhancing role for European industry when the primary agent for enhanced competitiveness was the market itself.

This market was no longer an EC territorially-defined entity - nor an 'internal' market, but the more organic, de facto *economically* integrating market encompassing the EC, EFTA, the US, Canada, Japan and some other Asian/Pacific countries. There emerged a competing political 'geography' between these two spatial definitions of market. The drive to greater FDI and globalisation as a means of welfare seeking, is in direct competition with a centralised vision of competitiveness stimulation in western Europe.

While trade policy and its instruments can be used broadly as a part of industrial policy within the EC; FDI has a tendency to undermine trade instruments, and at EC Commission level, to undermine EC industrial policy itself. The European Commission proved unable to forestall the extension of benefits to external firms which had the capacity to internalise their operations. These firms had a vigorous input into this outcome: which in turn had origins in EC trade policy towards Japan in the late 1970s and early 1980s - a perceived necessity given the enormous competitiveness gains of Japanese industry from the 1960s onwards.

In ensuring the fairness of internal and external access to the emerging market, the EC came to resemble a 'mini-GATT' - rather than a tightly operated executive. This juncture was largely arrived at by a sophisticated interaction between firms, EC sub-states and EC states. The Japanese government did not play a leading role in the investment dynamic. Consequently there has not been a linked bargain regarding reciprocal investment access for

European firms in Japan.¹⁵⁵

The need for regulation of multi-national enterprises and capital remains. The seriously contested issue revolves around *where* - at which level of political authority - the power of such regulation should be centred. This *problématique* is posed thus by Milivoje Panic: "What exactly is the 'area' (meaning the grouping of independent national entities) most likely to enable its constituent units to pursue effectively the policies needed to achieve and sustain a high level of economic welfare? In other words, what is an optimum policy area in the 1990s?"¹⁵⁶

This is a particularly pertinent issue in the context of the EC. The states retain a 'total' FDI relationship with Japan which includes incentives, bi-lateral negotiating, and if necessary, local content requirements. The Commission failed to establish a more assertive role *vis-à-vis* Japanese investment, and is now itself more captive to the neo-liberal philosophies of the British and Dutch governments - no longer seeking a stronger role in this domain. Reluctantly, and after the failure of 'new zone' attempts to regulate inbound FDI, the Commission could be said to have arrived at the position already anticipated by Saucier; "It is more likely that the Commission will lean towards *laissez-faire* rather than adopt a middle position if this implied taking active steps."¹⁵⁷

Neven and Siotis favour the supra-national level for the formulation of FDI guidelines.

It is in the interest of each government to impose some barriers to foreign direct investments which source domestic technology but at the same time all countries would be better off if nobody intervened. This suggests that foreign direct investment

¹⁵⁵ Felix Rohatyn stresses the political significance of such access: "This would be the time for US corporations to acquire stakes in Japanese companies. Such ownership would not only improve trade flows, but would create the kind of *political* influence that comes only from having an actual presence in a market." Rohatyn, Felix 'World Capital: The need and the risks' *New York Review of Books*, 14 July 1994. p.50 (emphasis added).

¹⁵⁶ Panic, Milivoje, *National Management of the International Economy*, Macmillan, London, 1988, p.317.

¹⁵⁷ Saucier, P. 'New Conditions for competition between Japanese and European firms' in Burgenmeier, B. and J.L. Mucchielli (eds.) *Multinationals and Europe 1992*, Routledge, London, 1991. p.130.

might have to be regulated by a supra-national institution.¹⁵⁸

If the supra-national 'solution' is preferred, Panic's question comes to the fore, and the choice in the case of the EC would be whether regulation is effective at the Community level or the global level.

Interviewed in June 1993, James Moorhouse MEP, author of two reports on the Community's relations with Japan indicated that the EC level could still have an important role: "If any foreign company wants to invest on a significant scale there should be a cost benefit analysis. We should have criteria within the EC as a whole on inward investment."¹⁵⁹ This position claims for the EC level a clear role in FDI matters, and as such is quite different from the 'hands off' approach of Commissioner Brittan. Holland's proposals in *The European Imperative* [a report to the Commission of the European Communities] are similar to those of Moorhouse, in that a viable role for the EC level again is envisaged.

Where possible, the Community should seek cooperative outcomes with Japan which recognize the success of Japanese flexible production, cooperation with labour, and constant innovation, rather than penalize Japanese firms for their own success. On the other hand, this cannot reasonably mean liberalisation under conditions of long-term asymmetric trade, nor ceding the innovation frontier in Europe to non-European firms.¹⁶⁰

This statement reflects the depth of the challenge to political integration of the multi-national enterprise. The first half of this analysis appears to be exactly what the liberal member states and the vast majority of sub-states throughout the community have been doing for almost a decade. The second part of the statement recognizes the need for regulation - but the difficult

¹⁵⁸ Neven, Damien and Georges Siotis 'Foreign Direct Investment in the European Community: Some Policy Issues' in the *Oxford Review of Economic Policy*, Vol.9, No.2, p.85.

¹⁵⁹ Interview with Mr. James Moorhouse MEP, Tokyo, 1 June 1993. The European Parliament resolution on Trade Relations with Japan (Moorhouse Report) adopted 22 January 1993 recommended the strengthening of competition policy with a view to minimising the "competitive granting of subsidies" para 55. Moorhouse reiterated his view on regulation in speech to the Council of the European Business Community, Tokyo, on 7 June 1993: "In Europe we must focus on the notion of common criteria for investment in the EC by foreign companies so as not to undermine the competitive base of the Community's industrial infrastructure."

¹⁶⁰ Holland, Stuart *The European Imperative*, Spokesman, Nottingham, 1993, p.77.

experience of the Commission in defending 'European firms' through trade and 'new zone' investment policy has failed to assert the power of political integration over economic integration.

Panic concludes that "...once economic problems assume global proportions there is really only one optimum policy area: the world."¹⁶¹ While the Commission encouraged member states "to follow a common line",¹⁶² FDI guidelines and new, technology-driven trade developments lay outside of Commission competence. The only remaining territorially-based strategy the Commission had for assisting 'European' industry through the market, was the 'all ships rising' concept, under which external firms benefit equally from enhanced market efficiency. In this case greater cooperative benefit accrues to states which lobbied hardest for Japanese investment.¹⁶³ There is thus a clear political reward for the pursuit of individual external *economic* policies. In such a globalising context, the role of the Commission - and regional political integration - becomes unclear. Unable to implement a Euro-competitiveness policy through the Single Market, and hesitant to embrace a liberal strategy in time to benefit more than a minority of member states - the Commission's strategy became reactive and *ad hoc* precisely at a time when *de jure* strategies sought to strengthen the political union between member states.

¹⁶¹ Panic, Milivoje *National Management of the International Economy*, Macmillan, London, 1988, p.326.

¹⁶² Commission of the European Communities *A Consistent and Global Approach: review of the Community's relations with Japan*, Communication of the Commission to the Council. p.8.

¹⁶³ Peter Robson and Ian Wooton observe that "countries chosen for the production facilities will benefit from the increased employment opportunities." 'The Transnational Enterprise and Regional Economic Integration' *Journal of Common Market Studies*, vol.31, No.1, March, 1993. p.86/87.

CONCLUSION

This thesis has analysed regional political integration in its global political economic context. The research focus emanated from, and was addressed in an analysis of EC-Japan relations in the period from 1985 to 1993. Specifically, this analysis concerned the relationship between the EC *in its constitutional entirety* and Japanese *firms*. The research treated both the political impact of Japanese direct investment on the European Community (1985-93) and the structure and functioning of the EC as revealed in its actions and reactions towards Japanese direct investment.

The methodology used in this study combined international political economy (IPE) and neo-geopolitical ('neo-Braudelian') methodology. The principal theories examined were those relating to European integration, and globalisation. Economic diplomacy was evaluated in the broader and more complex context of concurrent, multi-level political economic bargaining. Such a multi-level approach provided an opportunity to evaluate regional political economic integration in the global system.

The order of the empirical chapters (on sub-states, states, and EC institutions) served to emphasise that Commission-MITI economic diplomacy takes place in the context of two other important strands of the relationship. The inclusion of states and sub-states was imperative to any causal understanding of change in EC-Japan relations.

That different levels of political authority had differing predispositions towards, and reactions to an important externality is evident from the empirical findings. In order to evaluate the integrative evolution of the Community in the period under review, relations between the three levels were examined. Evaluating the extent of political economic integration - in this case EC integration - is difficult since no 'measurement' criteria are commonly accepted. However in evaluating both the impact of Japanese FDI on the EC, and the structure of the EC itself as revealed in its encounter with the phenomenon of FDI; the primary theoretical issue concerning regional political integration and globalisation can be addressed.

FDI relations were not the preserve of any central authority within the Community. Implicitly, FDI represented a challenge to the effectiveness of supra-national industrial policy.

The states and their internal regions played more important interface roles with Japanese firms than Community-level institutions. This was the opposite situation to trade policy, where the legal competence of the Commission is preeminent.

FIG.2 EC EXTERNAL TRADE/FDI COMPETENCIES

	TRADE (AGREEMENT) COMPETENCE	FDI POWERS
EC MEMBER STATES	NO	YES
EC COMMISSION	YES	NO

The increase in volume of Japanese investment came about as a result of the changing strategies of Japanese firms in the global economy. But EC policy itself (through anti-dumping measures and the Single Market Programme) was an important causal factor in this development and its timing. Simultaneously to supra-national constitutional strategies to enhance competitiveness; various member states and sub-states were engaging global capital and production. Further, the outreach of states and sub-states during the era of single market construction, marked a shift from competitiveness confrontation to cooperation.

The evolution of the EC single market - from scepticism over the role of Japanese firms within Europe - to neo-liberal acceptance, was reflected in a hard-fought bargain between 'dirigiste' and 'neo-liberal' forces within the Community. Bi-lateral relations between liberal states and Japanese firms (and sub-states and Japanese firms) played a central role in the evolution of the market in a liberal direction.

The primary strategic *raison d'être* of the European Community in the mid-1980s was to address the problems of competitiveness and unemployment within its territories. The SEA/92 initiative was a project to effect clearly envisaged gains. The execution of such a competitiveness-enhancement strategy required the enforcement of an exogenous/endogenous geopolitical distinction, which liberal states were reluctant or unwilling to institute. Such a distinction was also more suited to the 'classical' trade and trade deficit era of the 1960s and 1970s, during which the geography of the Euro-Japan relationship was largely static in the

absence of high-volume FDI. The concept of competitiveness as perceived to exist between the EC, the U.S. and Japan prior to the era of high-volume FDI became an anachronism, even as 'neo-territorial' projects such as the '92 Programme, NAFTA and APEC were gaining momentum.

The EC member states played a central role in the evolution of the EC-Japan relationship. Although constrained in the pursuit of trade agreements, the EC member states were active in trade promotion and FDI policy. The FDI alliance of liberal Community member states with Japanese firms, was one of the critical determinants in setting the Single Market Programme on a liberal trajectory. The western European market area thus became a catalyst for developments in the broader global economy. Liberal states saw advantage in embracing the globalising economy - *dirigiste* states dismantled their state controls only reluctantly and incompletely.

EC sub-states adopted a positive disposition towards Japanese FDI - a global, *de facto* economic integrative phenomenon. FDI was embraced by EC sub-states primarily for the economic welfare and employment gains which it offered. Sub-state strategies were highly sensitive and responsive to the shift from trade to *trade plus FDI* in the EC-Japan relationship. While the Commission was drafting the SEA, which implied competitiveness-enhancement by exclusion - the regions were actively seeking external allies to enhance efficiency. Such activities of the sub-states (and liberal states) had a direct influence on the evolution of the Commission blueprint for the single European market.

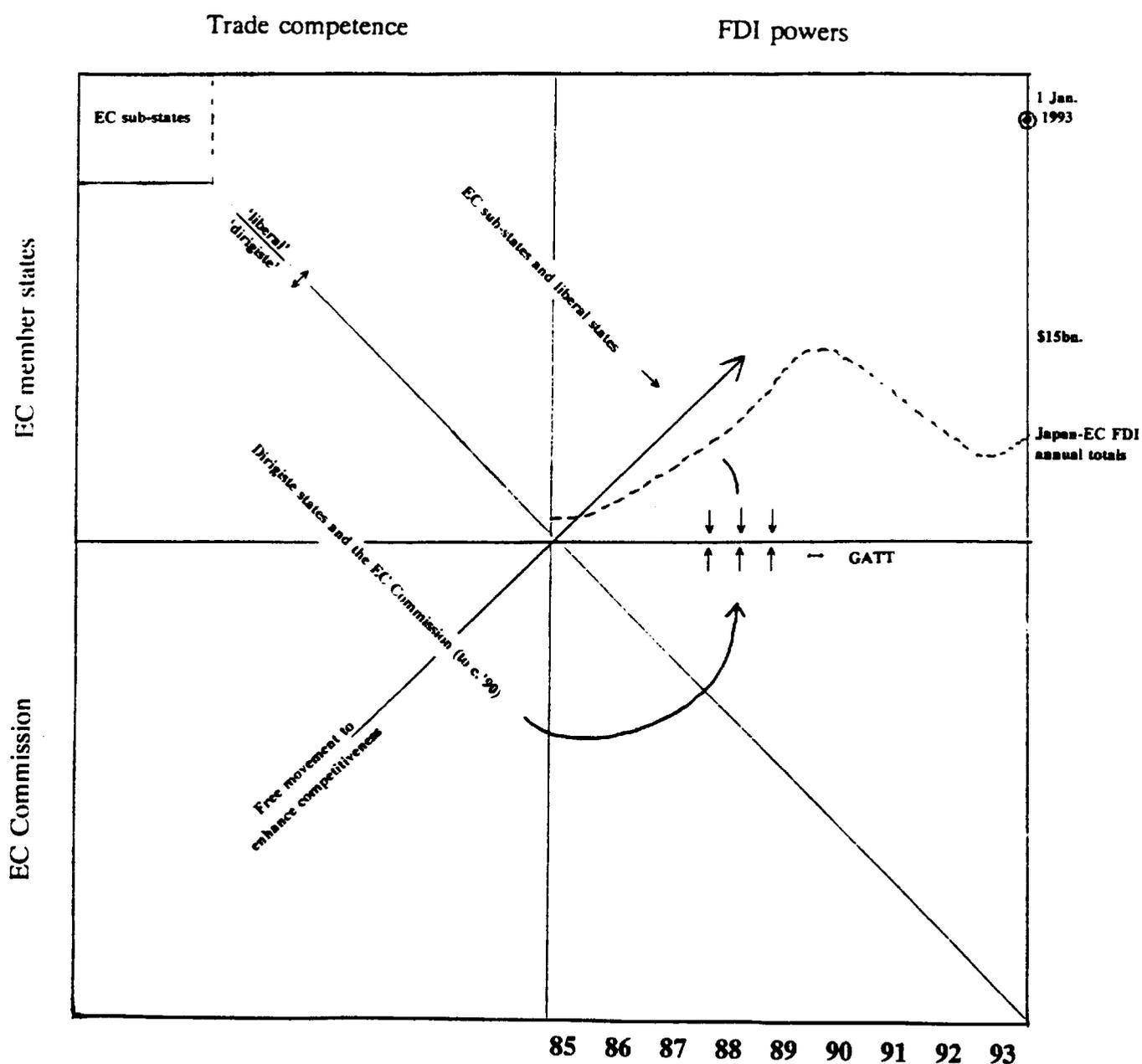
This thesis finds a significant co-relation between increased levels of FDI and increased political tension between the constituent actors within a politically integrating bloc. The presence of Japanese and other TNCs presented the Community with a dilemma. The lack of an EC FDI legal competence presented an opportunity for liberal states to maintain their openness to global capital and production. A contest developed between, on one hand; Japanese firm-liberal member state (and sub-state) alliances; and on the other, the power of the Commission to conduct a uniform response to externalities.

This contest was manifest in Commission attempts to regulate FDI through trade policy

instruments. The pursuit of such a strategy implied that the embryonic single market was far from liberal until the power of globalisation and its accompanying exogenous/endogenous bargains made it so. The rise in global FDI exposed the incompleteness in the Commission's set of external commercial policy instruments.

FIG.3 COMMUNITY COMPETENCIES, FDI, AND INTERNAL POLITICAL RESPONSE TO JAPANESE CAPITAL, 1985-93

Figure 3 attempts to capture the interactive complexity of EC commercial competencies; the role and political economic disposition of member states and sub-states; and systemic tension caused by globalisation, exemplified by inbound Japanese direct investment, 1985-93. The Japan-EC FDI level, peaking over US\$14bn. in 1989, is detailed in CHART 1, p.37.



The extension of anti-dumping duties to include component parts (1987) was condemned by GATT in 1990. When the free movement of goods principle was tested by UK-Nissan in 1988/89, a liberal outcome was the only logical one in accord with SEA free movement of goods principles. Reinterpretation of 'trade era' rules of origin aimed at third country Japanese plants, was the period's most divisive external commercial policy conflict within the Council. In the age of globalising production, the Commission struggled to enforce the geopolitical integrity of the EC itself. Member states refused to permit the Commission to extend the 'totality' of its external commercial powers, from trade competence to *trade plus FDI competence*.

The process-oriented nature of the concepts of 'integration' and 'globalisation' was noted at the outset. These two concepts do not, without qualification, describe actualities. Western Europe is not fully 'integrated' - the world is not fully 'globalised'. This research project concerning the impact of an important externality on the European Community, affords an opportunity to evaluate both the theories and the phenomena to which they refer. Theories of European integration attempt to explain *de jure*, political economic, regional integration. Theories of globalisation attempt to explain *de facto*, economic globalisation.

Theories of European integration primarily evaluate the structure and evolution of the European Communities. However, in the course of evaluating such theories in light of the empirical results obtained - and viewing the EC in its constitutional entirety - some insights can also be obtained regarding the EC member states and regions.

The demise of state functions predicted by some functionalist theorists was not apparent in EC-Japan FDI relations.¹ The SEA/'92 era in the development of the Community may be seen to have commenced with a Commission-initiated neofunctional response to issues of competitiveness *vis-à-vis* the U.S. and Japan. Both the Act and the 'internal' market programme can be viewed as attempts to strengthen the geopolitical integrity of the bloc. Functionalist logic implies that the state becomes less important as specific tasks are

¹ Mitrany, David *The Functional Theory of Politics*, Robertson for LSE, London, 1975. See pp.20-21 above.

undertaken. Within the Community however, the growing presence of Japanese firms highlighted liberal/*dirigiste* divisions in the Council and led to a state-centered response to global economic integration.

Neofunctionalism describes a more conscious handing over of powers to supranational authorities. While the member states delegated decision-making authority in the field of trade agreements (to DGI), the growth of globalised capital and productive volume and mobility, changed the regulatory relevance of this competence. Advances in globalisation, manifested by increasing FDI, outpaced the authority of the Commission. The Commission was thus forced to bargain with member states to address this 'regulatory lag' through the dubious extension of trade instruments. Political tension within the bloc was thus increased. States, with their residual powers of trade promotion and FDI bargaining and regulation, retained two highly powerful competencies with which to engage global economic forces. Further, the Commission was blocked from enhancing its FDI regulatory role, and had one 'new zone' attempt to extend its *de facto* competence to FDI (*viz.* anti-circumvention) condemned by GATT. In the 1991 EC-Japan automobile agreement, where the Commission has tentatively (and only until 1999) encroached upon FDI regulation, the Commission's new 'competence' constitutes little more than an structured 'gentleman's agreement' with the MITI. While neofunctionalism offers some insights into the evolution of the EC external trade competence, it is of little use in explaining the member states' 'Gaullist' retention of power concerning FDI matters.

Functionalists recognised the value of liberal internationalism, but decried its lack of institutional structure. Ironically, the explanatory powers of both functionalism and neofunctionalism receded at a time when a form of neo-liberal internationalism - globalisation - was offering cooperative alliances across the globe. Simultaneously, there was a lack of *global* 'counter-veiling' regulatory power in the system.

The strong role of states in the EC system has been stressed by inter-governmental theory which emphasises inter-state diplomacy within the Community. While inter-governmentalism has strong explanatory potential; this research project points to two problems. The first of these is the common deficiency in EC scholarship of over-emphasis on endogenous forces:

including endogenous states. Neo-Braudelian geopolitics which stresses the potential of externalities to 'manipulate from without' is a useful methodological corrective. Secondly, inter-governmentalism does not sufficiently stress non-state or non-governmental actors. IPE provides valuable correctives to this defect by stressing that the important power interlocutors need not be states.

The EC has frequently been compared, explicitly or implicitly, to federations in the global system. The European Community is not a federation, nor does 'ever closer union' necessarily imply such a constitutional destination. Indeed, the importance attached to the 'four freedoms' as a path to greater global competitiveness was partially inspired by perceived competitive advantages in the U.S. federal system. However, the Commission strategy has essentially been *de jure*. The free mobility of persons throughout Community territory could conceivably be an important counter-balance to inter-state and inter-regional tensions regarding FDI 'loading'. However, the difficulty of attempting to enhance competitiveness through *de jure* measures is illustrated by the comparatively low level of such pan-EC mobility.

One area in which the literature on federalism has been helpful in analysing EC-Japan FDI affairs has been at the level of sub-states. The growing literature on federal states in the global system is of considerable value. This is not least because (like IPE) the literature on sub-states is critical of the IR focus on states. This thesis finds that sub-states play important external relations roles in non-federal, as well as federal systems. The EC literature on subsidiarity has largely and surprisingly, neglected the role of sub-states in EC-external relations. This is a significant defect, since the empirical survey in Chapter III finds a dynamic role for EC regions seeking to enhance local welfare through bargains made with extra-Community enterprises.

The bonds between states and sub-states have evolved in an innovative manner; responsive to global political economic opportunities. The relationship between states and sub-states is qualitatively different from that between the EC level and the member states. There is no evidence that sub-states in their external relations activities ally with the Community-level against states.

Globalisation refers to the increased inter-connectedness of the systemic political economy, driven by financial, technological and information dynamics; and the systemic consequences thereof. Increased global trade and FDI are among the strongest manifestations of such globalisation. Various concepts of globalisation were discussed. These included historical concepts of world and regional economic spaces; literature on the development and organisation of large business organisations; and more recent concepts of contemporary globalisation.

Motion and *de facto* change were the hallmarks of Fernand Braudel's work on the Mediterranean and his writings on early modern Europe.² His emphasis on trans-territorial activity, driven by economic signals in an organically interconnected world has much relevance to late-20th century global phenomena such as FDI. To adopt Braudel's terminology, the EC is a *world-economy* in the *global economy of the world*.³

A *world-economy* has three characteristics: a given geographical space; a pole or center; and three zones (central, intermediate and peripheral). The Community occupies a given geographical space, and has attempted to harness the resources of adjacent territories into an overall competitiveness advantage. In the age of greatly increased capital and productive mobility, this territory can be accessed by firms, rendering the exogenous-endogenous (or 'club' function) less enforceable than during the era when trade was unaccompanied by high volumes of FDI. Although the EC does have a secretariat in Brussels - this does not correspond to Braudel's concept of 'pole', historical examples of which were at various times; Venice, Amsterdam and London. Rather, the Community is multi-polar, reflecting the importance of economic centers such as London and Frankfurt, and the importance of its member states. Braudel's 'polar' concept focused attention on evaluation of the Commission's attempts to orchestrate member state positions *vis-à-vis* important externalities.

² Braudel, Fernand *The Mediterranean and the Mediterranean World in the Age of Philip II*, [1949]. Collins, London, 2 vols., 2nd ed., 1972. See pp.8-13 above.

³ Braudel, Fernand *Afterthoughts on Material Civilization and Capitalism*. Trans. Patricia M. Ranum. The Johns Hopkins University Press, Baltimore, 1977. See p.11 above.

The question of the extent to which the Community could enforce the logic of the 'internal' market in competitiveness enhancement is effectively one of an attempt to establish a 'Braudelian pole' in the European political economy. The system of economic, social, political and individual activity across borders which is Braudel's *economy of the world*, eschews exogenous-endogenous divides so prevalent in IR theory, and admits the constant possibility that external forces can have profound effects on the evolution of systems. In particular, the use of Braudel's concepts points to the uneven 'jurisdictional fit' between the regional political economic entity, and the increasingly global market. This geopolitical dimension is an important conceptual compliment to the methodology of international political economy.

Literature on the history and organisation of 'big business' examines the evolution of one of the primary forces for globalisation. It does so largely from an endogenous perspective - while the more recent contribution of IPE is concerned with the systemic context. By stressing the historical origins of FDI, various authors provide a useful counterweight to theories that globalisation and the challenge, or even threat of globalisation are entirely new. This thesis finds that although the state must bargain with transnational corporations; it is efficiently doing so. One of the proofs of this is the strong relationship between states and sub-states in external relations. Sub-states were frequently found to play coordinated state-auxiliary roles in both federal and non-federal systems. Business historians have pointed to the state-firm dynamic for some time. In this context, Vernon and Servan-Schreiber's⁴ concerns about the threat to state sovereignty were misplaced. However, this does not mean that FDI has no impact on the potential of supra-national authorities to nurture efficiencies from the *bonds* between states.

Coase's concept of internalisation has clear trans-territorial applications.⁵ Inter-firm and intra-firm bonds are the facilitators of FDI. This research project, in examining the

⁴ Vernon, Raymond *Sovereignty at Bay: the multi-national spread of the U.S. enterprise*, Longman, London, 1971. Servan-Schreiber, Jean Jacques *Le défi américain*, Denoel, Paris, 1967. See p.103 above.

⁵ Coase, Ronald H. 'The Nature of the Firm' *Economica*, Vol. 4, London, 1937. pp.386-405. See p.27 above.

relationship between the EC (in its constitutional entirety) and Japanese firms, has analysed the nexus of two relational phenomena - regional integration and globalisation. Such inter-firm and intra-firm bonds are not only commercial. Strange has stressed that firm-firm and intra-firm bonds have political effects.⁶ In contrasting the efficiency of bonds between (and within) firms, with the bonds within the integrating bloc - an opportunity arises to address the core *problématique* concerning integration and globalisation.

Coase's original concept of internalisation referred to commercial efficiencies. Since the activities of firms also have political affects, this thesis has attempted to apply the concept of internalisation to international relations. Should the agenda between two entities be predominantly political economic, and if FDI becomes an important element in such a relationship, the phenomenon here identified as the 'internalisation of an external relationship' can take place - effectively promoting global *de facto* cooperative integration.

At the outset, the European Community was characterised both as a structure and a strategy. Globalisation was defined in terms of the increased volume of transactions over territories since the mid-1970s, and the systemic consequences thereof. This analysis of relations between the European Community and Japan (1985-93) provides an opportunity to evaluate the extent of two forms of integration in which the EC and Japanese firms have been leading protagonists.

This research does not find an increase in the level of political integration in the European Community between 1985 and 1993. There is much evidence to suggest that the systemic political economic environment in which the Community exists is an even greater determinant of the Community's destiny than at any previous time. This may seem ironic since the concept of 'external federator' has been applied to the Cold War period. Increased capital and FDI mobility have greatly undermined the exogenous-endogenous geopolitical distinction, as the EC is increasingly exposed to exogenous developments in commerce - its chosen area of greatest integration.

⁶ Various works; see p.7, fn.3 above.

Even here however, the competence is far from complete and the regulatory 'lag' between trade policy and developments in global FDI has exposed deep commercial philosophical differences between member states. Nor did the 'liberal settlement' of the SEA blueprint mean the end of such differences. In effect, the prelude to the 1st of January 1993 was marked by belated attempts to reopen debate on freedom of movement, where external goods and capital were concerned. (Nor has single market liberalism precluded liberal-sceptic states from blocking the Commission extending its authority to negotiate vital non-merchandise issues in the WTO. Arguments *pro* and *contra* global social and environmental guidelines for production, are looming continuations of the liberal/dirigiste debate between member states in an era of incomplete Commission competence.)

The EC is not a pure inter-governmental system. States like France and Italy are evidently beholden to a more liberal regime than they envisaged whilst negotiating the Single European Act. There is no evidence of automatic functionalism revealed in this study - states have reinforced their trade and investment *promotion* functions in EC-Japan affairs and retain the bulk of FDI powers. Nor can the EC be described as a neofunctional entity when states resist greater Commission authority in the important sphere of FDI powers. While there appears to be a nascent 'federalism', even within centralised states like Spain and the UK, there is no evidence that the EC is moving, or at present capable of moving, towards a federal system.

A continuous theme throughout this synthesis has been the tension between European integration and firm globalisation. This is not a state-firm tension. Rather, it is a tension between firms which seek to extend their influence trans-territorially, and emergent schemes to improve bloc competitiveness through political economic integration. This thesis finds that *de facto*, economic integration as manifested by global FDI, undermines the construction of *de jure*, politically integrated regions.

This analysis of the Community's experience with Japanese FDI suggests that different kinds of territorial governments react differently to the opportunities and challenges of trans-territorial firm activity. The EC, the member states and the sub-states are all territorial entities. This research suggests that whilst all three levels of administration must bargain with trans-national corporations; it is the supra-national level which finds its powers of

coordination most challenged by the alliances between its constituent parts and external firms. For liberal states and sub-states, Japanese FDI can be seen to have posed a viable alternative to centralised EC (SEA/'92 programme) competitiveness stimulants. The presence of Japanese firms within the Community is a challenge to the relationship between competitiveness-enhancement measures and territoriality. This conclusion does not preclude the possibility that regional *economic* integration (throughout Europe) and global *economic* integration may be mutually supportive. Nor does it preclude that ultimate gains from the market might accrue to *all* participants. Such an outcome however, would further undermine the 'competitiveness' function of an EC-level secretariat.

The elusive locus of 'guardianship' of the economic interest emerges as a major theme on the European side of EC-Japan affairs. The investment dynamic in fact reveals that the notion of political guardianship of economic interest has as many constitutional implications as the 'liberal' versus 'dirigiste' debate. Precisely at the point when the Commission acquired full legal competence over trade matters, the increase in FDI and the globalisation of production challenged the EC-external commercial frontier - admitting a greater role for globalisation processes in the evolution of the European economy. Competitiveness-enhancement was becoming ever difficult to manage in the globalising environment into which the '92 programme was born. The increasingly global dimensions of investment and finance blurred the member/non-member distinction precisely at a time when the Commission elected the market as the site for enhancing its political economic fortunes. The 'internal market' was proven to be an oxymoron as the club and market became indistinguishable. But the increasingly liberal market - fully accepted by the Commission by 1993, had a destiny of its own. Or rather, had a destiny which was charted by external as well as internal actors.

The EC is a quasi-legal structure, whose most distinguishing characteristic from a global perspective, is not so much its power, but its lack thereof. The EC is more than a collection of states. However the extent to which it is so, depends upon the period and the realm of competence in question. The SEA/'92 initiative was intended to enhance the global standing of the Community, but in the absence of a constitutional settlement regarding external commercial competence, the dividend was questionable from the outset. A settlement does not mean that the EC would cease to evolve, but that a sense of priority on important matters

might be guided by principles strong enough to over-ride the sum of conflictual bargains. This in turn, does not imply that bargains - even conflictual or lowest common denominator ones - are inefficient. However, the means of attempting to solve an essentially constitutional question - the dearth of EC-level FDI regulatory power - by *ad hoc* reinterpretations and GATT-contrary applications of trade instruments, was an inefficient means of enhancing the stature of the Community in one of its most crucial relations. In its relations with Japan and Japanese FDI, the EC member states once more postponed constitutional settlement. But on this occasion - unlike the Council's refusal to endorse the authority of the Commission to negotiate with Japan in the early 1960s - the alternative welfare enhancement of global economic integration was both manifest and viable.

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INTERVIEWS

- Mr. James C. Abegglen, **Gemini Consulting (Japan)**, Tokyo, 13 April 1993
- Mr. C.J. Dirkzwagar, Commercial section, **Embassy of the Netherlands**, Tokyo, 13 July 1993
- Mr. John Doherty, **Industrial Development Authority of Ireland**, Tokyo, 13 July 1993
- Mr. Jean-Pierre Dubois, Commercial section, **Embassy of France**, Tokyo, 21 July 1993
- Mr. Nobuya Etoh, **Toyota Motor Corp.**, Tokyo, 28 May 1993
- Mr. Yoshiaki Gogami, European and American Operations of **Nissan**, Tokyo, 15 July 1993
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- Mr. Masae Harashima, **Price Waterhouse**, Brussels, 20 August 1992
- Mr. Shigeru Horikoshi, **Ogaki Kyoritsu Bank (Europe) S.A.**, Brussels, 22 July 1992
- Mr. Yuji Hosoya, International Business Affairs Division, **MITI**, Tokyo, 16 June 1993
- Dr. Alexis Jacquemin, *Cellule de Prospective*, **Commission of the European Communities**, Brussels, 23 July 1992
- Ms. Jaspersen, Commercial Section, **Embassy of Denmark**, Tokyo, 9 July 1993
- Mr. Kiyoshi Kobori, **Baden-Württemberg Representative Office**, Tokyo, 21 July 1993
- Mr. Teruhiko Mano, **Bank of Tokyo**, Tokyo, 7 April 1993
- Mr. Rui Boavista Marques, Investment Dept. **Embassy of Portugal**, Tokyo, 8 July 1993
- Mr. Takeo Miyauchi, Industrial Development Department, **Embassy of Luxembourg**, Tokyo, 15 July 1993
- Mr. James Moorhouse, M.E.P., Tokyo, 1 June 1993
- Dr. Reinhard Neumann, Investment Committee, **European Business Community**, Tokyo 18 June 1993
- Mr. Christopher Norall, Forrester, Norall and Sutton Esqs. Brussels, 16 July 1992

Prof. Gorow Ono, **MITI Research Institute**, Tokyo, 25 March 1993

Mr. C.E.A. Ripley, Investment section, **Embassy of the UK**, Tokyo, 23 March 1993

Mr. Takashi Saegusa, President, **Canon Italia SpA**, Milan, 7 April 1992

Mr. Michio Sasamori, **Hitachi**, European Business Development Department, Tokyo, 30 June 1993

Mr. Hisashi Tainaka, **Canon**, Affiliates Management Division, Tokyo, 15 June 1993

Mr. Eiji Toyosaki, **Canon**, Tokyo, 15 June 1993

Dr. Malcolm Trevor, **EC-Japan Centre for Industrial Cooperation**, Tokyo, 31 March 1993

Mr. Antonio Verde, Commercial section, **Embassy of Italy**, Tokyo, 16 July 1993

Mr. David Whibley, Legal Department, **Rank Xerox (UK)**, Marlow, 31 March 1992



