FROM THE IRON TRIANGLE TO THE CROSS-BORDER TRIANGULAR MERGER

JAPAN’S CHANGING INWARD FDI PROSPECTS

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Abstract

The weakness of Japan’s economy during the “lost decade” of the 1990’s prompted critical revaluation of many regulatory policies that became entrenched during the country’s rapid expansion in the postwar era. At the time of the bursting of Japan’s bubble economy, regulation and the behavior of the private sector had combined to cause low levels of imports and inward investment relative to those into other wealthy nations. This paper focuses on outlining the causes of Japan’s low inward foreign direct investment (FDI) level and the reforms of policy and behavior that have, at least on paper, lowered barriers to it. Having provided this background, the paper progresses to description of relevant private and public sector actors’ current impressions of the inward FDI market informed by interviews with Japanese and American agencies conducted for this project from July to August, 2005. The paper concludes that the myriad policy and corporate behavioral changes suggesting that inward FDI may soon increase have fostered a feeling of expectation among both Japanese and American officials that belies the lack of empirical signals that a notable such rise is occurring.
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Introduction

More than any other developed economy, Japan has earned a reputation as a protectionist country in the postwar era. Famous disputes on automobiles, semiconductors, and photographic film have garnered headlines worldwide when foreign states cry foul at Japan’s alleged formal and informal barriers to trade. Regardless of its policies, the Land of the Rising Sun’s growth into the world’s second largest economy means that within its borders there now lies an enormous arena of trade and investment. As the aforementioned controversies have proclaimed, trade and capital flows from abroad have had a hard time breaching Japan’s borders. However, the environment for foreign businesses in Japan has changed markedly since the end of the bubble economy in 1989 and subsequent recession, which is only now showing signs of having ended. Alongside this evolution of the market has come a shift in policymakers’ and market participants’ perceptions of the relative importance of trade and investment policy in Japan’s international economic relations. The greater attention being paid to investment issues by both Japanese and foreign actors is signaling that there are changes occurring on the ground that hold the possibility of fundamentally transforming the character of Japan’s economic relations with the rest of the world. The writing of this paper was motivated by interviews in Summer 2005 in Tokyo with officials at key public and private sector agencies during research focusing on the remnants of Japan’s postwar developmental state. The accounts given by both Japanese and foreign nationals were striking enough to motivate analysis of inward foreign direct investment (FDI) in particular. The interviews elucidated a surprising prevailing feeling of optimism among all parties that belied Japan’s reputation as a protectionist country. This analysis investigates the inward FDI market in modern Japanese history, and makes use of the interviews to show how foreign governments’ and businesses’ impressions of it have changed since the end of Japan’s bubble economy.

Generally speaking, this paper summarizes Japan’s struggles to balance the interests of its economic and cultural inheritance with revisions necessary for future growth. Specifically, the focus on inward FDI has been chosen to elucidate Japan’s
relations with the overseas firms and nations that have alleged its history of protectionism. In the context of a WTO-overseen international trade regime, Japan’s overtures toward lowering investment barriers are a fulcrum of relevance in evaluating Japan’s commitment to free trade. Because inward direct investment grants management rights to foreign actors, discussion of it elicits consideration of the possible presence of nationalist impulses manifested in mercantilist policy and behavior that are more vivid than issues related to merchandise trade, which does not necessarily divest management rights. However, the link between trade and investment is intimate, and one cannot be understood without consideration of the other. Therefore this analysis includes description of how Japanese policy and behavior has shaped international trade as well. The focus on inward FDI is further motivated by its difference from portfolio investment. While portfolio investment involves a limited, more liquid stake in a firm that can be sold on relatively short notice, this paper concentrates on the long term commitment inherent to direct investment.

Special attention is paid to the relationship between the United States and Japan, whose bilateral economic negotiations were the subject of some of the particularly insightful interviews that motivated analysis of the subject. Empirical data on inward FDI and M&A developments up to the second quarter of FY2005 provides the most recent evidence of whether the increased attention given to such transactions by state-level negotiators and firms have produced measurable effects.

The paper’s five parts combine quantitative and qualitative description of Japan’s changing market for foreign investors. Part I presents relevant empirical data showing Japan’s low level of inward FDI relative to the other major developed economies in the Group of Seven (G7) leading industrial nations. To illustrate the interests and inclinations that are shaping the changing market for foreign investors, Part II of the paper summarizes the historical justification for and means of limiting inward FDI in postwar Japan, before Part III brings the analysis up to date with a review of the changes in policy and behavior that are responsible for the changing shape of the Japanese direct investment market since the bursting of the bubble economy in 1989. As Part III shows,
evolutions in Japanese policy and behavior have neither consistently improved inward FDI prospects, nor have they occurred in all aspects of the economy and its regulation. However, interviews with public and private sector actors in August and September, 2005 described in Part IV suggest a strikingly overall rosy picture of the general trajectory of inward FDI possibilities among both Japanese and foreign participants.

In the course of this analysis, attention will be paid to the following three possible explanations for the interviewees’ current impression that direct investment issues have become significantly more important relative to trade issues in Japan’s economic relations with others in the developed world:

1. Japan now has increasingly attractive opportunities for direct investment that have made related issues worth discussing.
2. Japan now has fewer trade barriers worth discussing.
3. Changing global political considerations are responsible for a different perspective on economic relations.

While explanations 1 and 2 describe changes in the structure of the Japanese economy, explanation 3 offers the possibility that factors such as global strategic and ideological concerns are integral to the take of foreigners on Japan’s economy, particularly the U.S. government’s.

In short, the conclusion offered in Part V is that on both sides of the Pacific Ocean, U.S. and Japanese actors have noticed a dramatic rise in the relative importance of investment issues in their states’ official negotiations. Landmark policy reforms have been enacted in Japan that have removed long-lived impediments to investment and takeover activity, and continuing discussion on persisting impediments indicates that further change can be expected. However, despite the breakthroughs, empirical evidence yields few signals that foreign direct investment activity has been rising as a result of the recent reforms. Differences in the quantity and types of activity between Japanese and foreign investing firms suggests persisting inequalities in the environment in which the
respective groups operate. The positive tone with which interviewees on all sides described investment affairs suggests though that the general trajectory of policy and corporate behavior is slowly equalizing the opportunities for foreign investors.

**Part I: The Data**

Japan is notable among developed countries for its low import and inward FDI levels. Figure 1 depicts the inward FDI levels from 1998 to 2004 of the individual G7 economies in absolute terms, as well as an additional curve showing the average of these countries minus Japan. The global boom in foreign investment at the end of the century is clearly reflected in the data, as is its dramatic fall after 2000. The lone exception is Japan, which consistently has ranked at the bottom of the group. Its uniqueness is magnified when viewed in relation to the size of its economy, the second largest in the
world after the U.S. Figure 2 exhibits the inward FDI to GDP ratio for the same countries over the same period.

Figure 2: Annual Inward FDI to GDP Ratio

Figure 3 shows the low level of FDI stocks in Japan relative to the same reference countries. The long-term situation of low direct investment by foreign actors that has caused such marked disparities between Japan and its peer developed countries is shown in this measure.
That there has been a remarkably low level of inward FDI in both absolute terms and relative to Japan’s large GDP is readily apparent. The low levels of inward FDI stock are a sign that follow-up investment is low, in addition to greenfield investment.

As mentioned in the introduction, trade and investment are complementary activities, meaning that increases in one leads to an increase in the other. As shown by Edward Lincoln in his work on Japanese-American trade relations in the 1990s, *Troubled Times*, exporting into Japan has involved related investments to provide product service, distribution, and retailing.¹ If complementarityism was a fixed rule, then the data shown in Figure 2 above comparing the inward FDI level to GDP ratio for our sample countries would imply that the curves of the ratios between the same countries’ imports and GDP

would be similar. And in fact, this is roughly true at least in that Japan is at the bottom of both, as shown in Figure 4.

![Figure 4: Total Imports/GDP Ratio](image)

A nuance to this data with notable implications is given in Figure 5. If trade and investment were equally complementary in all countries, then one would expect that the ratio between inward FDI and imports would be alike as well. However, not only does Japan have the lowest level of both inward FDI and imports relative to its economy’s size, it also has the greatest disparity between the two measures. Put differently, imports and inward investment are less complementary in Japan than in any other G7 country.
This empirical evidence suggests that the low levels of inward FDI are even more striking than the low levels of imports, which is startling considering how much criticism Japan has gotten over its showings on the latter measure.

As will be discussed in greater detail later in the paper, the regularity of merger and acquisition activity (M&A) in Japan sheds further light on the makeup of investment activity by both domestic and foreign actors. Because M&A is the primary means by which inward FDI occurs in developed countries\textsuperscript{2}, measurements of it can show differences in opportunities between Japanese and foreign investors. Figure 6 shows that M&A in Japan has risen sharply in recent years, signifying a remarkable level of restructuring in the economy. By separating the data into groups showing whether the buyer and target firms were Japanese of foreign, a huge disparity based on the country of origin of purchasers is apparent. The skyrocketing M&A activity is a domestic phenomenon, accompanied only slightly by purchases by foreigners.

The data above supports characterization of Japan as a remarkably unattractive place for foreign direct investors. Clear differences between indigenous investment and inward foreign direct investment mean that there are unequal opportunities defined by the nation of origin of the investor, and the difference between Japan’s figures and those of the other leading developed countries elucidate Japan’s idiosyncratic investment arena.
Part II: Why has inward FDI been so low?

A legacy of regulations designed to protect immature industries has had the effect of reducing inward investment into Japan even after such regulations were removed. The reason is twofold. First, the development of Japanese businesses in the protected sectors filled many opportunities for growth that foreign firms would have been interested in but were prevented from making use of. Second, the subsequent low levels of accumulated FDI stock in Japan means that follow-up investments to earlier projects are less common. As mentioned above, no analysis of the determinants FDI activity is complete without consideration of the factors the shape its complements: merchandise and service trade. Thus the following description includes issues influencing trade as well.

II.1 The Legacy of Protectionist Policy

II.1.a Administrative Guidance

The development of Japan’s competitive industries was facilitated by the process of administrative guidance, by which the state acted to promote internationally competitive industries through affecting the nature of competition between Japanese firms. Administrative guidance also gave the state a role in the market relationships between domestic and foreign firms, and its assistance of Japanese players limited the penetration of overseas ones.

Administrative guidance has become a catchall term for any number of government actions. In Chalmers Johnson’s words: it is “constrained only by the requirement that the ‘guidees’ must come under a given governmental organ’s jurisdiction, and although it is not based on any explicit law, it cannot violate the law…”³ “Its power comes from government-business relationships established since the 1930’s, respect for the bureaucracy, the ministries’ claim that they speak for the national interest,

and various informal pressures that the ministries can bring to bear.” The variable form which administrative guidance takes is based upon its being apart from a direct legal mandate, and the informality of its power.

In addition, the Ministry of Industry, Trade and Investment (MITI), like other organs of the state, drafts legislation, and thus has a significant voice in law and policy creation. In the words of Karel van Wolferen:

In the everyday business of governing Japan, groups of officials, especially those of the ministries of finance, international trade and industry, construction, and post and telecommunications, wield a great deal of power, definitely more than they are theoretically authorized to exercise. They restrain, control and provide spurs for the economy. They make nearly all laws- which, if not everything, is quite something in terms of measurable power. These laws are almost always rubber-stamped by the Diet, and the bureaucrats typically proceed to use them as means to achieve their own cherished aims.5

An excellent example of how these resources were brought to bear against a foreign firm is given by MITI’s actions to hinder IBM in the late 1950’s. A presence in Japan since the prewar era, IBM-Japan was organized as a yen-based company and as such was affected less by Japanese regulation of foreign exchange (discussed in greater detail later). However, MITI was able to meet its mercantilist aims otherwise. In a meeting with IBM, MITI’s Deputy Director of the Heavy Industries Bureau at the time, Sahashi Shigeru, stated bluntly: “We will take every measure possible to obstruct the success of your business unless you license IBM patents to Japanese firms and charge them no more than a 5 percent royalty.” At another meeting, “we do not have an inferiority complex toward you; we only need time and money to compete effectively.”

4 Johnson (1982), pg. 266.
IBM agreed to sell its patents. As IBM leased, rather than sold its machines, MITI developed a plan to create a competing Japanese entity that would do the same. It used its Development Bank to create and finance the Japan Electronic Computer Company which offered for lease hardware produced domestically.  

In the IBM example administrative guidance included direct state action to limit a foreign firm, but MITI has also acted to organize Japanese businesses into collective behavior that limited foreigners’ market penetration. One year after the end of the postwar American occupation, the Antimonopoly Act was amended in 1953 by a bill proposed by MITI that permitted “depression” and “rationalization” cartels. Even before occupation ended, the occupation authority began to relax its constrictions on the zaibatsu conglomerates in order to allow their existing organization to rapidly develop Japan into an industrial power to counter the developing East Asian communist presence during the early coalescence of the Cold War. Subsequent cartel activity thus became largely legal, with MITI often playing a leading role in codifying price-fixing and other anticompetitive behavior. “MITI encouraged, often initiated, and helped to enforce these arrangements, encouraging the price leaders and pressuring domestic buyers to continue to honor long-term arrangements despite less costly foreign alternatives.”

Favoritism toward domestic suppliers has been particularly rife in publicly owned businesses, in which an industrial policy designed to develop Japanese firms has often taken precedence over the profitability of state-owned companies, such as Nippon Telegraph & Telephone (NTT). In response to complaints by American trade officials in the late 1970’s that NTT “was buying huge amounts of equipment, virtually all from Japanese suppliers, at higher prices than those of U.S. suppliers,” the opinion of

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6 Johnson (1982), pg. 247.
7 Johnson (1982), pg. 227.
Japanese management was bluntly clarified by its president: “The only things NTT will procure from U.S. suppliers are mops and buckets.”\textsuperscript{11} Even after NTT’s privatization from 1986 and measured liberalization of its purchasing policies, in 1992 it purchased less than 5% of its annual investments from foreign firms.\textsuperscript{12}

\section*{II.1.b Regulation of Foreign Exchange and Inward Investment}

Tight control of foreign investment and exchange played a leading role in protectionist policy. At its enactment in 1949, the Foreign Exchange and Foreign Trade Control Law banned the private flow of foreign exchange both entering and leaving the country. Until 1979 inward investment was subject to a prohibition principle that allowed only for selective case-by-case transactions.\textsuperscript{13} The Control Law’s supplementary Foreign Investment Law allowing only case-by-case exemption to the Control Law’s edicts was gradually relaxed starting in the 1960’s to permit particular types of transactions to occur.\textsuperscript{14} The determinant of what type of investment was permitted became the sector to which the capital was directed, and the sectors opened up were those that had reached an internationally competitive level which meant that few foreign investors chose to get involved.

The Foreign Exchange and Foreign Trade Control Law also allows prohibition of inward direct investments where they are viewed as a threat to domestic industry. This provision’s blanket bans on inward FDI have applied to agriculture, fisheries and forestry, mining, petroleum refining, and leather manufacturing.\textsuperscript{15} Armed with the power to screen the flow of exchange allowed the MITI bureaucracy to manage both capital and

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\textsuperscript{12} NTT \textit{Procurement Activities 1992}, NTT, pp. 5.43, and \textit{NTT Procurement} (no date), NTT America. Referenced from Noll & Rosenbluth (1995), pg. 163.
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\textsuperscript{14} Matsushita (1993), pg. 243.
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\textsuperscript{15} Matsushita (1993), pg. 245.
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technology movements in a hands-on manner that “…was the single most important of industrial guidance and control that MITI ever possessed.”\textsuperscript{16} The ministry acted to develop capital intensive industries in Japan pioneered by foreign firms while preventing outsiders from gaining market share. Control of foreign exchange was employed “…to separate the foreign technology from its foreign ownership, patent rights, know-how agreements, proposals for joint ventures, capital participation, voting rights, and foreign managers on boards of directors.”\textsuperscript{17}

Of increasing significance over the period of Japan’s development have been the policies shaping the environment for M&A activity which, as mentioned in Part I, is the primary form taken by direct investment into developed countries. The regulation of capital flows described above severely limited the feasibility of foreign firm’s buying a significant interest in a Japanese business.

\textbf{II.2 Keiretsu Relationships and Corporate Behavior}

\textbf{II.2.a Cross Shareholdings}

Cross-shareholding relationships developed in the postwar era as Japanese firms raised most of their capital through banks rather than through public tenders of shares.\textsuperscript{18} Limited liberalization around Japan’s joining the OECD in 1964 spurned an explosion of cross-shareholdings between Japanese firms, including banks, establishing one of the modern characteristics of the country’s vaunted and vilified \emph{keiretsu} networks, discussed in greater detail below.\textsuperscript{19} According to the Ministry of Economy, Trade and Industry

\footnotesize{\textsuperscript{16} Johnson (1982), pg. 194-195.  
\textsuperscript{17} Johnson (1982), pg. 217.  
\textsuperscript{19} Fukao & Amano (2003), pg. 3.}
(METI\textsuperscript{20}), crossholdings were as high as 46\% of total shares in 1992.\textsuperscript{21} They solidified corporate relationships anchored by banks that prevented managers from fearing that shareholders would sell their equity to an outsider to realize share value. Without this risk, managers in \textit{keiretsu} firms placed a higher priority on growth than on maximizing share value, knowing their capital position was guaranteed by other members of the \textit{keiretsu}. Support of many struggling businesses was justified on the grounds of avoiding lay-offs, as many Japanese firms felt officially or unofficially bound to provide lifetime employment to their full-time workers.\textsuperscript{22}

\section*{II.2.b Japanese Corporate Culture}

The issues of loyalty and even morality that come into play in Japanese boardrooms when the possibility of selling all or a portion of the firm is discussed are often the equals of considerations of the company’s finances and strategy. Selling is viewed as the selfish behavior of one incapable of adequately managing the corporation, and management’s shameful rejection of its responsibility to employees. The roots of these ideas run very deep.

Since the beginning of the Meiji era in 1868 and especially since 1945 Japan has experienced a dramatic economic structural shift from being a largely agricultural society to one where the majority of Japanese live in ever growing cities. Accompanying this change has been the increasing identification of workers with their company. In the past loyalty was primarily to one’s rural household, or \textit{ie}, whose members included farmhands and workers often unrelated by blood, while blood relatives of the \textit{ie}’s head living independently were not members. The histories of several older Japanese firms operating today date back to the time when individuals did not own property, the \textit{ie} did. Even new Japanese firms often make reference to goals that sound strikingly like those of a family: in Karel van Wolferen’s words: “the company benefits and exists for its employees, whose ‘sincere efforts’ are expected in return for all that previous managers have done to

\textsuperscript{20} As part of bureaucratic reorganization in 2001, MITI was renamed METI.
\textsuperscript{21} MITI, quoted in EIU (2005), pg 15.
bring it where it is.”

“The ie of today are the work groups in the large corporations.”

There is an ethic to employment in Japanese corporations that borders on religious faith, well exemplified by the singing of company songs, often at daily morning meetings held at the majority of firms. Witness the song of Toyota Motor Corporation, a modern firm that rose to prominence only in the postwar era:

Wishes for overflowing sunshine and green, We open the new age with guts and an eternally expanding human network… We keep growing tomorrow, with a unified mind and continuous effort, Our, Our, Our Toyota…We form our history with a worldly dream, wisdom and rich technology, Bright future, with a unified mind and new strides, Our, Our, Our Toyota.

Japanese managers are thus beholden to a cause much greater than their firm’s bottom line. As nearly all of them have spent their entire adult lives within the company that their careers started and progressed, “presidents and other executives identify more with employees than with shareholders because they once were in the same shoes.”

This devotion not only to one’s corporation and other members of one’s keiretsu, but also to partner firms in involved in joint projects. In the words of Takeo Hoshi:

Even after going through the lists of characteristics that we observe in a typical corporate group, deciding whether or not a specific firm belongs to a group is a difficult task…Beyond the core companies, one has to determine the membership of a company by looking at its relation

23 Van Wolferen (1989), pg. 166
25 Quoted from Van Wolferen (1989), pg. 168.
26 EIU (2005), pg. 21.
to a group in bank borrowings, cross-shareholdings, board member exchange, and so on. Thus the border of a corporate group is fuzzy.\textsuperscript{27}

Ronald Dore describes Japanese enterprise cooperation as occurring in three ways: a central firm and its satellites, groups of firms of relatively equal status usually centered around a bank, and oligopolized industry associations that may behave in a cartel-like manner.\textsuperscript{28}

These issues are significant impediments to foreign investment activity, particularly M&A. They imply a significant value placed on historical and social ties within firms that limit the entrance of outsiders. The entrance of a foreign actor into a management role in a Japanese firm hurts not only existing loyalties both within the firm and with corporate partners, but also prompts questioning the continued value placed on these loyalties in the future, a radical idea not easily digested by most Japanese.

This variety of loyal formal and informal inter-firm relations is responsible for many of the difficulties found by newcomers to Japan, especially those from overseas lacking familiarity with or sensitivity to the unique cultural norms found there.

\section*{II.2.c Vertical Networks}

An impediment to inward FDI related to the above discussion of management loyalty to employees is the complicated supply and distribution systems that bring products to the Japanese market. In 1968, the ratio of wholesale to retail transactions in Japan was 4.8 to 1, versus 1.3 to 1 in America.\textsuperscript{29} The complicated layers of middlemen in Japan between production and market are a challenge to new entrants, both those

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working to establish new export markets and those planning to open a distribution or retail business.

The multi-tiered structure of many Japanese industries systems has been defended on three grounds: 1) they allow for lower levels of corporate taxation; 2) they increase employment; and 3) they allow for core firms to share absorption of risk with suppliers. In many Japanese sectors these interests have provided critical mass opposed to the sort of restructuring that would accommodate new entrants better.

An exemplary case showing how the vertical structure of Japan’s economy has limited foreign firm’s exports is provided by the distribution of photographic film. From the 1960’s the Natural Colour Photography Promotion Council (NCPPC), consisting of the four major Japanese photographic film and paper producers, collaborated in structuring domestic film distribution networks so as to prevent outsiders’ entrance into the market after related trade and investment policy liberalization. This collaboration assisted the continued dominance of Fuji and Konica, the major Japanese players, to the detriment of competitive foreign film producers, namely Kodak. The Council agreed upon common terms with distributors including shortening of payment terms, greater use of volume discounts, and promotion of progressive rebates to tighten relations along the vertical chain, a process described later as “keiretsu-nization”. A document related to this restructuring process produced by MITI in March 1970, the Guidelines for Standardization of Transaction Terms for Photographic Film, advocated these measures as prevention of “…the disruption of the established order of transaction terms by foreign capital.” The guidelines called for shortened terms of payment and volume discounts

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30 Johnson (1982), pg. 13.
31 Johnson (1982), pg. 313.
throughout the distribution chain, not only between manufacturers and primary wholesalers (which had already been achieved at the time), but also between primary wholesalers and secondary wholesalers, and between secondary wholesalers and retailers.\textsuperscript{34} This is an explicit statement of inter-firm collaboration against foreign competitors by fixing distribution terms, overseen by MITI. Its fruit spawned a GATT/WTO case in the 1990’s, to be discussed in Part III of this paper.

Legislation complicating the entrance of new firms in the retail sector was best exemplified by the Large-Scale Retail Stores Law, passed in 1973, but with predecessors dating back over 40 years.\textsuperscript{35} Devised as a means to protect small and medium sized retailers, the law required businesses to report to MITI plans to open a new store of over 3,000 square meters, and to the prefectural government plans for stores of over 500 square meters. The subsequent clearing process required the new firm to explain to existing small shopkeepers its plans, gain their approval under the auspices of the government, who can then delay or stop its opening or require a reduction in floor space.\textsuperscript{36} In addition to impeding inward FDI by restricting the large-scale retailing pioneered by non-Japanese firms, this law was claimed by the United States to constrain its exports as summarized by Matsushita (1993):

The United States government argued that the restriction of entry of new supermarkets into local markets was an impediment to the access of foreign products into the Japanese market. The reasons are that where as smaller retailers are often integrated within vertical distribution networks constructed by manufacturers and are not in a position to sell foreign-

\textsuperscript{35} Daikibo Kouri Tenpo Ho, Law 109, 1973.
made products, supermarkets in Japan are relatively independent from large manufacturers and are in a position to sell foreign-made products.\textsuperscript{37}

Inward FDI has thus been limited by the need to adjust to the more heavily layered vertical structure of the Japanese economy, actions by veterans to limit their entry, and guidance and legislation produced by the government. This has been of particular concern to foreign firms in merchandise export and retailing industries.

**Part III: Are Impediments to Inward FDI Unraveling?**

The features of the Japanese economy that limited inward investment began to be challenged by developments in both the post-bubble domestic environment and internationally.

**III.1 Changing Macroeconomic Conditions**

All of the major changes in the environment for inward direct investment can be traced at least indirectly to the dramatic macroeconomic shifts Japan has undergone since 1989. Among them, the most obvious reason for the rise in M&A since the late 1990’s, for Japanese buyers has been the need for corporate restructuring caused by Japan’s long recession. And consolidation has occurred on a massive scale in the last decade. Whole Japanese industries have radically evolved in the effort to return to profitability. Witness the drops in the numbers of major Japanese companies in the following sectors: from 14 to 3 in oil, from 7 to 3 big cement companies, from 14 to 3 in pulp and paper, from 7 to 3 in industrial gas, from 5 to 4 in steel, and from 15 major banks to 3.\textsuperscript{38}

\textsuperscript{37} Matsushita (1993), pg. 295.

It was in the late 1990’s that foreign firms made many of their largest Japanese acquisitions, the majority of which were distressed and had no alternative to selling, such as Renault’s purchase of Nissan and Ripplewood Holdings’ purchase of Long-Term Credit Bank. A smaller number of M&A deals involving foreigners were strategic rather than by necessity of the Japanese target, such as Vodafone’s purchase of Japan Telecom and J-phone.\(^{39}\)

However, as discussed in Lincoln (1999), despite Japan’s long recession and policy revisions, inward investment remained low before and even after 1991.\(^{40}\) But because its evolution into a high-cost country with competitive businesses had already occurred by this time the history of low levels of foreign acquisitions of Japanese firms has limited the scope of subsequent inward investment because Japan, like most developed countries, receives most of its inward FDI as M&A or as a result of earlier M&A.\(^{41}\) Despite the aforementioned examples, foreign M&A activity in Japan remains extremely small as shown in Figure 6 above.

In his discussion of trade, Lincoln writes that the continued competitiveness of Japan does not satisfactorily explain its limited imports and suggests other microeconomic factors that also limited inward direct investment. Some foreign firms may have lacked organizational techniques unknown to native businesses, other countries were less expensive than Japan for manufacturing, and licensing technology was an appealing alternative to setting up shop in Japan. But Lincoln suggests that Japan’s growing purchasing power and the post Plaza Accord appreciating yen made the country a better export market for foreigners, who subsequently would invest in complementary distribution, research, and after-sales service resources there. Japanese organizational advantages were limited to mainly the manufacturing sector, in which foreigners would be hesitant to license their technology to Japanese rivals. That investment has remained low can be attributed to “the difficulty of acquiring Japanese firms and the perception that

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\(^{39}\) EIU (2005), pg. 4.
\(^{40}\) Lincoln (1999), pg. 91
\(^{41}\) Fukao & Amano (2003), pg. 2.
a local presence would not necessarily enhance market access.” Lincoln quotes a 1991 survey of American businesses by the American Chamber of Commerce in Japan to elucidate the impediments to this access. Besides cost, the culprits are “difficulties in recruiting local staff (essentially [Masamu] Yoshitomi’s lifetime employment argument), complex or intricate methods of doing business, complex distribution systems, existence of keiretsu relationships, and nontransparent government regulations and policies.” The existence of microeconomic problems thus cited should prudently be considered to be equally as important as the changing macro environment in determining the playing field for foreign investors and exporters, and any improvement in the macro environment was softened by other factors.

**III.2 Partial Revisions to Protectionist Policy**

**III.2.a Administrative Guidance**

The most notable attack on Japan’s alleged protectionism via administrative guidance was the U.S. government’s multi-front assault on behalf of Kodak during the photographic film case of the mid-nineties described earlier in section II.2.c. It featured a WTO case, a hearing before Japan’s antitrust body, the Japan Free Trade Commission, and bilateral gestures that were a key component of the Structural Impediments Initiative. It remains the most extensive legal action made against allegedly anticompetitive Japanese regulations, and is effectively summarized in the WTO document detailing the American grievance:

> At the time each round of tariff concessions was made, the United States reasonably anticipated that better market access through improved price competition would result from the concessions, and neither the

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43 Lincoln (2005), pg. 95.
United States nor any of Japan's other trading partners could have foreseen that the Japanese Government would impair the value of those concessions through an intricate web of measures designed to counter the effects of liberalization.\textsuperscript{44}

In the course of the WTO hearing, America attempted to take advantage of a GATT clause stipulating that informal government involvement can shape what may at first glance seem like private market behavior, such as collusion between firms, and that such involvement can be ruled illegal. However, proving the existence of informal tinkering by MITI was too tall a task for the American side, despite third parties such as the EU and Mexico attesting to their existence. The WTO panel ruled in Japan’s favor, and the U.S., motivated at least in part by their desire to establish WTO credibility, didn’t appeal and the case was over by March 1998.\textsuperscript{45}

As the essence of Japanese administrative guidance is its existence by precedent and informal power, case-by-case protests against it as exemplified in the Kodak-Fuji case have a limited scope of exacting widespread change even if the verdict goes against Japan. The ability of Japan’s pervasive governing bureaucracy to manage market activity remains strong, and with it the possibility of supervised inter-firm collusion to control inward foreign investment and trade.

\textbf{III.2.b Strides in Regulation?}

Changes in Japan’s regulation of direct investment have had a mixed effect. By the time the competitiveness of the Japanese economy had become old news, in 1979 the process of a foreigner making an investment in Japan was reformed from selective permission to general permission with the duty of reporting the transaction to the

\textsuperscript{44} WTO DT/DS44/R 6.12.3 (pg. 167).
Japanese Ministry of Finance in advance. In 1991, this was changed to an ex post reporting requirement, effectively permitting most forms of capital transfers.\textsuperscript{46}

The Free Trade Commission, Japan’s antitrust body, has been beefed up in the post-bubble era with more resources and investigative power, as well as stiffer penalties for violators. Additionally, cartel members who decide to inform the commission of their anticompetitive scheme will be penalized less than the others as an incentive to promote the outing of collusive activities. However, the new, strengthened JFTC remains much weaker and less active than its American or European counterparts.\textsuperscript{47} As the fairness of the Japanese market is routinely called into question by foreign businesses, antitrust policy remains a concern.

In other regulatory areas, several legal reforms since the mid-nineties have had important consequences for foreign investors:

The revision of the Anti-Monopoly Act in 1997 allowed the creation of holding companies, which promised conglomerates increased flexibility to manage their businesses. Merger procedures were simplified in 1997. A new type of stock swap was permitted for domestic companies in 1999, with tax deferral on such deals granted in 2000. A new system for corporate spin-offs was implemented in 2001.\textsuperscript{48}

However, one M&A tactic where foreign and domestic firms continue to be explicitly discriminated between is the triangular merger, wherein the equity of a subsidiary of the purchasing firm merges with that of the target firm. This usage of shares as purchasing currency is allowed to Japanese firms, but not foreigners. Legislation granting this ability to overseas firms was passed in the Japanese Diet, but its

\textsuperscript{46} Matsushita (1993), pg. 244.
\textsuperscript{47} Fry, James D. “Struggling to Teethe: Japan’s Antitrust Enforcement Regime” in \textit{Law and Policy in International Business}. Vol 32, no. 4, (Summer 2001), pp. 825-857.
\textsuperscript{48} EIU (2005), pg. 14.
implementation has been delayed for one year after April 2006, its previously scheduled
date of enactment.\(^\text{49}\)

In 2006-07, the new capital-adequacy rules of the Basel 2 accords will force many
Japanese banks to sell more of their holdings, and thus putting more equity into play that
was previously in institutional hands.\(^\text{50}\)

\section*{III.3 Keiretsu Relationships and Corporate Behavior}

\subsection*{III.3.a Cross-Shareholdings}

In the difficult economic environment for Japanese firms after the collapse of the
bubble economy, the insolvency of what came to be known as “zombie” companies was
exposed. Creditors of these chronically unprofitable businesses lost willingness to
sustain them. Banks began to write off the losses incurred from their bad loans, and took
advantage of one of the few means to profit in Japan’s no growth “lost decade” of the
1990’s, which was selling equity. Cross-shareholdings nearly halved in the 12 years to
2004, falling to 24% of the total.\(^\text{51}\)

On the other hand, an April 2005 Nikkei survey found that “only 27\% of firms
reported that their cross-shareholding relationships were being or had been completely
unwound.”\(^\text{52}\) In reaction to the rise in M&A activity since the late 1990’s some major
firms have opted to take the pre-emptive defensive measure of actually rebuilding their
cross-shareholdings. These firms include Sumitomo Warehouse with Daiwa House
Industry, Nishin Steel with Nippon Metals, Nippon Oil with Cosmo Oil, and Nippon
Steel with Kobe Steel. “In explaining the move, the president of Nippon Steel, Akio

\(^{49}\) EIU (2005), pg. 23.
\(^{51}\) METI, referenced from EIU (2005) pg. 15.
\(^{52}\) EIU (2005), pg. 27.
Mimura, says: ‘It is important to give the impression that cross-shareholding will raise the cost of a buy-out for the buyer.’”

III.3.b The Slow Rise of the Shareholder

Undervalued shares are ripe takeover targets, and many (mostly foreign) investors are finding Japanese equity attractive because of signs of the domestic economy’s turnaround and many Japanese firms’ possession of assets viewed to be ripe for sale. Many publicly held firms have assets and cash worth more than their market capitalization, because Japanese managers view the cash as a means to smooth out cyclical challenges or as a resource to be used in case of emergencies.

In a relevant example, in 2000 a shareholder activist fund, M&A Consulting, unsuccessfully attempted a hostile takeover of such an asset-rich firm in the property sector, Shoei. Revising its management priorities to reduce the possibility of another such attempt, Shoei’s management was able to raise its capitalization more than 470% by July 2005.

An individual shareholder who challenges corporate governance viewed as repressing share value is often inhibited by the dominance of management-friendly stakeholders and shareholders. Additionally, the peculiar sokaiya, professional “semi-gangster” extortionists aiming to profit by threatening to expose dirt on management of corporations they hold small holdings in have caused the vast majority of shareholder meetings to be held on the same day, and limited their average length to under an hour. While these practices may have begun as a means to thwart the sokaiya, they also restrain critical shareholders at one of their best opportunities to voice their views. A new trend is giving shareholders the option of voting in such meetings by computer or cell phone,

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53 EIU (2005), pg. 29.
54 EIU (2005), pg. 23.
which was allowed by 271 firms in 2005. This assists their ability to participate in multiple meetings simultaneously.\(^\text{56}\)

The decreases in both cross-shareholdings and the portion of shares held by institutional investors like banks described in section III.3.a is happening concurrently with a recent rise in the Japanese equity holdings by overseas investors. Since the bottoming-out of the market in 2003, foreign investors are playing a leading role in the subsequent doubling of the Tokyo Stock Exchange’s Topix index. Since April 2003 foreigners’ 22 trillion yen ($191 billion) of Japanese equity purchases has resulted in their holding about a quarter of all listed shares today.\(^\text{57}\) This change in the composition of shareholders holds the possibility of increasing the importance of share value in the priorities of management as investors seek return on their holdings. This may be particularly true for Japanese firms whose equity has been bought by foreigners, to the extent that foreign shareholders are less sympathetic toward the Japanese rationale for deprioritizing share value described in section II.2.a’s discussion of cross-shareholdings.

A more immediate incentive for managers to pursue such reprioritization was a 1997 policy revision allowing executive stock options for the first time, although with restrictions on their issuance. But by 2005, only “4% of Japanese firms award stock options to their managers, compared with 60% of North American firms in 2000.”\(^\text{58}\) Thus managerial incentives to adopt practices more similar to their western counterparts remain comparatively limited despite this policy reform.

Another suggestion of the limits of the amount of reprioritization of share value going on in Japan is given by the size of the portion of M&A deals that involve unlisted firms. That in the past five years more than 70% of all such transactions in Japan have involved one or more unlisted companies implies that the amount of attention paid to share value by managers is a key factor in determining a firm’s openness to M&A

\(^{56}\) “Shareholders’ Meetings Go Online” in \textit{The Japan Times}, June 28, 2005.
\(^{57}\) “The Last, Best Game” in \textit{The Economist}, October 20, 2005.
\(^{58}\) EIU (2005), pg. 21.
possibilities. Because the managers of unlisted firms are the top shareholders, their sensitivity to share value makes them more receptive to M&A than publicly traded firms.\textsuperscript{59}

And even among such publicly traded firms, the ideas of many Japanese managers remain in conflict with those of shareholders. In a statement by the powerful Nippon Keidanren business organization entitled \textit{Reasonable Defense Measures against Takeovers Detrimental to Corporate Value are Needed}, the rationale of using defense measures against M&A such as the share value diluting “poison pill” is supported. The balance between share value and the traditionally prioritized “corporate value” mentioned by Keidanren that also includes “employees, local communities and other stakeholders” remains a point of contention.\textsuperscript{60} Thus the lack of prioritizing share value lessens Japan’s attractiveness to direct investors seeking to realize gains in their investments.

\textbf{III.3.c Emerging Exceptions to Traditional Japanese Corporate Culture}

Cordial inter-firm relations have been a traditional component of the Japanese corporate world, but the M&A activity that developed since the late nineties has recently taken a turn for the nasty. While consolidation and industrial restructuring took the form of friendly mergers at the beginning of the boom, since 2004 hostile takeovers have caught most of the press in the Japanese M&A world. Hostile bids had been considered something only foreigners do, although there has never been a foreign hostile takeover of

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\item \textsuperscript{59} EIU (2005), pg. 4.
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a Japanese firm. But what the last year has shown is that some of Japan’s businesses have become willing to use such tactics as well. Traditionally Japanese firms have grown organically, not via mergers and acquisitions. Recent activity in Japan suggests that M&A is now viewed as a means to grow, not just as a means for insolvent companies to gain liquidity through selling themselves. Moreover, firms are willing to engage in M&A of both types without gaining prior approval of the target.

The first shocking example of uncouth corporate behavior involved some of the most conservative firms in the country. The 2004 friendly merger between Mitsubishi-Tokyo Financial Group (MTFG) and UFJ Holdings was interrupted by the unsolicited entrance into the fray of Sumitomo-Mitsui Financial Group (SMFG) which offered to buy UFJ as well. Shortly thereafter Sumitomo Trust (related to SMFG) went to the courts to stop the initially planned MTFG-UFJ merger as well. MTFG eventually prevailed, but needed to pay a higher price than expected for UFJ and compensation to Sumitomo Trust.

Next came 32-year old Takafumi Horie, an internet entrepreneur who in Spring 2005 launched a hostile bid with his company, livedoor, for a subsidiary of Japan’s largest TV broadcaster, Fujisankei Communications. Because of cross-shareholdings, Horie was able to control a sizable stake in the venerable Fujisankei before several rounds of litigation and Fuji’s location of a white knight left livedoor with just a modest profit for its labor.

The significance of these and other events in the last year is that if they suggest greater tolerance of Japanese behavior once thought to be characteristic of foreign firms, foreign firms may have a growing variety of strategies to consider to pursue their M&A targets as well. However, because many in Japan think unfavorably of the reputed

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61 Westmore, Donald (Executive Director, American Chamber of Commerce in Japan). Notes taken during the interview, August 3, 2005.
ruthless, profit-driven motives of outsiders, “it is the Japanese upstarts that are acting most aggressively whereas the foreign funds try to stress how socially responsible they are.”

As a result, foreign M&A remains largely limited to activity where the buyer has been able to exhibit itself as a partner worthy of the loyalty still valued in Japanese corporate culture. For example, “60% of all M&A deals involving foreigners since 1998 have involved unlisted Japanese companies, and were often small deals with firms or subsidiaries where relationships already existed.”

Part IV: Positions of Today’s Players and Politicians

The statistical data provided in Part I showed no clear sign of a shift in Japan as an FDI market, and its modern history as described in Parts II and III has shown change but nothing approaching widespread elimination of impediments to inward FDI. What this fails to show is that there has been a shift in both Japanese and foreign perceptions of how attractive the Japanese economy is to foreign direct investors, as well as how it differs from the other leading nations’. This change is evident in the impressions elicited in interviews conducted in August and September 2005 in Tokyo with officials from Japanese and American public and private sector. The accounts of all actors suggest a stronger feeling of optimism than ever before surrounding the economic relations between Japan and the rest of the world, especially regarding inward FDI.

The position of the Japanese government on inward FDI is, at first glance, clear. Prime Minister Junichiro Koizumi gave a speech in January, 2003 laying out his plan to raise inward FDI, saying, “We will take measures to present Japan as an attractive destination for foreign firms, with the aim of doubling the cumulative amount of

65 EIU (2005), pg. 4.
investment within five years.” The persistence of the Japanese recession had given credence to voices for reforms that challenged the essence of the alleged Japanese economic model. Market-oriented reforms and openness to foreign exchange appeared on the agendas of both ruling and opposition party members. A renewed emphasis began to be placed on investment issues in the deliberations of Japanese ministries, foreign trade delegations and businesses. In economic negotiations with foreign states, these concerns had been sidetracked by prioritization of sectoral problems that limited foreign firms’ exports of goods and services to Japan. But a fall in the value of the yen, depreciation of asset valuation and miserly domestic demand drove up the number of M&A targets attractive to investors at the same time that *keiretsu* cross-shareholdings were decreasing. This phenomenon was exacerbated by Japan’s exposure to the East Asian Crisis of 1997-1998. Within these circumstances, investment came to be viewed more favorably as a means of injecting capital into the economy.

A visit to the gleaming offices of the Japan External Trade Organization (JETRO), the government’s trade and investment promotion body, in a new skyscraper in the pricey Akasaka neighborhood of Tokyo is visual evidence of the government’s support for its activity, manifested in JETRO’s ballooning budget, notable in fiscally-strapped Japan. In addition to providing free office space, specialized advisory and networking services at its six Invest Japan Business Support Centers in major Japanese cities, JETRO pays many prospective investors’ airfare and hotel expenses to come and study opportunities in the country through its Invest in Japan Study Program. According to a JETRO official interviewed, many domestic businesses complain about the extravagant treatment that it offers to assist foreign competitors.66

On the international front, the issues that have historically limited inward FDI and imports to Japan have been the subject of rigorous discourse not only domestically but also in negotiations between Japan and other nations’ delegations, notably the U.S. The significance of bilateral negotiations between the United States and Japan is

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66 Interview with official of Invest Japan Department, Japan External Trade Organization (JETRO) wishing to be kept anonymous. August 3, 2005.
informed by America’s position as the primary foreign investor in Japan and the unique depth of its engagement in Japanese policymaking. However, the United States’ depth of involvement in the Japanese economy does not imply a difference between its interests and those of other foreign states. According to a METI trade official interviewed, there are “not many differences between European and American ideas on Japanese regulatory issues,” allowing for the partial assumption that the interests of other developed countries’ investors are also served by the activity of American trade negotiators.

Japan’s frosty economic relations with the U.S. during the 1990’s imply that its economy had earned widespread overseas criticism. The contention in economic relations between the U.S. and Japan inspired academic works with titles such as “Troubled Times”, reflecting the tense atmosphere in the nations’ trade negotiations and animosity in the countries’ people at large. In the nascent post-Cold War era, American delegations felt freer to protest alleged Japanese protectionism in a manner that in the past would have been deemed inappropriately terse for the most important democratic country on the Pacific Rim. But in the 1990’s, Japan’s economic might made it the recipient of American concern previously directed to the Soviet Union’s military power. In the parlance of the time, “the end of history” meant that fear of military threat was of less relevance than monitoring potential competitors in the liberal global economy. Through such a lens the potential for a major rival to the U.S. to arise in Japan was viewed as a real possibility. Its rise from postwar ashes to becoming the world’s second largest economy was the greatest feat of economic growth ever. Academics everywhere lauded the fruits of a Japanese economic model that was presented both in opposition to the deregulated nature of America’s and as the cause for Japan’s success. When Bill Clinton was inaugurated as President in January, 1993, it was noted that Japan was in the midst of a recession, however its extent and cause was ambiguous enough for belief in Japanese economic competitiveness to be sustained. On the streets and in the living rooms of the U.S. evidence of this was in abundance. Japanese automakers’ export sales

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67 Lincoln (1999), pg. 82.
68 Interview with official of Americas Division, Trade Policy Bureau, Ministry of Economy, Trade and Industry wishing to be kept anonymous. August 11, 2005.
were booming as their models were both a better value and more reliable than products of the domestic Big Three of GM, Ford and Chrysler. TVs and stereo equipment by Japanese giants Sony, Panasonic, Toshiba, Hitachi and others dominated the hi-fi market while their American competitors like RCA moved their production facilities to the Far East. The emasculation of many of America’s flagship enterprises was a blow to both national pride and the job market. The nightly news rolled footage of laid-off auto workers bashing Japanese imports in expression of the anger felt at the foreign foe.

However, both the Japanese and American negotiators at work today see themselves operating in a far more cordial environment and with a different focus than the merchandise trade issues that dominated the agenda into the mid-nineties. The prolonged recession and subsequent changed posture of Japanese politicians to inward FDI mentioned above improved the tone of the delegations’ meetings. Negotiations were described by an American Embassy official in Tokyo as comprehensive: “I can’t think of anything we don’t talk about.”

The content of these negotiations sheds light on what subjects are now taking precedence. In the words of an official in the Americas Division of the Trade Policy Bureau at METI, “Quite frankly we don’t have many problems regarding sectoral issues,” and “The US government doesn’t propose many sectoral issues”. In estimating the changing priorities in negotiations relating to foreign businesses operating in Japan, the METI trade official estimated that in the early nineties 70-80% of their content was sectoral, whereas now it’s “much less”. The shift has been toward the regulatory and legal issues more relevant to investment projects. According to Donald Westmore, recently retired former Executive Director of the American Chamber of Commerce in Japan (ACCJ), the ACCJ’s biennial *U.S.-Japan Trade White Paper* series had to be renamed *U.S.-Japan Business White Paper* in 2001 because the priority has shifted

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69 Interview with a United States Embassy of Tokyo official, September 6, 2005.
70 Interview with METI official, August 11, 2005.
significantly away from only trade, to FDI’s prominence. In Mr. Westmore’s words, there has been a “total change”.71

Such positive sentiments were echoed by the officials interviewed at the U.S. Embassy in Tokyo, who are in touch with their Japanese government contacts on a day-to-day basis. As said by one, “It’s like a mature friendship”. Another U.S. embassy official believes that recent changes in Japan’s openness to foreign business are no passing trend: “The time frame [of reforms] is accelerating.”72

One possible caveat to this rosy picture is that political considerations related to security issues have limited America’s willingness to press forcefully on issues it knows are sensitive or unlikely to bear fruit. With North Korea’s nuclear intransigence an increasing concern to both countries from the late 1990’s, China’s rise, and a renewed American focus on global security after the September 11, 2001 terrorist attacks, Japan’s status as the key American ally in East Asia deepened the need for overall relations to be favorable.

After the discovery of a BSE-infected cow in December 2003, American legislators from beef producing states have been pressing for retaliation for the resulting Japanese ban of American beef imports. Strikingly, the Japanese trade official interviewed said his impression was that the Americans he speaks with across the negotiating table and over the phone were less trigger-happy in threatening retaliation than in the past: “In the 1990’s, BSE would’ve been a big battle.”73 While continued foot-dragging for Japan’s planned removal of the ban means such American measures are a possibility, the impression given was strikingly cordial. The official elaborated that since 9/11/01, “to [his] knowledge, The US government is more tolerant now.”74 However, the American Embassy officials interviewed firmly claimed to have never

71 Westmore interview, (August 3, 2005).
72 Interview with a United States Embassy of Tokyo official wishing to be kept anonymous, September 6, 2005.
73 Interview with METI official, August 11, 2005.
74 Interview with METI official, August 11, 2005.
heard that politics was tainting their policy stances, saying: “I’ve never heard anything coming down, saying ‘Drop that issue!’” and “I see no evidence that we pull back on any issue.”

But another possible means by which the improvement in the tone of negotiations may be misleading is that the American side has decided to divert its focus from the traditionally contentious area of American exports to Japan to inward FDI to take advantage of the current political backing exemplified by Koizumi’s stance.

**Part V: Conclusion**

The testimonials of the actors described in Part IV belie the lack of progress in Japan’s inward FDI seen in the data reviewed in Part I. Where progress has certainly occurred however, is in the discourse between Japan and its trading partners like the United States and within Japanese boardrooms and political bodies. Japan’s economic woes made opening to foreigners in the financial sector an increasingly appealing option to Japanese policy makers.

A limited number of foreign acquisitions was happening at the same time as the shift described by Mr. Westmore at the ACCJ was coming to pass. This could be viewed as only a rise in the importance of investment issues, or a normalization of economic negotiations between Japan and other developed countries such as America. In full form it should be expected that two nations discuss issues related to all aspects of their economic relationship and not be prone to having the effects of one problem cause discussion of other areas divulge into stalemate. Whether or not this normalization is happening remains open to question, but viewing Japan’s foreign economic relationships with this process in mind paints an optimistic picture for its future negotiations. In an ideal bilateral relationship, discussion between both parties is continuous, all-inclusive,
and cordial, and the opinion of both Japanese and American national delegations is that meetings between the two sides are now all of these.

While the end of all disagreement and controversy over economic relations may never come, it is worth emphasizing again that continuous, inclusive, and cordial relations are the ideal. That the discussion is shifting from trade-related issues to investment issues can also be viewed as progress. As explained by the Japanese trade official, “trade comes before FDI because there is less risk” and FDI occurs when the “roots of trade grow deeper”. Therefore topics for negotiation should of course naturally follow suit. Another more accurate (or cynical, depending on your opinion) perspective is that in Japan trade comes before FDI because there were laws strangling FDI, but the point of agreement is that now the situation is closer to the ideal where both sectoral and investment issues are discussed willingly. Such open discussion suggests a weakening tendency for Japan to get defensive about its allegedly protectionist policies, for example in international negotiations. An illustration of this trend is that JETRO has in recent years closed some of its offices in America while opening new ones in China because “We believe trade conflict [with America] is getting settled down, now it’s shifting to China,” in the words of an official in JETRO’s Invest Japan department.

Which returns us to the question of causality in the brightening of opinions on Japan’s inward FDI prospects that was raised in the introduction, and the three possibilities suggested then:

1. Japan now has increasingly attractive opportunities for direct investment that have made related issues worth discussing.
2. Japan now has fewer trade barriers worth discussing.
3. Changing global political considerations are responsible for a different perspective on economic relations.

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75 Interview with METI official, August 11, 2005.
76 Interview with JETRO official, August 3, 2005.
Support for the first two possibilities was given in Part III. The changes to Japan’s market for inward FDI and trade have been significant, but not without setbacks. The third possibility, namely that the rich capitalist countries opposed to the possible threats of North Korea, China, and terrorism should soften their internal quarrels, seemed to be minimized by the Japanese and American state officials who describe their bilateral relations as mature enough that their economic consultations would not cause any trouble that could effect strategic relations.

However, the continued presence of strategic threats, and more importantly the dramatic restructuring of the Japanese economy and the policies regulating it, as well as rich countries’ continuing desire to exhibit their subscription to the status quo of free trade mean that all three reasons for today’s actors’ bright forecasts are credible. Moreover, it must be noted that they are mutually reinforcing, which is a signal that these three factors are likely to develop together, and facilitate more inward FDI than ever.
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