European Reactions to Japanese Trade and Investment

By Louis Turner

While European reactions to Japan remain cautious, the worst excesses of Japan-bashing are certainly out of fashion. Since the removal of the controversial Madame Cresson as French prime minister, political reactions have been muted. European politicians have seen how successful the United Kingdom has been in attracting Japanese investment and realize that open attacks on Japan are counterproductive.

Ironically, the danger of such attacks is being reduced as the intensity of Japan's entry into the European economy has temporarily fallen off. The collapse of the bubble economy, the strengthening of the yen and the current recession in Europe mean that Japanese companies have become significantly more cautious about their European involvements. According to Japan External Trade Organization (JETRO) statistics, the increase in the number of new Japanese affiliates in Europe has been declining since 1991. During 1992, approximately 20 Japanese companies actually retreated from their European operations.

On the other hand, Europe is entering a new period of self-questioning. Most of the Continent is now in an economic recession. There is an awareness that European companies are no longer strong enough to support the kind of welfare system Europeans have come to expect. As Euro-pessimism starts to increase, there is a danger that a scapegoat will once again be sought. The success of Japan in both trade and investment would make it a possible target one more time.

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For the moment, though, Japanese companies report little tension. The same JETRO study has 87% of such companies in Europe claiming there is no friction with local communities. Two years ago, less than half of them were making that claim.

A lessening of tension?

The trade imbalance between Japan and the European Community is still a source of continued friction. At $31.2 billion in 1992, it remains large, and reduction remains an important goal for the EC Commission. Despite the size of this imbalance, however, EC-Japanese trade diplomacy seems to have reached a certain level of maturity.

On a political level, the EC Commission now has the outlet of the annual high-level EC-Japan dialogue which was launched in 1991 with a joint declaration, signed in The Hague. The EC has used this framework to push for what is called the "trade assessment mechanism." This is a series of bilateral talks begun in early 1993 which is meant to discover the causes of imbalances and trade obstacles in specific sectors which concern the two sides. This "mechanism" is somewhat controversial, in that the Europeans undoubtedly see it as something which should run parallel to the Structural Impediments Initiative which Japan has with the United States.

Even if the Japanese side questions some aspects of this dialogue, it now means that the Commission can raise issues which concern it with its Japanese counterpart. For instance, in July this year, the dialogue touched on issues such as whether European companies were getting their fair share of the liberalized Japanese public procurement market. In particular, the Commission raised the question of the sourcing of the engines which JAL would use in its new Boeing 777 order, and of the Self-Defense Force's intentions for purchasing executive jets.

This EC-Japan dialogue on economic issues is much less developed than the equivalent Japan-USA framework, and this influences European strategies. The EC Commission—like most informed Europeans—is deeply suspicious of the American tactic of pressuring Japan to hit numeric targets in specific sectors. In European eyes, such managed trade is dangerous because the strongest negotiating partner achieves its goals by squeezing out politically weaker competition. The Europeans claim that this explains why the USA gained more than four times the benefits Europe did when Japan opened public procurement to foreign suppliers last year.

So, in the July 1993 EC-Japan negotiations, the EC representatives went out of their way to speak up against managed trade. As Sir Leon Brittan, the EC commissioner with responsibility for trade negotiations put it: "If sectoral targets are dangerous when agreed by others, they don't become less dangerous when agreed by us."

These fine words are, however, undercut by events in the auto industry.

European companies in this sector (including the American companies in Europe) are having extreme difficulty in catching up with the Japanese competition. In 1991 they forced the EC Commission to negotiate a limitation agreement with Japan, whereby Japanese automotive exports to Europe should be limited for the rest of the 1990s—after which the European market should be totally open. This deal was surrounded by ambiguities, such as how the output of the Japanese automotive transplant factories in Europe

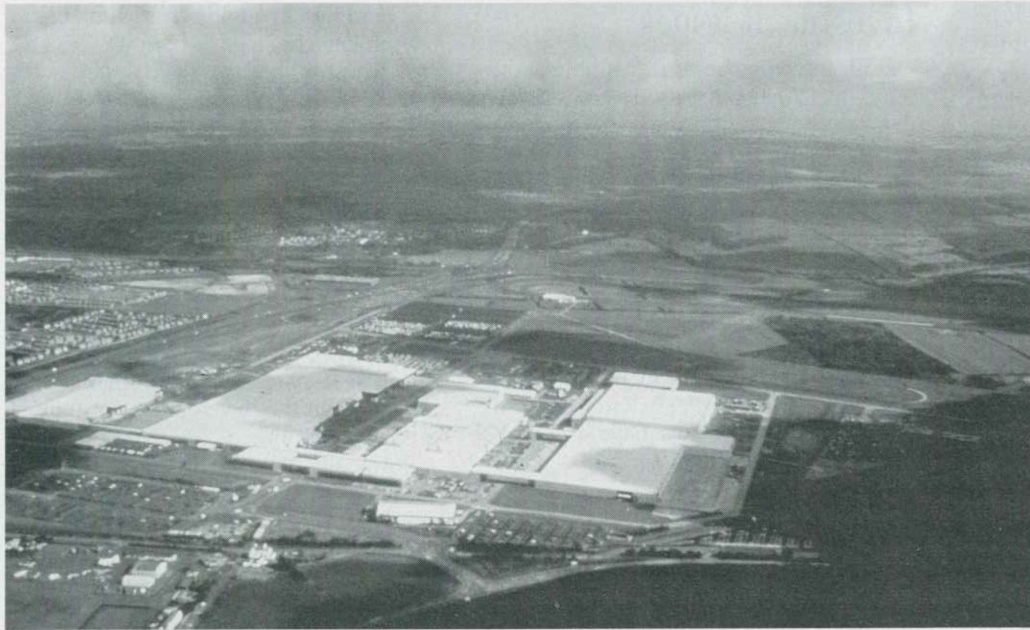

Photo: Nissan Motor Co., Ltd.

Nissan Motor's plant in England

should be "taken into consideration" in any calculation of permitted Japanese sales. The EC Commission made a series of clarifications on how they felt the spirit of the agreement should be interpreted. It is not always clear that Japanese negotiators actually accept European interpretations on issues such as what proportion of unpredicted falls or increases in the European automotive market the Japanese industry should be expected to take on.

This agreement has proved difficult to administer. Twice in 1993, the Europeans have come back to the negotiating table to argue that slumping demand for autos in Europe means that Japanese auto exports should be cut back still further. In addition, the whole issue of how Japanese transplant production should be treated has been left (to some European eyes) unresolved.

Developments in this sector are slightly worrying. It is no longer just Jacques Calvet of Peugeot who is making a strong (in his case, emotive) anti-Japanese case. During 1993, the American company Ford went on record that Japanese investments in Europe were unsatisfactory because they were not sufficiently integrated. Even more worrisome, German companies, which were once firm advocates of free trade, have become more protectionist. An influential (but controversial) executive who moved from General Motors to Volkswagen, the Spaniard Jose Ignacio López de Arriortúa, was quoted in August as saying: "Unfortunately, [the Japanese] are different. I don't like their way of living ... if you are losing this battle [for industrial supremacy] and you have new bosses, then sooner or later you will have the same style of living as your bosses." (*Independent* 23 Aug. '93)

These are extreme views but they are not uncommon in the European auto industry. Already, the strength of this lobby has twice forced the EC Commission back to the negotiating table with Japan. One can argue that market conditions in 1993 have been exceptional, but one is still left with a slight worry about how firm Europe's promise to free auto markets from the year 2000 now is.

If one puts the automotive sector on one side, trade relations between the EC and Japan seem less emotive than they have been in the past. We seem to have passed through the era of constant anti-dumping actions against Japanese exporters. This may be because Japanese companies have learned how to make the necessary transplant investments and to control export surges. It may also be because the relevant authorities in Brussels are scrutinizing calls for anti-dumping actions much more carefully.

Interestingly, we are starting to see the development of "retro" exports from Japanese plants in Europe back into Japan. Admittedly, this is still a small-scale development, and Nissan's exports to Japan have been averaging around 1,500 per annum. In March 1993, they announced they would be adding four-wheel-drive (4WD) vehicles (Terrano II) from their Spanish operations. Toyota is starting to export components from its U.K. operations back to Japan. In addition, as the strengthening yen makes importing more imperative, we are starting to see announcements of quite significant switches in purchasing policies by Japanese companies—such as Mitsubishi Corporation's deal with Pilkington Glass in the sheet glass field.

Given that the strong yen has, for the moment, ruled out most politically sensitive export surges from Japan, the European focus is shifting toward the issue of market access to Japan for both goods and services. The trade diplomats currently focus on the restrictive treatment of foreign lawyers in Japan, distortions in liquor taxes which affect whisky imports, restrictions on leather goods and the slowness in liberalizing airline traffic.

On issues such as these, Europeans and Americans are both allies and rivals. Both want Japan to push ahead with opening its markets. However, they are deadly rivals in areas such as aircraft, with sales to Boeing being seen as defeats for Europe's Airbus interests

(and vice versa). Obviously, Japan has to be free to choose its trading partners. However, European concerns are deeply felt. The Europeans worry that key orders in sectors such as aerospace and telecommunications will go to the USA more for political than economic reasons. As long as we are in an era in which Japan's import policies are "politicized," it is inevitable that the Europeans will seek to register their interests strongly in Tokyo.

Even if sectors such as aerospace exports to Japan remain relatively sensitive, the average European is not likely to become too excited. However, the Japan-European trade relationship does contain one activity which will remain visibly controversial for as long as it continues. This is the issue of the reprocessing of plutonium fuel needed for Japan's nuclear program.

This is a sector in which there is a classic "perception gap" between Japan and Europe. Japan (perhaps along with France) is one of the few industrialized countries whose policy makers view nuclear power as a relatively benign source of energy. Elsewhere in the world—particularly in the USA but also in large parts of Europe—worries have grown about the dangers of nuclear accidents or the diversion of nuclear products to war-like or terrorist purposes. To such opponents of nuclear power, the nuclear trade between Japan and the reprocessing plants in France and the United Kingdom is particularly controversial. For one thing, it involves plutonium, which is seen by nuclear critics as the key product which has to be controlled. In particular, this Japan-Europe cycle involves transporting this product around half the globe thus increasing the chances of accidents or deliberate attacks by terrorists. The safe journey earlier this year of the Akatsuki Maru, with its 1.5 tons of reprocessed plutonium fuel from France, will not have reassured the critics. These will remain a vocal, unofficial but well-publicized group who will surely try to publicize future consignments of reprocessed fuel. The economic attractions of this trade may well be convincing ... but it will remain controversial.

Investment issues

With the collapse of the bubble economy, investment in Europe has slowed, thus giving the first wave of Japanese investors time to settle down in the European environment. Currently, there have been few controversies, though there still is an underlying tension between the United Kingdom, which has openly welcomed such investment, and other countries, such as France and Italy, which have been critical of Japanese investments in the past, but are now more actively encouraging them. (The French now have a government program called "Le Japon, C'est Possible.")

The first point to make is that Japanese investors have allayed most original European fears. For instance, they have not insisted on dominating European partners. The British point to the way that Fujitsu has allowed ICL to play a relatively autonomous role within Fujitsu's global strategy. They also point to the way that Rover's alliance with Honda has allowed the British auto manufacturer to pull itself back toward profitability, without having to become a Honda subsidiary. Clearly what is happening is that Japan's European partners are becoming de facto *keiretsu* members, rather than becoming cogs in a closely integrated organization coordinated ruthlessly from Tokyo.

Not all collaborations have persisted. Recently, the long-lasting joint venture between Philips and Matsushita was dissolved, reflecting the fact that the latter is now seeking to play the same kind of global role which Philips has long pioneered. Such a corporate divorce is a natural development in these circumstances, and it merely signals that alliances are never permanent affairs. As the interests of the two partners develop, some alliances will deepen and some will inevitably wither away.

There are examples of alliances which have been deepening. Siemens, for instance, is another company which has learned how to collaborate with Fujitsu. This alliance has recently been extended to include the joint development of the next generation of mainframe computers. Ford has a badging deal with Nissan for the latter's Spanish-built 4WD vehicle. Mitsubishi has an alliance with Volvo in the Netherlands—though Mitsubishi's more ambitious plans for an alliance with Daimler Benz, the German aerospace and auto conglomerate, seems unlikely to come to very much. However, in terms of Euro-Japanese relations, the occasional failure or unbundling of an alliance does not matter. As long as major players like Siemens see a positive case for deepening their alliances with companies like Fujitsu, then the development of mutual trust will continue.

Politically, though, it is the fate of the automotive transplants which will dominate the debate in the next two or three years. Nissan's factories in the U.K. and Spain are now being joined by those of Toyota and Honda—also in the U.K. Combined production from these plants has risen from 320,000 in 1992 to a projected 450,000 to 500,000 in 1993. (This prediction will certainly prove over-optimistic since the collapse of European demand for automobiles has been unexpectedly severe and plans for exporting from the U.K. to the rest of Europe have had to be cut back.)

These plants have been accepted well in the United Kingdom, where they are seen to be a way of rebuilding an uncompetitive automotive sector. They are hitting targets for localized component supplies. They are also getting far higher levels of productivity from their European operations than are their local competitors. Nissan U.K., for instance, claims that it is producing its Primera model with 12.5 hours labor per car, against a 20 to 22 hour average achieved by competing European companies. Unlike the case of similar transplants in the USA, there has been remarkably little controversy over the nationality of the component suppliers, though some European-based competitors are starting to focus on this issue.

One senses that this automotive sector will remain a problematic one for some time to come. Clearly, the Japanese companies intend to expand their transplant operations in Europe—but such an expansion will be in an industry already

facing severe over-capacity for the rest of this decade. There is bound to be some continued friction as this process unfolds.

Whatever the future diplomacy surrounding autos, one can see the steady evolution of Japanese investment strategy, as the first generation of investors increasingly reinvests and otherwise improves its localization policies.

We are, for instance, starting to see Japanese companies in the early stages of rationalizing their relationships across Europe. Nissan, for instance, has been having troubles with its Spanish subsidiary and has had to inject a further $130 million into it. It is also starting on the process of slimming down the number of suppliers it uses in its U.K. and Spanish operations. During this process, the company will undoubtedly be increasing the amount of its common purchasing which can be spread across the two operations.

At the same time, Japanese investors are improving the quality of their investments in Europe. To some extent, they are moving this way for purely internal reasons. However, such steps are also politically wise because the most common accusation still made against the current generation of investments is that they are "screwdriver" affairs. As Mr. Ian McAllister, the chairman and managing director of Ford Motor Company put it earlier this year in a letter to a British newspaper: "The Japanese could make an even more significant contribution if they were to transfer more of their high-wage, high value-added research, design and engineering to Europe." ... and this is starting to happen.

On the automotive front, Nissan has created a 360-employee operation called the Nissan European Technology Centre, which is charged with helping in the design and development of vehicles. It has already led the design for the Terrano II model which Nissan will retro-import from Spain back into Japan. Nissan is spending a further £20 million on this Centre to expand its vehicle testing facilities.

Other Japanese companies are following the Nissan route and are also designating parts of their European operations to take the lead in developing certain products. Canon has done this with their European Research Centre for certain advanced audio products. Sony has similarly designated its Basingstoke-based operation in the UK as the company's lead research and development center for designing professional broadcasting equipment.

We can also see the start of more fundamental research activities. Hitachi and Toshiba both have a relationship with Cambridge University's world famous Cavendish laboratory, where they are conducting research into quantum mechanics. In the case of Hitachi's £1 million-per-annum Cavendish investment, the Anglo-Japanese research team has already developed a single electron device. Sharp Laboratories Europe has a larger research operation in the Oxford Science Park where they had 42 staff in March 1933.

Conclusions

The relationship between Europe and Japan will never be an easy one, but the current state of affairs between them seems reasonably positive. Japanese companies are putting down substantial roots in Europe, and seem relaxed about the reception they are getting.

However, the current economic downturn in Europe may lead to a temporary increase in trade friction. After all, not all Europeans are totally committed to free trade, and there are voices within Brussels calling for a European version of Super 301—a mechanism which would allow the EC Commission to act unilaterally where it felt that European interests were being affected by trade distortions.

During this coming period, the best indicator of how relations are developing will be how the automotive understanding between the EC and Japan evolves. There will undoubtedly be some political strains in this sector during the current automotive slump. On balance, such strains should not lead to any wider long-term crisis. JJTI

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tributions that were made during the Gulf War. Further, as Garten notes, it is also possible to apply thinking about burden sharing to social and economic policies, as well as global environmental protection, but this has not always gone so well in reality.

Garten brings up several conditions for leadership and of these the most important is the existence of a clear sense of purpose that can be fully understood by the people of one's own country and other countries that follow. This was typified by the "communist containment policy" of the Cold War.

With the loss of this type of clear sense of purpose a vacuum has occurred. Certainly the U.S. took enough military leadership during the Gulf War. However, in order for this to function financial backup from Japan and Germany was indispensable. Regardless of this volume's title, *A Cold Peace*, although the overall threat of nuclear war may have disappeared the world is hardly in a state of peace. How should the leadership vacuum be dealt with? It is most likely a question of how Japan, Germany, and the U.S. can actively cooperate in burden sharing and how each will make use of its leadership resources for the benefit of the rest of the world. This will also naturally require that advanced nations other than these three also strive to actively shoulder their responsibilities.

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