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A Policy Crossroads?

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European Business in Japan:
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by Susan Strange[1]

With a few exceptions, European business in Japan has only a modest presence and generally speaking a low profile. This is in sharp contrast with the very visible presence of Japanese firms doing business in Europe - Britain especially - and in North America. The figures, rough as they are, are striking. The stock of Japanese direct investment in other countries is 20 times greater than the stock of foreign direct investment in Japan. Even the Keidanren, the patronat of Japan, has admitted as much.

The other sharp contrast is between the response of Americans and Europeans to this imbalance. In America in recent years it has been a top subject of discussion among politicians, business interests and academic writers. The literature on the subject of Japanese business success not only at home but in the United States is vast. Much of it lies in management studies : how and why Japanese firms succeed where others fail. (Dore, 1987; Abegglen, 1973; Moroshima, 1982; Komiya, 1991). Some of it lies in policy studies: how the imbalance has come about and what should be done about it. (Encarnation, 1992; Prestowitz, 1988; Zysman and Cohen, 1987; Tyson, 1992; Bergsten and Noland, 1993). It fits with the widespread perception among Americans that now the Cold War is over, the battles of the future will be economic and will be between America, Japan and Europe, the three industrialised powers referred to as the Triad. (Hart, 1992; Albert, 1991; Thurow, 1992; Van Wolferen, 1990). The general tone of the American debate and of the literature it has generated

[1] Research for this paper was supported financially by the Commission of the European Communities and by the Japan Foundation. Research assistance by Thomas Bourke and Leslie Hoy is gratefully acknowledged, as was the cooperation of many officials and corporate executives in Tokyo.

has recently been more critical of Japan for failing to provide a level playing field than of American business for failing to move with the times and adapt to the exigencies of a world market economy.[2] The American concern, moreover, is bipartisan. The US Senate, through the independent agency of the Office of Technology Assessment, last year commissioned a major report on the investment imbalance and the implications for future policy.[3] In short, if the US government regards the imbalance in trade and investment with Japan as a major foreign policy issue, it is only reflecting academic and political opinion in the country at large.

In Europe, the issue is far down the political and intellectual agenda. The first concern of the British, the Italians, the Germans, the French and the rest is with their respective domestic politics and with internal national issues. In foreign policy, to the extent that such a thing as a European foreign policy exists at all, it is with the immediate neighbours of the European Union so-called, with the EFTA countries, with the ex-socialist neighbours of central Europe, with Russia and the Ukraine - and, of course, with the tragic saga of Yugoslavia. The literature on European relations with Japan, in contrast to the comparable discussion in America, is sparse in the extreme. It tends to the historical and is mostly confined to specialists on Japan. One best-selling book, Michel Albert's Capitalisme contre Capitalisme has dealt analytically with the competitive nature of Triad relations. There have been some less well-known studies of the subject of this article (Rothacher, 1983; European Parliament, 1992)

What follows is motivated by the belief that this European indifference

[2] James Abegglen, the veteran Japan-watcher and business consultant in Tokyo is a notable exception. He has persisted in the belief that the causes of the imbalance lie as much or even more with US managers than with the Japanese. It is a view most Japanese, but few other Americans, share.

[3] Its first report, Multinationals and the National Interest, was published in September 1993.

and general disinterest is both myopic and mistaken. It is also motivated by the hope that a serious discussion of economic relations with Japan could be started. There are reasons for thinking the time for it may be ripe, and that it need not have the emotive overtones of the American debate. But an informed discussion has to be based on three elements. Each forms a section of the present paper. One is the nature of the barriers at present deterring European business from entering the Japanese economy, and the changes currently taking place on the Japanese side. Some of the evidence for this section is derived from published work and official documents. Some is derived from a small but selective number of interviews recently made with foreign managers in Tokyo. This will form the first section of the paper.

The second section, equally necessary for informed discussion, attempts a summary of the historical background to the 20:1 imbalance of investment. This will emphasise the roles played in the whole postwar story by firms, as distinct from but alongside those of governments. This is the perspective on international political economy developed in Rival States, Rival Firms by John Stopford and myself, and which we referred to as 'triangular diplomacy' (Stopford and Strange, 1991). It draws heavily on the work of Japanese specialists in business schools, notably Dennis Encarnation and Mark Mason, and of economic journalists such as the present editor of The Economist, Bill Emmott.

The third and last section will spell out the larger geopolitical context of the specific issue of barriers to foreign firms. It will argue against any European agreement to help the United States to put coercive official pressure on the Japanese government to bring down the barriers, what is called in Washington, 'multilateralising gaiatsu' (foreign pressure). It will make the case for reinforcing the weakest leg of Triad relations - that between Japan and Europe - in the wider interests of better management of the world's political economy in the aftermath of the Cold War. The argument to be developed has some relevance to some of the long-running debates in academic quarters. One is about whether the international political economy - the capitalist system, in effect - does or does not require the intervention of a hegemonic power if it is to remain both stable and prosperous. My argument will be that in present circumstances a triangular balance of power - an old concept for realist writers on international relations - may offer a better hope of peace, prosperity and good government than depending on hegemonic leadership. I have to admit that this represents a change of mind. I have argued in the past that Hegemonic Stability Theory based on the common premise of declining American power, was for American scholars a convenient rationalisation of the short-term unilateralism that in my view has dominated US foreign economic policy for the past two decades. If, as I have argued in the past (Strange, 1982, 1987), the decline in American power, especially structural power, was being grossly exaggerated, then the crucial problematic was not where to find an alternative hegemon (Gilpin, 1987) but how to persuade US policymakers to forswear negative hegemony and to return to the sort of positive, constructive leadership that the US exercised in the early postwar years. I have now come to the conclusion that the best hope of achieving such a U-turn by the Americans may be for the Europeans and Japanese to develop a little multilateral gaiatsu of their own.

How real are the barriers ?

The overwhelming opinion of foreign opinion in Japan, whether in government or business, is that it is the informal barriers to foreign-owned firms that are now the most important and effective. There are government practices and policies - even a few tariffs and trade barriers - that are still impediments to FOFs, but by comparison with the informal barriers they are relatively unimportant. The two most important informal barriers are the keiretsu relationships between Japanese firms and their suppliers and distributors ; and the obstacles in Japanese culture and law to mergers with, and acquisitions of existing businesses in Japan. The latter, it is conceded is an obstacle for everyone, Japanese firms as well as FOFs.

Keiretsu in Japanese means linkage, lineage or just 'system', the way of doing things. They are of two kinds, horizontal and vertical. The rude word for some horizontal keiretsu would be cartel. A more polite term for others might be conglomerate. Both can trace their roots back to the old prewar zaibatsu that the Americans' postwar occupation authorities tried to break up, as they did in Germany with the decartelisation measures. Indeed, three of the current eight horizontal keiretsu groups -Mitsui, Mitsubishi and Sumitomo - are continuations of the old zaibatsu (OTA p.88). Typically such groups include a major bank, a large insurance operation, a trading company and a congery of sectoral firms loosely associated with one another. One recent study estimated that the six major groups accounted for as much as a quarter of Japan's GDP since the war: another that two-thirds of Japan's imports are handled by trading companies affiliated with the major keiretsu (Rapoport, 1991 and Gerlach,1992, both quoted in OTA report p.89). The association is maintained through mutual shareholding. Partners' shares are not customarily bought or sold on the open market. It is also maintained by giving preference to other partners in business, whether buying or selling.

Vertical keiretsu are a chain of suppliers - of raw materials, of components, of finished goods for distribution - organised by and through a major manufacturing firm. Large firms like Toyota or Matsushita may have linkages with well over a hundred different primary suppliers and literally thousands of secondary ones. The suppliers are dependent on the core firm, and may carry most of the risks of changing market conditions or corporate strategy. But the link is mutually understood to be a long-term one and promises the smaller firms a measure of security. It is not unlike the relationship of tied public houses in Britain to the big brewery firms, or of large retail chains like Sainsbury or Marks and Spencer with their "own-brand" manufacturers. Anyone who has read Moroshima's Why Japan Succeeded (Moroshima, 1982) will not miss the implicit feudal origins of these linkages, and thus the association of the practice with Japanese culture and history.

The question, of course, is not so much whether the practice is breaking down as whether it can be penetrated by newcomers. Obviously the long term commitment to existing partners, whether horizontal or vertical makes it more difficult for an outsider to enter the charmed circle. But not necessarily impossible. Anecdotal evidence suggests that FOFs too - given time -can develop keiretsu-like relations with suppliers or with distributors. Nippon Lever, for instance, has built up what it regards as a very satisfactory relationship with a Japanese firm which operates vending machines on the pavements of Tokyo and other big cities. Nippon Lever supplies the cans of tea and other soft drinks; the Japanese partner looks after the machines. And outside Japan, in north-east England for example, the steady rise in the local content of Nissan cars is not entirely due to the fact that its Japanese suppliers followed Nissan to the Newcastle area. Some British suppliers have also become part of this offshore vertical keiretsu.

Nor is Nissan alone in extending the system beyond other Japanese firms to foreigners. The OTA study already cited notes the record of Nippondenso, the world's largest auto parts manufacturer, and a part of the Toyota keiretsu. It has no less than 11 plants in North America, 4 in Europe and 12 in Asia. But although Toyota owns a quarter of its shares, Nippondenso also produces parts for Honda, Mazda and Mitsubishi and also for US car firms.

The other private sector barriers of which foreign-owned firms repeatedly complain is the difficulty of getting into the Japanese market by buying an existing Japanese company or arranging a merger with one. Most of the complaints, it has to be said, come from the Americans, for whom M and As - mergers and acquisitions - are a common feature of the business world. Indeed, there was a time in the mid-1980s when about the only profitable departments of some of the largest US banks were the ones arranging M and As for their clients. It was, after all, in the United States that the junk bond was invented as a means of financing corporate takeovers. (Michael Milken went to jail - briefly - not for issuing junk bonds but for making a personal profit out of the insider knowledge so acquired.) Although there was a decline in US takeovers in the early 1990s, there has recently been a new wave of deals in America.[4] In Germany, by contrast, it is also difficult for foreign firms to buy into and thus take over existing German companies. The Kuwaitis for instance once wanted to buy up Krupps, but were refused. The reason is not dissimilar from those in Japan. In both countries, there are government regulations that make takeovers difficult, but it is more in the culture and in private corporate structures that the barriers exist. In Germany the large shares of industrial firms owned by the major banks constitute a big obstacle, even to other European firms. In Japan, small firms are often the creation within living memory of their founders. "Chief executive officers of small and medium firms," I was told by a Japanese specialist in such matters, "think of their firm as an extension of themselves and their family. To sell out would be shameful -like selling their personal identity."

Another very good reason for the rarity of corporate mergers and acquisitions in Japan lies in the system of inheritance taxation. There are two ways the family owners of a business can avoid paying rather heavy inheritance taxes. One is to sell the business to a dummy company so that it no longer

[4] Financial Times, February 17, 1994.

figures in the founder's estate. Another is to arrange a management buy-out in which the ownership or part of it passes to the senior employees.

Selling out to a foreign multinational has been the least preferred option. Moreover, foreign firms complain that they rarely have equal opportunities with Japanese competitors. The information that a business might be open to offers is seldom made public; foreign firms only get to hear of it when a Japanese rival has already clinched the deal. The figures speak for themselves. In 1992, EC-based firms acquired 37 local firms in Japan. Although this was more than double the 1989 figure, it compared with 257 mergers or acquisitions between Japanese firms in Japan in the same year.[5] Figures for 1990 showed an even greater disparity between 115 EC firms acquired by Japan-based firms, and only 10 Japanese firms acquired by EC firms. Yet though attitudes change only slowly, some observers expect the current recession, and the fall in share values, to make family members more eager to realise capital from some of their investments. Others insist that the multiplicity of factors behind the obstacles to M and As mean that this 'screen door' will not disappear in a hurry.[6]

The other crack in group exclusivity is where - as might happen anywhere - the cosy cartel becomes complacent and allows others to develop new technologies by which they can enter the local protected market. One of the strongest and most centralised keiretsu is in the glass industry. The Japanese market is dominated by just three large firms,led by Asahi Glass, the centre of a horizontal grouping of companies, all Japanese. But, as the US trade negotiators complained last year, none of the group had the technology to

[5] European Business Council,(1993) Restructuring Japan; M and A opportunities? pp.8/9. The source for the figures cited is Yamaichi Securities.

[6] The phrase 'screen door' to denote an informal, but effective barrier to entry is Mark Mason's in American Multinationals in Japan (1992). See also a survey of the economic literature in Bergsten and Noland (1993).

produce thermal glass. Either, it was argued, room for US firms like Dow, Corning (or for that matter British ones like Pilkington) should be made in the market, or they should be allowed to join in the oligopolistic group.

Another instance of the technology factor came from ICI. Long-established in Japan, the firm recently developed a plastic 'mix' that can be used to produce, quite simply, an imitation marble bath. Since baths play such a big part in Japanese domestic life and culture, the product had been highly successful in gaining market shares - through, of course, local bath-manufacturers and distributors. Yet another was a deal worked out by Rover (Japan) with Kawasaki to produce rolling stock for the shinkansen (bullet trains).

One of the sectors where foreign technology has often had the technological edge over local firms is pharmaceuticals. The result is that the leading FOFs - mainly American but also British, Swiss and German - have 20 per cent of the market in Japan. Health care, with an ageing population is clearly a growth market, and foreign manufacturers who are world leaders in this sector are bound to benefit.

The keiretsu system and the barriers to M and As in Japan are common knowledge. Less familiar are some of the practices of government which suspicious foreigners see as part of a clever Japanese conspiracy to keep FOFs out, but which more likely have persisted because there was no particular reason to change, so long as the economy was growing so fast and everyone was prospering.

One such is the accounting system. It requires corporate transparency through independent external audit of only the largest firms with issued share capital of more than 500 million Yen. This means that the proportion of companies required to make their accounts available to the general public is lower in Japan than in nearly every major industrialised nation. This serves to increase the disadvantage suffered by companies seeking to assess with any confidence the financial position of a competitor, acquisition target or joint venture partner.[7] The tax system also discriminates in practice against new 'greenfield' ventures by allowing the firm to carry forward its early losses against its liability to tax for only 5 years. Since new ventures rarely become profitable in any economy in less than 5 to 7 years - and sometimes longer (Picciotto, 1992; Reddaway, 1967) - the new venture launched by a large conglomerate Japanese firm is at a distinct advantage over the European or American newcomer starting from scratch. In Britain and Germany, by contrast (though not in France or Spain) tax losses can be carried forward indefinitely. Some firms are also put off starting up in Japan by the regulations on profits remitted abroad. Japan applies a 10 per cent witholding tax on such repatriated profits, while most other developed countries have adopted the OECD standard rate of 5 per cent.

Such measures are not unknown in many developing countries anxious to keep for their weak economies the benefits of local operations by FOFs.[8] They make less sense in Japan which is the world's largest holder of gold and foreign exchange reserves and the world's largest creditor and aid-donor. Similar echoes of Third World practices are heard when European managers list some of the administrative aggravations they have encountered in doing business in Japan. Flowers, and fruit, for example are two things the foreign visitor finds inordinately expensive in Japan. One reason is the administrative hassle involved in bringing them in to the country. Customs offices are mostly closed over week-ends and are slow and inefficient at the best of times. Flowers die and

[7]EBC op.cit.p.17.

[8] See Stopford and Strange (1991) for a comparison of such measures in Brazil, Malaysia and Kenya. One of the striking factors accounting for the greater success of Malaysia in attracting foreign capital was its longstanding policy of never restricting the repatriation of profits - the result as we explained of an old deal by which Britain gave military support in the early days of independence.

fruit rots while they wait to be elaborately fumigated against foreign pests to clear customs. Health and pest-control regulations are complex and exhaustive. The exchange rate and the consequent cheapening of foreign goods has only made the customs bottleneck worse. To avoid the logjam at Narita airport, smart firms have taken to importing through other major city airports.

The administration of product safety and quality standards is another common complaint, more aggravating for imports than for local production. But since even for the latter, spare parts and machine tools often have to be brought in to Japan, the multiplicity of rules is frustrating. For instance, although not only BMWs, Mercedes and Rolls Royce but also Rovers 4-wheel drive cars have done well in Japan in recent years, the procedure involved each individual product having to get official approval, instead of a sample of each consignment as is the more usual practice. The same sort of complaints are heard from firms selling cosmetics and toiletries in Japan.

Lastly, there are a number of other more questionable complaints made by foreign firms against the 'screen door' protection of the Japanese market against foreign penetration. That they are based on established fact and common practice is not in doubt. It is whether they are quite so peculiar to Japan as some of the firms make out. The American literature tends to paint the picture of Japan as the eccentric, odd-man-out in an otherwise liberal open economy. But it may be that the United States and Britain are the outliers, not Japan; and that even then the US itself is not entirely innocent. Some of its own habits, rules and practices dating back to the Buy American Act of the 1950s are not altogether liberal.

One such complaint concerns government procurement contracts habitually awarded to Japanese and seldom to foreign firms. Anyone familiar with the literature on national obstacles to the Single European Market is well aware that discriminatory public procurement - in defence products, in telecommunication products, computers, shipping services and many other sectors - is a far more important impediment to the SEM than tariffs or quotas on imports. Much public procurement moreover involves construction; and the Japanese construction industry is notorious among Japan-watchers for its corrupt connections with the yakuza or criminal gangs. A 1992 report to the European Parliament complained quite seriously that whereas European companies got practically no contracts in Japan, Japanese construction companies actually got 2.2 per cent of European contracts.[9] Many of the MEPs who read the report must have been well aware of exactly the same corrupt sharp practices common in Europe, and especially in such regions as Southern Italy or Northern Ireland (Arlacchi, 1991).

Another well-publicised complaint against the Japanese concerns the restrictions upon foreign professionals, especially lawyers. There is little doubt that foreign firms have found these irksome. But it would be hypocritical to pretend that it is only in Japan that invisible barriers protect the professions. Let a British dentist, taking the EC rules on rights of establishment seriously, try and set up a practice in France.[10] In the United States, the American Medical Association has for years insisted on US qualifications before a foreign practitioner, however well qualified, can even write a prescription.

Then there is the whole question of competition policy. The United States representatives have complained that insurance in Japan is not covered by anti-trust or competition rules. True, but it is also a fact that in certain niches of the business foreign firms like AIC or Royal Insurance are doing quite good business in Japan. As in banking, the innocent researcher soon begins to suspect that the foreign firms who by diligence, perseverance, charm or firm-specific

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[9] Report to the European Parliament by James Moorhouse MEP, 1992.

[10] My own dentist tried to do so and gave up in despair.

assets of one kind or another have managed to get inside the Japanese screen door are more than content with their lot. I have even been told that some are afraid that liberalisation undertaken under foreign pressure might be used by their Japanese competitors to undercut them and drive them out for good.

The Historical Record

There is no denying that many European diplomats and businessmen in Japan believe that 'gaiatsu works'; that the pressures put from time to time by the US government on the Japanese has produced positive responses. Although performance has not always lived up to promises - as in the share of the semiconductor market promised to the Americans by the end of 1993 - yet the pressure, even the threat of punitive counter-measures, has produced significant results. To the extent that European governments individually, or the European Commission collectively, has less clout and can utter less dire threats than the Americans, these Europeans are content to be free riders on American tough diplomacy.

In the short run, it may be true that 'gaiatsu works'. But as I shall argue, in the long run, I believe it is already proving counter-productive. In February 1994, for the first time a Japanese prime minister not only resisted US pressure but signalled the fact publicly by refusing to sign the usual cover-up communique. Many Japanese must have cheered his courage. Even bystanders commented that it was short-sighted of President Clinton to apply pressure on a fragile coalition at a time when the US economy was recovering and the Japanese one still suffering the worst recession since the war.[11]

And in the wider perspective of political relations in the Triad, a short-run benefit for a few European businesses from going along with American gaiatsu

[11] Financial Times February 15,1994

cannot be worth the long term damage to Europe-Japan relations. Moreover, the historical record on this issue tells a different story.

Firstly, the record shows how inconsistent US policy has been toward Japan. In the mid-1960s, without warning, US policy underwent a total volte-face. The Japanese were expected to adjust quickly and without complaint. This was not how things are usually done in Japan. Yet volatility has often characterised American politics, domestic and foreign. The Macarthy witch-hunts following close on New Deal liberality was a domestic example. In economic policies deeply affecting America's allies, Europeans will remember Nixon's sudden, unilateral move on August 15, 1971 to devalue the dollar and abolish the Bretton Woods gold-exchange system of fixed exchange rates. Developing countries will remember the suddenness of the monetary volte face ten years later when the United States under Reagan abruptly shifted from an inflationary to a deflationary monetary policy. It was they who were then expected somehow to adjust quickly and without complaint to higher interest rates, and heavier burdens of debt. There are other instances, but it would be wearisome to list them all. The point is only that the Japanese covert and unofficial measures against foreign firms from the late 1960s on have to be seen in the context of American U-turns .

Secondly, the historical record shows that corporate diplomacy has played a much larger part in making holes in the Japanese strategy of closure to foreign firms than it has usually been given credit for.[12] US firms may even have achieved more over the post-war years than the US government. This is a point that emerges from studies by business economists, but is largely ignored by

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[12] See for example, the 1993 study by Fred Bergsten and Marcus Noland, Reconcilable Differences? United States-Japan Economic Conflict The emphasis is almost exclusively on government policies. The authors recommend changes in the domestic policies of both governments. The role of firms is only incidentally referred to.

mainstream economic theorists. It is also consistent with the model of international political economy and the notion of 'triangular diplomacy' developed by John Stopford and me in Rival State, Rival Firms (1991).

For those not already familiar with the historical record on this issue, there follows a brief summary of the highlights. Japan specialists will already know the details and will also be aware that I have drawn heavily on the work of Dennis Encarnation and Mark Mason.[13]

The story begins, for these purposes, with the reign of General MacArthur as the autocratic ruler of Japan under US occupation from 1945 to the conclusion of Dulles' peace treaty in 1952. In that time, while US policy in Europe pushed hard for the liberalisation and privatisation of trade and for openness to US private enterprise, the policy in Japan was just the opposite.[14] The restrictions put on foreign firms in US-occupied Japan were every bit as restrictive as those of the Peoples' Republic of China or the USSR.

Why? Some historians would argue that this was only out of respect for a long tradition, going back to 1640 and the Tokugawa closure to the outside world, a closure that was not greatly changed by the arrival of Admiral Perry and the Meiji restoration of 1868. True, a few treaty ports were opened to western traders and after the first world war, a few - mostly American - firms were allowed actually to assemble manufactures in Japan. But the 'respect for Japan' explanation is unconvincing. MacArthur not only acted like a modern Mikado, he broke up the large powerful zaibatsu and imposed agricultural reform in the countryside.

[13] Dennis Encarnation and Mark Mason, 'Capital Liberalization in Japan', International Organization Winter 1990. Also Dennis Encarnation, Rivals Beyond Trade (1992).

[14] For the argument, in my opinion exaggerated, that the Marshall Plan was, in large part, a strategy to make Europe safe and comfortable for American capitalism, see Fred Block, The Origins of international economic disorder (1975)

A better explanation, surely, lies in the respective roles of Europe and Japan as front-line areas in the Cold War with the Soviet Union. Despite the trauma of the atom-bomb, Japan had only to be a compliant forward base so that the US could resist any expansion of either Chinese Communist or Soviet power in the Pacific. Unlike Japan, European countries harboured active communist minorities whose resistance to military alliance with America made rapid economic recovery a vital American interest, for mainly strategic reasons. A necessary condition for this was a restoration of trade across national frontiers, and an infusion of American manufacturing technology. Hence the conditionality of Marshall aid, which included open access for American firms - who in any case had had a much larger presence in prewar Europe than they did in prewar Japan.

Under occupation, therefore, Japan received generous aid with few strings attached, was given lucrative military contracts and encouraged to push its export industries. In addition,laws were made in Japan that gave the Ministry of Finance almost total control over all foreign exchange transactions with foreign firms outside the country.[15] New entrants were effectively barred. A few foreign firms that had functioned in Japan before the war - oil companies like Shell, chemical companies like ICI and a few high technology firms - were later allowed back in. But they could neither convert their profits into foreign exchange nor transfer fees or royalties to their parent firms. Ford and General Motors which had been nationalised during the war were not allowed to invest the yen they had got as compensation into new assembly plants. As two informed American observers remarked recently, 'The US has played a part in Japan's emergence as the most closed market among the industrial countries'[16]

[15] Notably, the Foreign Exchange Control Law (1949) and the Foreign Investment Law (1950).

[16] L. Silk and T.Kono, 'Sayonara Japan Inc' in Foreign Policy No 93.p.117.

When the occupation ended in 1952, little changed. By the end of the 1950s, FOFs had been allowed to invest less than $100 million all told. The government allowed in only firms that accepted a junior role as minority shareholders in Japanese firms. But these joint ventures were not allowed to diversify into new business nor add to their capitalisation. Only a very modest proportion of profits could be taken home. The only other crack opened in the defensive wall was to allow in a few FOFs which agreed to repatriate nothing at all and functioned only as yen-based companies. This followed a bilateral treaty with the US in 1953 and another later with Britain. At this time, the official US attitude was one of total indifference.

The only significant breakthroughs were through corporate diplomacy. (Encarnation and Mason, 1992, p. 35-38), notably by Coca Cola and IBM. In 1956, after a decade in which Coca Cola was bottled in Japan exclusively for sale to US troops, the company at last found a way to break in to the civilian market. The price was high. Its major competitor was also let in, and both were subject to heavy taxes and government control over price, advertising and marketing. They also had to function as yen-based companies. But Coca Cola's bargaining with the government was reinforced by firm-firm diplomacy. Choosing Kirin, the biggest Japanese beer company - and therefore potential opponent of competition from Coke - the company negotiated a deal by which Kirin bottled coke in the Osaka region with machinery supplied by the Mitsubishi group. It also set up a sweetener fund to pay off the disgruntled small breweries.

Where Coca Cola's firm-specific asset had been the palpable civilian consumer demand for the product, the IBM story was based on the firm-specific advantage of computer technology eagerly sought by a half-dozen Japanese producers. Fujitsu, Hitachi, Toshiba and the rest certainly pressed MITI to do the deal with IBM, arguing that Japan's exports would suffer if they could not get access to IBM technology. IBM knew that its technological lead would shorten in time. The agreement therefore licensed IBM technology to the Japanese, accepted restriction of its local production, a 5 per cent limit on royalty fees and a commitment to export from Japan. In return, though, it could set up the first majority-owned local affiliate and for 5 years could remit as much profit home as it pleased. A breakthrough indeed, but one achieved only through state-firm and firm-firm diplomacy. As Encarnation and Mason comment : "In the absence of official support, IBM and other American MNCs had to manipulate their control of firm-specific assets to generate both local allies and, in concert with those allies, Japanese government concessions." (p.37)

The official US U-turn around the years 1964-66 has to be seen against the wider background of international monetary relations and changes in the US and Japanese balance of payments. By 1964, it was clear that the Kennedy advisors who had assured the President that ad hoc measures would be enough to defend the dollar despite the worsening deficit had been over-optimistic. Triffin's warnings about the defects of the gold-exchange system were heeded and the demand from Europe for international monetary reform was growing. At the same time, Japan was at last showing a payments surplus. As a member of the OECD and the IMF which at last had accepted Article VIII, Japan was expected to conform and to liberalise its controls over capital just as the Europeans had done in 1958.[17]

The record suggests widespread Japanese disbelief in the seriousness of such demands. At the OECD, the government registered a long list of

[17] In fact, it did the opposite. Too many MNCs, American and European, had been encouraged by the IBM breakthrough to set up yen-based companies in Japan despite the restrictions on them. Taken aback by this sudden influx, the government in 1963 actually suspended the yen-based policy on the grounds that it was soon to abolish all restrictions on FOFs. But 'soon' was slow in coming.

exceptional deviations from the liberal principle. It was hard for the Japanese to understand why the United States had turned so abruptly from protector to policeman, from assisting Japan to stay closed to insisting that, all of a sudden,it should open up. Hitherto, the Americans had not only given Japanese exports much more open access to the American market than the Europeans had given to theirs. They had also first pressured the latter to let Japan become a member of GATT and then made them stop using Article XXXV to keep Japanese textiles and other goods out of their sheltered ex-colonial markets.

To cut the story as short as possible, American impatience with Japan mounted as the dollar's vulnerability increased and as the 1967 devaluation of sterling promised more trouble to come. Few Japanese can have understood these external pressures on Washington policy makers. By 1966/67, US politicians were openly criticising Japan for procrastinating and encouraging the Europeans to do the same. It was at this point that the Japanese government, encouraged by public (and of course business) opinion, took steps to erect informal barriers behind the formal policies keeping foreign competitors out. There is little doubt that this strategy had the full approval of public as well as business opinion. There had been something of an influx of new firms prepared to accept yen-based and junior status for the sake of getting a foot in a growth market. The press referred to this as an invasion and there was much public debate about what to do. The majority view, expressed by a vice-minister of MITI to the OECD in 1970, was that only by eschewing free trade and protecting high value-added industries could Japan avoid sentencing its population to the Asian pattern of stagnation and poverty as producers of textiles, toys and other goods made with cheap labour.[18] The Foreign Investment Deliberation Council (FIDC) was consequently given regulatory

[18] Yoshihisa Ojimi, quoted in Abegglen and Stalk, (1985) pp. 71-2.

authority and was packed with representatives of domestic industry and the Liberal Democratic party. It then drew up a series of restrictive rules for foreign firms and shareholders. What happened thereafter has been summarised by Dennis Encarnation:

"Japanese oligopolists gradually moved to replace public regulation with private restrictions... As aggressive intermediaries between American multinationals and the Japanese state, Japanese oligopolists managed to control both the timing and the substance of changes in their continuing strategic investment policy. In the end, Japanese oligopolists took charge."

That judgment is confirmed by recent conversations with foreign managers of firms in a variety of sectors of the Japanese economy. It is also evident that the stories of IBM and Coca Cola were followed by other instances of trilateral diplomacy involving both Japanese business interests and branches of the bureaucracy. An important deal struck around the time of the switch from public barriers to private ones,involved Texas Instruments (Encarnation and Mason, 1990. p.44-45). Its firm-specific asset in the mid-1960s was control over patents critical in the manufacture of integrated circuits. Its interest was in supplying IBM in Japan from its own affiliate. For four years, its efforts were rejected by Tokyo. Official American complaints went unheard. Finally in 1968, it negotiated a deal with its Japanese competitors to license its envied technology to them in return for being allowed in as joint partner with Sony, under obligation to 'consult' with MITI on its market share. (OTA, 1993, p.35, Box 2-8).

Another important deal was Chrysler's 1969 surprise agreement with Mitsubishi. The latter was keen to get access to the American firm's worldwide network of car dealers. In return, Chrysler could build and sell cars in Japan through a joint venture with Mitsubishi. Ford followed with a similar deal with Mazda, General Motors with Isuzu. MITI, whose rationalisation plans to bring about mergers of smaller manufacturers to compete with the big firms were thus frustrated, was not amused. The episode also showed that Japan Inc. was not quite the unitary actor that some foreign observers had supposed.

The pharmaceutical industry was another sector where Japanese firms wanted access to foreign technology to gain market shares from competitors. Merck's joint venture deal with Banyu was another example of firm-firm diplomacy. The overall conclusion is that some foreign firms were allowed in, usually as partners only, and only when they brought some firm-specific asset coveted by Japanese business. Otherwise the screen-doors controlled by private oligopolies, aided by language difficulties, the difficulty of recruiting good local staff and (until recently) the high cost of property, proved singularly effective. The picture by 1993 was of a few - comparatively speaking - old-established and large foreign multinationals fairly comfortably established in Japan; of a few smaller enterprises with high technology or world reputations in the luxury end of the market; and of very many small and medium foreign firms who had, I was told, attempted to break into the market but after a few years had given it up as hopeless, closed down their Japanese operations and gone away. There are no statistics on the failures.

Meanwhile, from the late 1970s to the early 1990s, the US increased official pressure on Japan to rectify the imbalance of trade. This was done first through a series of VERs (Voluntary Export Restrictions) and after 1988 through the Super 301 clause of the Trade Act, which effectively used a 'black list' of countries, Japan among them, which the US decided were acting unfairly. In 1986,the Japanese were 'persuaded' by such threats to sign the ad hoc semiconductor agreement, according to which the government was supposed to make sure that US firms increased their market share in Japan to 20 per cent. The emphasis all along has been on trade, although all the evidence suggests that the trade imbalance is only a mirror for the asymmetry between the easy (and early) access that Japanese firms had to the foreign markets, especially the American one, and the limited access of foreign firms to Japan. (Encarnation, 1992)

In stages, since that time, there has been a significant change in Japanese official policy, culminating by 1991/92 in a series of affirmative action measures to promote new ventures by foreign firms in Japan. The low-cost loan programme started by the Japanese Development Bank in 1984 has been substantially increased and made more accessible - although at first only 3 per cent of FOFs had taken JDB loans. Local and central taxes on foreign firms have been simplified and reduced. The Foreign Exchange Control Law was revised in 1992 so that the government asked only for ex post notification of investment. (MITI,1992) Prior notification, carrying the possibility of official objection, was needed only for defence-related production where there was a possibility of technology transfer to foreign firms; and for the natural resource sectors like forestry, fishing and mining in which all OECD countries were free to lay down exclusive rules. In 1993, the government even set up a new office, FIND, whose avowed purpose was actively to assist foreign firms to find partners and market-shares. At the official level, there is now little difference between Japan and European rules and administratively Japan seems somewhat more helpful to newcomers than France, for example.

American sceptics - and some Europeans - insist that these changes are the result of pressure; and also that official liberalisation in the 1990s as in the mid-1970s, is still only cosmetic, so long as the real, informal obstacles remain. A longer, stronger, collective push is therefore needed to effect real change. The OTA report mentioned above specifically states as its goal 'to suggest a framework for concerted multilateral action to construct a system of international commerce - one that constrains mercantilism, balances interests among nations and between nations and firms and facilitates business conditions conducive to international commerce.' (OTA 1993. p.11)

The alternative explanation, which seems to me more persuasive, is that the root of current change lies in Japanese domestic politics. Behind the poor showing of the Liberal Democratic party at the last elections lay a series of political scandals not unlike the tangentopoli in Italy. The full extent of the zoku giin links between politicians and the business interests who funded them was revealed. The revolt of voters was echoed by a movement for change in the Keidanren and other business circles. The Keidanren came out with a 10 year plan to cut back and rationalise the government bureaucracy - in their own interests as much as those of foreigners. The switch is not unlike the change around 1989/90 in business opinion in South Africa; old policies of apartheid in one case and closure in the other were proving too big a handicap to firms needing to compete successfully in world markets. Significantly, 21 of the 30 items in the government's emergency economic package in September 1993 were changes suggested by the Keidanren.[19] The bursting of the bubble economy and the long-lasting and severe recession is also bringing change and there is a new attitude among Japanese consumers in the shops and among students in the universities. Faith in life-long employment and the virtues of hard work and long hours, tolerance of high retail mark-ups, and of anti-competitive cartels are all fast disappearing. Provincial and regional discontent with central government, as in Europe or Canada, is vocal and growing. In short, the shift in official and organised business opinion is responding much more to domestic change and domestic pressures than it is to coercion from the Americans. When the latter plead their case as being on behalf of the Japanese consumer, they are preaching to the converted. Their tone, however, is much too holier-than -thou. In recent months, it has not gone down well. A Financial

[19] Keidanren Review No. 142 October 1993. See also an article on political reform by Keidanren President, Masaya Miyoshi in the same issue.

Times headline when Hosokawa refused to reach agreement with President Clinton said it clearly : "Plaudits pile up at home for hardline Hosokawa; In the face of domestic recession the sight of a Japan that can say No is a new and welcome one in Tokyo"[20]

Europe's Response

In this situation - as in others - the European governments have been undecided and ambivalent. France, which has only one firm in the top 50 foreign firms in Japan compared with 29 American, 4 British and 5 German, has been openly hostile.[21] Britain, with the largest share of Japanese firms in the EC, is much more friendly and has several active bilateral associations. Yet when the British prime minister visited Japan in 1993, he brought more complaints than olive branches, as had M.Delors earlier in the year.

Of the two strong arguments why the European governments should make no promises to the United States on collective gaiatsu, and on the whole should refrain from official complaints, one is tactical and pragmatic; the other is strategic and geopolitical. The tactical and pragmatic rests on the availability, and greater effectiveness in practice, of direct representations by business firms organised on a sectoral basis, industry by industry. Even before the European Commission set up its Tokyo office in 1974, the heads of the various European Chambers of Commerce had joined together to exchange information and coordinate their efforts on behalf of member firms. By 1983, this had evolved into the EBC -European Business Community - with a Council, a minuscule secretariat and a number of sectoral committees, and a few regional branches.

[20] Financial Times February 14, p.4.

[21] Gemini Consulting (Japan) November 1992 calculates these equity-adjusted shares for the top 50 foreign firms. Among these, US firms account for over 72 per cent of the total, German firms 28 per cent and British 28 per cent. France has fewer than 1 per cent.

The EBC claims to be the only forum presenting a unified European view on trade and investment matters -meaning that it has Swiss and other non-EC firms; its secretary, Keld Hammering, is Danish and has wide Scandinavian contacts. Bypassing governments, it uses quiet informed discussion with the relevant authorities rather than the bluster and bullying -and consequent media attention - inseparable from public diplomacy. It has established close links with key parts of the Japanese bureaucracy - the prime minister's Import Board, MITI's Fair Trade Commission, JETRO and the Office of Trade and Investment Ombudsman. Each committee draws up reports on reforms which it would like adopted.

If the premise is correct that reform, when it comes, will result from a Japanese perception of national interest in change rather than from external pressure, then the member governments of the European Union would be wise to leave representation on specific matters to the EBC. That does not preclude giving the organisation some financial assistance. Delegation of responsibility added to discreet financial support,from state to private bodies, is used in aid and relief programmes so there is no reason in principle why it cannot be extended to trade and investment diplomacy, especially if it avoids political division between EU member governments. Where the European governments can and do usefully intervene is through the jointly-run EC-Japan Centre for Industrial Cooperation. Set up in 1987, it conducts intensive Japanese language courses for European managers, and operates a valuable information service for firms.

So much for the tactical and pragmatic reason why European governments should refuse to join the United States in multilateralising gaiatsu. The other reason is geopolitical, derived from conventional realist theories of international relations and world systems. These suggest that a stable world order may be achieved either through the dominance of a benign, public-spirited hegemonic power or, alternatively, by a balance of power. The balance of power concept incidentally, applies equally to industrial relations between management and employees, or to inter-communal relations between ethnic or religious communities. The abuse of power, leading to a destructive and eventually destabilising build-up of resentment and anger on the other side, is best held in check by some sort of equilibrium between the power of the parties.

Since the end of the Cold War, the world has had neither a benign, public-spirited hegemonic order nor a stable balance of power. The old bipolar balance in world politics has gone. It was one essentially of mutually destructive military capability based on nuclear weapons and intercontinental missiles, between the United States and the Soviet Union. On the American side it took precedence over and to some extent suppressed the balance of power between the three leading centres of financial and commercial power in the world market economy - America, Japan and Europe. This was because both the latter were dependent on American nuclear protection. What has been called the 'implicit bargain' was that the United States would provide, pay for, and more or less unilaterally administer military security for the affluent alliance. But in return for the nuclear umbrella, Japan and Europe would not challenge American hegemonic dominance in the management of finance and trade in the world market economy. American vetoes on change and reform were absolute, as the record for the 1960s and 1970s clearly shows. Whatever complaints there may have been over the management were silenced by the awareness of military dependence (Strange,1986).

Now, with diminishing perceptions of military dependence, the implicit bargain is no more. But in its place there is neither a true trilateral balance of power nor a benign hegemonic order.[22] A true trilateral balance would require that any two of the three parties would be both able and willing to check and restrain the third. A benign hegemonic order would require that one party exercised predominant power in the system, and was prepared to use it, even at some cost to itself, for the benefit of all.

Instead, there is a triangular configuration of power in which the predominant partner, the United States, exercises asymmetric structural power in the world market economy but feels itself neither able nor willing to fulfil the classic responsibilities of a beneficent financial hegemon. (Kindleberger, 1973). It neither provides an international currency which is stable in terms of real goods and services ; it does not offer an open market for surplus goods; nor does it unequivocally stand ready in a crisis to supply liquidity to the global banking system. Its dominant position has rather been used since the early 1970s to pursue narrow national interests, both financial and commercial, and to impose on others, rather than accept for itself the adjustment costs both of changes in market conditions and in US economic strategies.

This abdication, compared with the early postwar period, has been excused by the declinist school in the United States on the grounds of a loss between the 1950s and the 1980s of relative power in the world economy. I have always argued that the declinists exaggerated this loss by using inappropriate indicators and drawing false conclusions from them. This led them to ignore the continued dominance of the United States in all four of the major structures of the international political economy. It has dominated global production through its control over a large, open and rich domestic market, and

[22] It seems legitimate to write of a trilateral rather than a multipolar balance, at least in relation to the management of the global market economy. Russia and China are absorbed by their own problems and neither they nor any Islamic state has the economic strength to play a significant part in issues of trade, finance or investment for some time to come.

through the predominance of American multinationals. It has dominated global finance through the predominance of the dollar as an international currency and the innovative leadership of US banks and financial centres. It has dominated the global security structure through its military and nuclear capability. And it dominates in the realm of ideas and beliefs through the intellectual resources of its universities, the leadership exercised by its professions, and, not least, through the worldwide popularity of its culture in films, TV, music, fashion and clothes (Strange, 1988).

For over a decade, I hoped that the abdication would be reversed, perhaps as a result of a change of Administration. I now think this was a futile hope, but not because, as some declinist writers supposed, power was passing from the United States to some other country, probably Japan (Gilpin, 1988). It was futile because the weight and complexity of the hegemonic burden had far outdistanced the capacity and willingness of any nationally-elected government voluntarily to act in the general, as opposed to the narrow national interest. The US, in short, had not lost relative power to another state but to the world market economy. The irony was that it was the United States which had been instrumental in shaping and creating this uncontrollable Frankenstein's monster. It was this shift in the state-market balance which accounted for the switch first in US foreign economic policy and then in academic thinking from liberalism in economic doctrine to 'strategic trade theory' which is no more than a euphemism for calculated mercantilism.

Thus, the asymmetry in the triangular balance remains. As a result of persisting US structural powers, American power over each of the other two parties is far greater than their power to exert influence over the behaviour of the United States. The Rio conference of 1992, when US obduracy was maintained against both European and Japanese opinion on environmental issues was a clear demonstration of this asymmetry. As a consequence both of this disparity and of history and habit, US-Japan relations at every level are much closer the Europe-Japan relations, just as US-Europe relations are closer than Japan -Europe relations.

Whether by accident, instinct or design, the recent strategy adopted by US policy makers has served only to reinforce this asymmetry. The US-Canada trade agreement was perhaps mostly a Canadian initiative to avoid Canadian goods ever being shut out of the US market. But its terms also served to increase US bargaining power with Japan, especially on cars. And the North American Free Trade Area including Mexico was unquestionably designed for the same purpose. By 1993, the US not only accused the European Community of jeopardising the conclusion of the Uruguay Round, it followed up the Kantor-Brittan eleventh hour confrontation with a summons to Japan and other Pacific states to the East to join it in Seattle for the inaugural meeting of the Asia Pacific Economic Community (APEC). True, APEC did not amount to much in practice. But as an exercise in economic statecraft, it sent a strong warning signal to the Europeans that they might be excluded from the fastest-growing region in the world economy. Divide and rule, indeed. (Baldwin, 1987; Higgott 1993).

Instead of supine acceptance of this hegemonic strategy, it would seem logical for Europe and Japan to combine forces wherever possible, and to act together more effectively than they did at Rio. It would be in the interests of everyone - including the Americans - if there were to be clearer and more transparent principles laid down for the management of financial institutions and markets, of national policies affecting exchange rates, of trade relations and the treatment of foreign investors. There are surely common interests shared by both the weak legs of the three-legged stool which makes up the Triad. Both are more dependent than the US on imported sources of energy, and therefore have an interest in some longterm arrangement with oil producers. Both have a strong interest in pressing on the United States stronger sanctions than any agreed in the Uruguay Round against and backsliding from the mechanism for trade dispute settlement in the GATT. At present, the eclipse of Russia allows the United States a special influence on the United Nations - an influence which is used only intermittently and for goals of direct interest to Washington not for the overdue reform and reconstruction of the organisation. A concerted strategy for UN reform could win support from Latin American and other Asians and Europeans. Similarly, a redistribution of voting power in the IMF and World Bank and in the regional development banks is long overdue. European and Japanese ideas on the necessary and sufficient conditions for a peaceful transition for ex-socialist economies are much closer to each other than they are to American ideas of leaving it to the market to manage itself. On each of these issues, there is also a silent constituency of opinion within the United States that would welcome rather than resist some more coordinated constructive diplomacy from the Japanese and the Europeans. Gaiatsu multilateralised could work on America too.

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