

Aiming for Harmony

By Toru Nakakita

Industry is changing in both Japan and the United States, and these changes—changes induced by massive Japanese direct overseas investment—must color any discussion of industry in the 1990s. Japanese overseas investment strategies are transforming the relations of comparative advantage, spawning new economic activity, and pushing efficiency to new heights.

There is a growing globalization, and it is imperative that Japan and the United States take the initiative in further opening their markets, easing their regulations, and harmonizing their standards to promote this globalization, which promises to invigorate the world economy and strengthen the foundations of peace. Globalization is the talisman for fending off protectionism in the 1990s.

American trade policy for the 1990s will increasingly be characterized by demands for reciprocal market liberalization in sectors where America has the comparative advantage (e.g. agricultural goods and high-tech products) and efforts to revive its manufacturing sector by encouraging competitively weak manufacturers to enter into international alliances and joint ventures.

Attracting Japanese direct investment and management techniques is a special focus of this industrial policy to enhance manufacturing competitiveness and rein-vigorate the traditional smokestack sector. Thus the next round of trade battles will center on a new export push by the United States and import expansion by Japan. While some Japanese industrial sectors may find this a painful process, consumers will benefit from lower import prices.

There has recently been a flood of foreign direct investment in the U.S., with a particularly dramatic increase in investment by Japanese companies. Lured by the dollar's slump on international exchange markets, Japanese and European companies rushed in with direct investment until, as of the end of 1988, total

outstanding foreign direct investment in the U.S. exceeded American investment abroad. By the end of 1988, Japanese investment in the United States totaled \$53.4 billion, second only to Britain's \$101.9 billion (Table 1). While much of the Japanese direct investment in the U.S. has been in banking, securities and real estate, a sizable portion is also being channeled to the manufacturing sector.

Streamlining, innovating

Voluntary export restraints are one reason for this rapid increase in Japanese direct investment in manufacturing in the U.S. By relentlessly pursuing operational streamlining and technological innovation in the latter half of the 1970s, Japanese manufacturing companies were able to become conspicuously more competitive in processing and assembly across the board. This was a mixed blessing, as it generated serious trade friction with the U.S. and provoked the institution of "voluntary export restraints" (VERs) on, for example, electrical equipment, steel, automobiles, machine tools and semiconductors. This was the birth of managed trade.

Yet with the yen's exchange strength starting in 1985, the significance of these voluntary export restraints has changed substantially. Today, they are seen not as a way to hold down Japanese exports but as a means of getting Japanese companies to invest in the U.S. and to bring their managerial know-how with them.

Not only did yen-denominated export profits fall as the yen strengthened, but higher dollar-denominated prices frequently meant that exports were less than the VER ceilings. As the VERs as formulated have become moot, America has moved to redistribute its import quotas globally. At the same time, efforts are under way to establish new rules governing trade in steel and other products.

While the initial momentum in this surge of Japanese direct investment in

the U.S. was defensive in nature as foreign investments were geared to offsetting export volumes, the scope of foreign operations has recently broadened to include sales, research, and a host of other activities in line with Japanese global strategies. In keeping with this sectoral broadening, there has also been a diversification away from simple investment and to a complex mix of equity participation, licensing agreements, business tie-ups and the like. Transplants also came into their own in 1989 to give Japanese automakers an increasing share of the U.S. market despite VERs and other restrictions. In fact, these transplants have sparked intense competition within U.S. manufacturing, forcing U.S. companies to beef up their production quality and perhaps even to overhaul their corporate cultures.

Because automobiles are so important to the bilateral trade figures, making up about one-quarter of the total value of Japanese exports to the U.S., it is worth looking more closely at Japanese auto exports. The VERs for automobiles started in 1981 with an annual ceiling of 1.68 million. This was raised first to 1.85 million and then to 2.3 million, where it has held since 1985. Actual export figures for 1987 and 1988, however, fell short of the ceiling, and the figure for 1989 is expected to be below 2 million.

At the same time as their exports have been below the VER ceilings, Japanese automakers have made rapid progress in transplanting production to the United States. A stronger yen has made building

Table 1 Direct Investment in the U.S.

	(\$ billion)	
	1987	1988
Britain	79.7 (27.1)	101.9 (37.0)
Japan	35.2 (5.4)	53.4 (12.2)
The Netherlands	49.1 (16.1)	49.0 (17.2)
Canada	24.0 (7.6)	27.4 (9.4)
West Germany	20.3 (9.3)	23.8 (13.3)

Notes: 1. Figures in parentheses are direct investment in manufacturing.

2. All figures are year-end values.

Source: U.S. Department of Commerce

Table 2 Japanese Passenger Car Presence in the U.S.

	1986	1987	1988	1989
Transplant production (unit)	510,000	630,000	790,000	1,040,000
Vehicle exports (unit)	2,300,000	2,190,000	2,100,000	1,940,000
Transplants as percentage of Japanese sales in U.S. market	18.1%	22.3%	27.3%	34.9%

compacts in the U.S. more attractive than exporting the same cars and has forced them to shift their exports to intermediate and bigger models where there is more added value. Thus the recent attempts to create second sales channels for intermediate models (Honda's Acura being a case in point) indicate that Japanese automakers recognize that these will be their main exports for the future. In the compact class, the transplants have gone from 18.1% of total Japanese sales in the U.S. market in 1986 to 27.3% in 1988 (Table 2).

If all of the Japanese automakers go ahead with their current production plans, the transplants will be making in the order of 1.9 million vehicles in 1992, meaning that transplants will account for around 50% of Japanese sales in the U.S. market.

Shooting for efficiency

Japanese automakers are today shooting for more efficient production systems and globalization to make them truly world-class companies.

Over the years, these Japanese automakers have developed highly competitive production modes, including quality control, just-in-time manufacturing and quick-paced model changes, to give them the production and sales clout they need to compete in the U.S. market. The key to these efforts has been an efficient system for providing the research and development people and the production teams with constant market feedback, and this system has succeeded in moving research, development and production much closer to the market.

Not only do the companies themselves benefit, consumers also benefit in that the system is able to supply what they want. For example, it takes the average Japanese automaker only 43 months to take a car from inception to market. The equivalent process in the United States and Europe takes 62 months. It goes

without saying that a company that is able to respond quickly to market requirements is a very competitive company.

As these Japanese automakers have moved more of their production closer to their markets, they have stepped up the competitive pressure on the American Big Three. And in response, the Big Three are moving to improve productivity and enhance standards.

Everyone knows about the new production technologies, but the management techniques are just as important. Here, Japanese management's efforts for better labor relations have caused many American managers to review their traditional approaches and to innovate. Likewise, the Japanese transplants are embarking on ambitious global strategies such as supplying OEM equipment to the Big Three, reverse-exporting to Japan, and exporting from the U.S. to the EC countries and the newly industrializing economies (NIEs) of Asia. The end result is likely to be a revival in manufacturing, the development of new management techniques and better productivity—an American manufacturing revival.

The same pattern holds in the steel, machine tool and semiconductor industries. In steel, for example, Japan has a U.S. import quota of about 5.6 million tons. Of this, exports usually fall short by 1.5 million tons, of which only 1 million tons can be carried over to the next year (meaning that 500,000 tons goes unused). This situation has arisen both because the domestic expansion in Japan has depleted the surpluses for export and because Japanese steelmakers have become more profit-oriented in their exports. As a result, a bilateral agreement was reached in the fall of 1989 to reduce the export quota and to draw up a new set of trade rules.

Recently, however, Japanese manufacturers have begun to locate overseas at an unprecedented pace. Although it was once assumed that smokestack industries such as steel did not lend themselves to

global strategies, the large steelmakers' wealth of managerial savvy has positioned them to participate in overseas project management, to supply technology and capital to joint-venture partners, and to embark on joint research for improved quality and new product development (Table 3). In large part, this trend in steel has been encouraged by the Japanese auto transplants' need for high-quality sheet for their factories. More and more, Japanese steelmakers are accepting trainees for total quality control (TQC) and other programs, are providing specialist assistance, and are otherwise contributing both in production and in labor relations.

While such activities do help their overseas partners, that is assuredly not their only purpose. Rather, they are intended as strategic responses to the challenges of the stronger yen and the hollowing out of the Japanese economy, and they are implemented in stark recognition of the fact that the U.S. market is the largest in the world.

New developments are cropping up in the semiconductor field as well. Although the 1987 Japan-U.S. semiconductor agreement was intended to settle rancor over charges of dumping, it left a bitter dispute over U.S. access to the Japanese market in its wake. Unabashed, the Japanese chipmakers pushed to locate production overseas, including not only the simple standardized service jobs such as assembly and inspection but also the higher-tech tasks of integrated production from circuit design to wiring. Since this demands micron-level precision, they require the kind of production skills and managerial attention to detail that resist being reduced to manuals. Despite these difficulties, many chipmakers are moving ambitiously to establish integrated production facilities in the U.S.

Not only is the establishment of these integrated production facilities very capital-intensive, the companies also face fierce spending competition in R&D for 4-megabit and 16-megabit DRAMs. This has made it all the more imperative that chipmakers cooperate in the development and production of new chips worldwide. OEM production and sales,

Table 3 Joint Projects by U.S. and Japanese Steelmakers

Participating U.S. and Japanese companies	Type of venture	Investment (\$ million)	Project plan	Location	Total investment planned (\$ million)
Nippon Steel Inland Steel Industry	Joint venture	① 60 (4%)	Cold rolled sheet—900,000 tons annually (end of 1989) Surface treated sheet—800,000 tons annually (spring of 1991)	Indiana Indiana	approx. 400 approx. 300
		② ? (50%)			
Nippon Kokan National-Standard	Capital participation	250 (50%)	Crude steel—5,900,000 tons annually (Great Lakes Steel Works, summer of 1984)—and surface treatment	Michigan Illinois Indiana	approx. 900 (1984–88) approx. 1,000 (1989–93)
Kawasaki Steel Armco	Joint venture	350 (40%)	Crude steel—4,800,000 tons annually (Middletown Steel Works, spring of 1989)—and surface treatment (Ashland Steel Works)	Ohio Kentucky	aprox. 500 (per half-year)
Sumitomo Metal Industries LTV	Joint venture	2 (50%)	Surface treatment: No. 1 Works as of January 1986 No. 2 Works as of end of 1990	Ohio	approx. 300
Kobe Steel USX	Joint venture	? (50%)	Crude steel—2,600,000 tons annually (Lorain Steel Works, basic agreement for February 1989)	Ohio	?
Nisshin Steel Wheeling-Pittsburgh	Joint venture	6.7 (67%)	Surface treatment—250,000 tons annually (April 1988)	West Virginia	approx. 70

cooperation in product development, technological tie-ups, and other international operations are among the many strategies pursued as a result.

No company can hope to succeed in this technology race if it tries to hold back by offering its partners obsolete off-the-shelf technology. The successful companies are going to be those that exchange information on new developments while they are still new and that work to broaden their product lineup until they are full-service manufacturers. And this need, perhaps most obvious in semiconductors but also increasingly evident in other industries as well, is accelerating the process of across-the-board globalization in planning, design, production and sales, and is thus profoundly altering high-technology trade patterns.

New trade rules

As noted above, the yen's exchange strength has meant that exports to the U.S. have fallen well below the VER ceilings and that companies have shifted from exports to transplant production. It has, in short, pushed the Japan-U.S. trade relationship away from the early export deluges to managed trade and now to massive direct investment—investment that has helped to rescue the flagging U.S. economy and to revive American industry. A transformation of this scope clearly needs new trade rules. While the U.S. frets over the pros and cons of reducing the VERs, the real debate is over how best to attract more investment by Japanese companies. In effect, the VERs have metamorphosed from a means of sheltering U.S. industry into a means of attract-

ing Japanese companies and gaining access to new managerial resources.

It must be remembered, however, that the full benefits of substituting transplant production for exports will not be felt overnight. Steel and other industries, for example, are having trouble finding the people they need in the local labor pool. And as long as the U.S. propensity for over-consumption remains unchecked macroeconomically, there is a very real possibility that this may spark another strong import surge. At the same time, the fact that the start-up transplants have to import parts and equipment could trigger a temporary rise in Japanese exports. All of these factors underline the need to see import substitution as a medium-term adjustment process that will last well into the early 1990s.

Nevertheless, the longer-term prospects are bright. Completion of the import-substitution process by the mid-1990s could be the much-needed brake on ever-expanding U.S. imports and significantly reduce the U.S. trade deficit. Japanese companies have a major role to play in resolving one of America's twin deficits. Fundamental changes are reshaping the Japanese and U.S. industrial structures, and midwifing a new industrial paradigm.

Given that the U.S. manufacturing sector is on the rebound, what industries are going to be its export leaders? This question must be addressed if we are to complete our picture of U.S. industry in the 1990s.

The American comparative advantage is mainly in such resource-intensive industries as agriculture, mining and natu-

ral resources, and technology-intensive high-tech industries. The traditional view of comparative advantage thus indicates that the U.S. economy should demonstrate strength in these sectors.

Agriculture, however, has lost its competitive edge recently, victim of government subsidies to prop up sagging farm incomes. These subsidies have also backfired in that they triggered a strong reaction from the European Community. Probably the best thing that could happen for American agricultural competitiveness would be for the Uruguay Round to agree on phasing out agricultural subsidies.

The limelight knowledge-intensive industries have changed considerably from generation to generation. Home electronics and automobiles were the stars of the 1950s and 1960s. Since then, leadership in these industries has gone to Japan and the Asian NIEs, and U.S. strength now centers on such fields as electronics, aerospace, oceanic resource development, nuclear energy, securities and financial services, biotechnology, medical equipment and pharmaceuticals. In these fields, the U.S. is still highly competitive and its research is at the cutting edge. This leadership in basic research is not expected to recede as long as the U.S. continues to value creativity and to be willing to innovate.

In the 1990s, therefore, the U.S. can be expected to bluntly demand that its allies open their markets in those sectors where it is highly competitive. These demands will surely be linked to the call for "voluntary import expansion" by its allies and will be intended to substantially raise the

total value of U.S. exports. They will be looking not for institutional opening but for tangible results.

At the same time as American leaders are pushing Japan to import more, the traditional manufacturing sector, especially steel, automobiles and home electronics, is making serious overtures for managerial know-how from Japan. And in the process, they will have no hesitation about stressing the dangers of trade friction and threatening to further reduce import quotas. Yet behind all of this bluster is a desire to draw on Japanese know-how and technology in revitalizing American industry and helping it regain its competitive position.

Strategies for the 1990s

With the rapid advance of globalization, managerial know-how is becoming increasingly important and the significance of national borders is changing. More companies will be active in M&A (mergers and acquisitions), joint ventures and the like, will be locating their head offices overseas, or will be designating more than one head office.

In turn, this eroding of national borders is bound to necessitate major changes in traditional economic theory, since that theory has been premised on the existence of borders defining specific economic areas. From an economic point of view, binding economic behavior within national constraints is an outdated vestige of imperialism entirely unsuited to the global era.

Today, the question is no longer where a country's boundaries are drawn but what kind of barriers there are at this boundary and whether or not capital can flow freely across it. If free entry and exit are guaranteed and profit repatriation is unimpeded, it does not matter where the company is. National registration being a secondary consideration, companies will then be able to achieve the most efficient global allocation of their resources.

And as corporate globalization progresses, this should also promote greater interaction among and hence appreciation of different cultures and values, thus gradually reducing international ten-

sions. Globalization is an economic principle that can usher in an era of peace, and this tide is already irreversible. As such, the debate over trade imbalances is also a relic of the past, since it is inevitably linked to and locked into concepts of sovereign national boundaries that no longer describe today's global economic realities.

In the 1930s, there was one bold politician-cum-economist in Japan who dared to criticize the military's imperialism and to rail against the colonization of Korea and Manchuria. He argued, "It is in our economic interests to free our overseas colonies and carry out projects with financial prowess and business acumen rather than by force of arms" and that "we can best enhance our capital wealth by opting for peace and directing our people's talents to academic research and industrial development." Thus spake Tanzan Ishibashi, a man who became prime minister after the war in the late 1950s. His ideas were scorned when they were originally voiced in the 1930s, yet history has proved his perspicacity. All of the human and other resources that Japan spent on establishing and maintaining colonial rule were squandered at great loss to both Japan and the colonial lands, but the globalization of Japanese industry in the wake of the yen's appreciation since 1985 has not only made Japan wealthy but has contributed greatly to the development of the other East Asian economies.

The fact that a company goes overseas should not be taken as implying decline for the company or its home economy. Rather, this globalization signifies improved economic efficiency, an increase in value-added production, and an enhancement of managerial know-how. Anyone doubting globalization's benefits need only look at the double-digit real increases in Japanese capital investment over the last four years.

It can, however, be claimed that companies will leave countries that are fraught with restrictions and will seek to participate in freer overseas markets. Japanese companies are already at the point where they can choose where they want to locate. From this perspective, the

best means of sustaining the domestic economy is to eliminate as many restrictions as possible and to take the lead in harmonizing international standards.

Although originating in trade frustrations, the Super 301 negotiations should be turned around and used as a forum for advancing the global economy, strengthening interdependence and easing restrictions. The urgent imperative for Japan in the 1990s is that of liberalizing its markets for high-tech products, financial services and agricultural goods (rice and wheat). There is no way Japan can avoid opening its rice market to imports.

At the same time, however, environmental and energy restrictions must move in the opposite direction, being clearly delineated and strictly enforced. There is a clear distinction between economic restrictions and social restrictions, and the push for deregulation must not mean a dismantling of social restrictions.

As mentioned at the beginning of this analysis, American protectionism is today leaning away from import restrictions and toward a push for export expansion, and the need to accommodate this by expanding its imports is a major impetus moving Japan toward the elimination of such informal trade barriers as *keiretsu* alliances, distribution complexities and the government's heavy hand. Opening the U.S. and Japanese markets is bound to benefit consumers worldwide and will promote the U.S. industrial transformation. Likewise, it is extremely important for the purposes of reciprocity that Japan streamline distribution, introduce a semblance of sanity to land-use policies, and remove other barriers to investment here, since the existence of these barriers in Japan offers an excuse for the United States to restrict Japanese investment there.

In short, globalization is the best and perhaps the only way to beat back protectionism in the 1990s. ■

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