Reducing the U.S.-Japan Trade Deficit by Eliminating Japanese Barriers to Foreign Direct Investment

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Foreign direct investment plays an integral role in world trade. Assets held by a domestic company in a foreign country constitute foreign direct investment.[1] Such investment expands trade because foreign subsidiaries typically buy goods and supplies from their parent companies in their home countries. This intracompany trade accounts for thirty to forty percent of world trade in manufactured goods.[2] Intracompany trade is primarily responsible for the $62 billion U.S. trade deficit with Japan in 1994.[3]

Foreign direct investment levels in Japan are extremely low. In the first ten months of 1994, foreign direct investment in Japan totalled $2.975 billion while Japanese direct investment throughout the world reached $32.604 billion.[4] In 1993, U.S.

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1. Peter Behr, *For Dinosaurs, Multinationals Are Looking Pretty Healthy*, WASH. POST, Sept. 8, 1994, at B11. For example, "when Sara Lee Corp. buys a clothing plant in Honduras, or AT&T establishes a research venture in China, or Mercedes-Benz builds a car plant in Alabama, that is foreign direct investment." *Id.* at B13. Foreign direct investment "covers direct spending on business operations, like acquisitions, plant construction and investments in other operations. Such spending is distinguished from portfolio investments, like buying securities or other such financial transactions." James Sterngold, *Rising Yen Might Widen This Gap*, N.Y. TIMES, July 7, 1993, at D1.

2. U.S. TRADE REPRESENTATIVE, NATIONAL TRADE ESTIMATE REPORT ON FOREIGN TRADE BARRIERS 168 (1994).

3. *U.S. May Meet Japanese Auto Makers; Renewed Car Talks Set For Feb. 15-17*, Int'l Trade Daily (BNA) (Feb. 9, 1995). "By 1980, Japanese subsidiaries in America—nearly all operating as wholesalers—distributed over three-quarters of all U.S. imports from Japan." DENNIS J. ENCARNATION, RIVALS BEYOND TRADE: AMERICA VERSUS JAPAN IN GLOBAL COMPETITION 119 (1992). In 1980, intracompany trade between Japanese subsidiaries in America and their parent companies in Japan contributed $9.5 billion to America's $10 billion trade deficit with Japan. *Id.* at 120. *See also* Richard Alm, *Trade Gap Isn't the Only Imbalance Existing Between U.S., Japan*, DALLAS MORNING NEWS, Oct. 3, 1994, at 1D (citing a 1993 Department of Commerce Study showing that 80% of Japanese imports into the United States go to Japanese subsidiaries).

4. *Foreign Investors Were Net Sellers of Japanese Stock in January, Figures Show*, International Business & Finance Daily (BNA), July 6, 1994, *available in* LEXIS, FEDSEC Library, BNAIBF File.

companies invested $900 million in Japan.[5] By contrast, Japanese companies invested $14.7 billion in the United States.[6] The U.S.-Japan investment disparity is not a recent phenomenon. From 1982 to 1992, Japan invested roughly $130 billion in the United States, while the United States invested $8.8 billion in Japan.[7] In addition, only forty-four percent of U.S. Fortune 500 companies have a direct commercial presence in Japan, while sixty-eight percent of Japan's top 500 corporations have a direct commercial presence in the United States.[8]

Foreign direct investment is central to gaining access to Japanese markets and reducing the U.S. trade deficit with Japan. To reduce the trade deficit, the Office of the United States Trade Representative (USTR) has, thus far, focused its efforts on lowering Japanese tariff barriers to U.S. products. The USTR must also work to increase U.S. direct investment in Japan. Increased U.S. direct investment in Japan will lead to increased sales of U.S. goods and services, thereby reducing the U.S. trade deficit.

This Note addresses how the low level of U.S. direct investment in Japan widens the trade gap, and whether pursuing increased investment, instead of only tariff reductions, better serves U.S. trade interests. Part I examines the extent to which foreign direct investment influences international trade. Part II reviews the history of foreign direct investment barriers in Japan and examines recent Japanese efforts to attract foreign direct investment. Part II also defines and distinguishes the formal and informal Japanese barriers that discourage foreign direct investment. Part III considers why Japanese programs aimed at attracting foreign direct investment have failed, analyzes legal and socioeconomic differences between the United States and Japan, and determines the extent to which formal and informal barriers are responsible for the U.S.-Japan investment gap. Specifically, Part III focuses on official government

5. *Foreign Direct Investment in Japan*, Country Profile, July 1, 1994, *available in* LEXIS, ASIAPC Library, COUPRF File.

6. *Japanese Direct Investment Abroad*, Country Profile, July 1, 1994, *available in* LEXIS, ASIAPC Library, COUPRF File.

7. Sterngold, *supra* note 1, at D17.

8. *Japan—Inward Investment Statistics*, Market Reports, Aug. 17, 1993, *available in* LEXIS, ASIAPC Library, MKTRPT File. The Japanese companies exert more control over their investments. Eighty-five percent of the Japanese investments in the United States are wholly-owned subsidiaries, compared to 67% of the U.S. investments in Japan. *Id.*

regulations, *keiretsu*,[9] the Antimonopoly Law, and differences between the United States and Japan in intellectual property protection. Part IV recommends the use of Section 301 of the 1988 Trade Act[10] to increase U.S. direct investment in Japan. While recognizing the possible negative consequences connected to the use of Section 301 sanctions, this Note finds that any agreement on foreign direct investment between the United States and Japan should be reached under the auspices of Section 301.

I. THE EFFECT OF FOREIGN DIRECT INVESTMENT ON INTERNATIONAL TRADE

Foreign direct investment expands global trade.[11] A recent study by the Japanese Ministry of International Trade and Industry (MITI) found that, in one year, foreign-owned subsidiaries imported $3.5 billion more goods into Japan than they exported, thus lowering the trade imbalance with Japan.[12] The USTR recognizes the importance of U.S. direct investment in Japan, stating in a 1994 report that "[t]he low levels of foreign direct investment in Japan are a direct cause of low import penetration of Japanese markets."[13]

Foreign direct investment increases international trade in several ways.[14] First, foreign direct investment is the most effective way to sell goods because a firm's alternatives (domestic production or licensing of foreign-based production) are less efficient than direct control of foreign-based operations.[15] By sell-

9. *Keiretsu* are tightly controlled groupings of Japanese businesses that work together to the detriment of foreign investors and business interests. Alex Y. Seita & Jiro Tamura, *The Historical Background of Japan's Antimonopoly Law*, 1994 U. ILL. L. REV. No. 1, at 115, 121. *See infra* notes 98-102 and accompanying text (describing horizontal and vertical *keiretsu*).

10. For a description of Section 301 and its application to Japan, see *infra* text accompanying notes 139-48.

11. "The underlying point is that [foreign direct] investments, not just low tariffs and open markets, are the engine for sales in foreign markets." Sterngold, *supra* note 1, at D17.

12. *Id.* Foreign subsidiaries in Japan account for 5% of Japan's exports, but 17% of its imports. *Id.*

13. *USTR Report Takes Aim at Japan in Foreign Trade Barriers Inventory*, 11 Int'l Trade Rep. (BNA) No. 14, at 534, 535 (Apr. 6, 1994).

14. Edward Graham, a trade expert at the Institute for International Economics, writes: "Overwhelmingly, U.S. exports of manufactured goods go to countries where there is substantial U.S. direct investment presence." Sterngold, *supra* note 1, at D1.

15. *See* Robert Z. Lawrence, *Japan's Low Levels of Inward Investment: The Role of Inhibitions on Acquisitions*, *in* FOREIGN DIRECT INVESTMENT 85-106 (Kenneth A. Froot ed., 1993).

ing finished and unfinished goods directly to wholly- or majority-owned subsidiaries in Japan, a U.S. company can bypass Japan's multi-layered distribution system, which is responsible for increasing the price of goods before they reach the Japanese market.[16] Also, foreign direct investment in Japan is a profitable investment. Japan is an important market because it provides a solid manufacturing base and a workforce capable of efficient production in high technology industries.[17]

Finally, foreign direct investment establishes a physical presence for U.S. companies in Japan. When a U.S. company purchases assets in Japan, by acquiring a Japanese company or by buying a plant to produce its goods, it promotes international trade in five distinct ways. First, it eliminates competition by buying out the competition. By purchasing a competitor engaged in the production of directly competing goods, strategic direct investment secures a greater market share. Second, foreign direct investment increases Japanese consumer awareness of the availability of U.S. goods and services. Third, by utilizing the skills and ingenuity of its Japanese employees, a U.S. corporation that buys a Japanese company can tap Japanese consumer trends and learn more about consumer preferences. By recognizing consumer preferences, the U.S. company can tailor its products and make them more appealing (and user friendly) to the Japanese consumer.[18] Fourth, the U.S. company can be more competitive by directly exposing itself to technological developments in the Japanese market.[19] Fifth, the U.S. company, through its foreign subsidiary, can provide more comprehensive and efficient post-sale service to its Japanese customers.[20]

16. Sterngold, *supra* note 1, at D17. "In America, for instance, Honda both makes cars and sells them to dealers through its own American marketing and distribution subsidiary. But General Motors has no production operations [in Japan] and sells autos through Japanese importers." *Id.*

17. *Economic Group Urges Measures To Entice More Foreign Investment*, 9 Int'l Trade Rep. (BNA) No. 44, at 1898 (Nov. 4, 1992) [hereinafter *Economic Group Urges Measures*] (citing a 1992 study showing that 70% of foreign firms view their investments in Japan as successful and 60% evaluate their Japanese plant performance as high).

18. UNITED STATES-JAPAN TRADE STUDY GROUP, JAPAN BUSINESS: OBSTACLES AND OPPORTUNITIES 31 (1983). In a 1982 survey of Japanese consumers, 43% complained that the main reason for not purchasing imported electric appliances was because they were difficult to use. *Id.*

19. Michael Borrus & Judith Goldstein, *United States Trade Protectionism: Institutions, Norms and Practices*, 8 NW. J. INT'L L. & BUS. 328, 350 (1987).

20. UNITED STATES-JAPAN TRADE STUDY GROUP, *supra* note 18, at 31. In a 1982 survey of Japanese consumers, 30% responded that they did not buy imported electric appliances because of poor post-sale service. *Id.*

While it takes hours or days for a Japanese company to service its goods in Japan, it can take months for a U.S. exporter that has no direct presence in Japan.[21]

Because foreign direct investment expands trade, it follows that an increase of U.S. direct investment in Japan would reduce the U.S.-Japan trade imbalance. To increase U.S. direct investment in Japan, however, it is important to analyze the forces that have been, and continue to be, responsible for low U.S. investment levels.

II. FOREIGN DIRECT INVESTMENT IN JAPAN: HISTORY, BARRIERS, AND NEW DEVELOPMENTS

Historically, Japan severely restricted foreign direct investment through formal government regulations and informal business practices. Long before World War II, Japan imposed government restrictions on capital inflows.[22] From 1945 until 1967, Japan virtually prohibited foreign direct investment.[23] After 1967, Japan generally limited foreign direct investment in Japanese companies to joint ventures or sales.[24] Because direct investment was formally denied to U.S. producers during the 1950s, 1960s and 1970s, many U.S. industries licensed their technologies to Japanese companies.[25] With the licensed technology, Japanese companies "refined their products and developed highly efficient manufacturing systems, while simultaneously being protected from the then superior products and productivity of foreign companies."[26] This strategy gave Japanese companies a competitive edge over American companies in Japan, and simultaneously helped to prevent American companies from gaining an investment foothold in Japan.[27] Ja-

21. U.S. INT'L TRADE COMM'N, PUB. NO. 2621, EAST ASIA: REGIONAL ECONOMIC INTEGRATION AND IMPLICATIONS FOR THE UNITED STATES 45 (1993) [hereinafter REGIONAL ECONOMIC INTEGRATION].

22. ENCARNATION, *supra* note 3, at 6.

23. U.S. INT'L TRADE COMM'N, USITC PUB. NO. 1437, FOREIGN INDUSTRIAL TARGETING AND ITS EFFECTS ON U.S. INDUSTRIES—PHASE I: JAPAN 72 (1993) [hereinafter FOREIGN INDUSTRIAL TARGETING]. The Foreign Investment Law of 1950 allowed the Japanese government to regulate the flow of foreign capital and technology into Japan. Until 1967, severe restrictions on foreign direct investment were in effect. *Id.*

24. *Id.* at 47.

25. Borrus & Goldstein, *supra* note 19, at 351.

26. *Id.*

27. LAURA D'ANDREA TYSON, WHO'S BASHING WHOM? TRADE CONFLICT IN HIGH-TECHNOLOGY INDUSTRIES 87 (1992). D'Andrea Tyson explains how the

pan created investment barriers to counteract the threat of U.S.-owned subsidiaries posing a competitive challenge to Japanese industry at home.[28] These restrictive policies served to discourage U.S. direct investment in Japan, while U.S. policy and business practices allowed Japanese direct investment in the United States.[29]

A. FORMAL AND INFORMAL BARRIERS AFFECTING FOREIGN DIRECT INVESTMENT IN JAPAN

To eliminate Japanese investment barriers, it is necessary to understand what they are and how they operate. It is also important to identify the barriers that U.S. negotiators can reasonably expect the Japanese government to eliminate. Some barriers are easy to eliminate, while some barriers are so deeply entrenched in Japanese culture and business philosophy that government action will have little meaningful effect.

The obstacles that foreign direct investors face in Japan can be divided into formal and informal investment barriers. Formal barriers consist of any official government action or regulation that directly hinders foreign direct investment. Informal barriers consist of private business practices, cultural phenomena and economic trends that negatively affect foreign direct investment.

1. Formal Government Barriers

Industry specific government regulations are among the most restrictive formal barriers to foreign direct investment in

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Japanese semiconductor industry was protected from U.S. foreign direct investment:

> Initially, American companies tended to discount the significance of these barriers, treating them as mildly irritating rather than life threatening. But as the protected Japanese market grew and ominous evidence of the successful Japanese challenge mounted, American companies began a 15-year struggle to open the Japanese market and to deter predatory Japanese business practices through various trade policy initiatives.
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> This struggle reaped little in the way of real gains, and by the early 1980's the American companies watched in disbelief as the Japanese companies surged into the open American market.

Id.

28. ENCARNATION, *supra* note 3, at 6.

29. *Id.* at 118. "After 1959, a decade was required for Japanese FDI in America to double; but for this FDI to double again, only one-half that time had to pass, the five years between 1969 and 1974. And thereafter, Japanese FDI in the United States doubled every year-and-a-half at least through the end of the [1980s]." *Id.* (citation omitted).

Japan. These restrictions and prohibitions have regulated primary industry in agriculture, air transport, banking and securities, broadcasting, forestry and fisheries, insurance, leather and leather products manufacturing, marine transport, mining, oil, and telecommunications.[30] Most of these regulations take the form of restrictions on, and even prohibitions against, foreign direct investment.[31]

Another formal government barrier is legislation that discourages foreign direct investment. For many years, the Foreign Exchange and Foreign Trade Control Law[32] allowed the Japanese government to restrict foreign direct investment and the importation of technology in any industrial sector if such imports might have "an adverse effect on similar domestic activities or the smooth functioning of the Japanese economy."[33] In 1992, the Japanese government amended the law to make it less restrictive in most industries. The amendments, however, did not cover industries related to national security, public order, and protection of the general public.[34] In addition, the law requires that foreign firms consult with the Ministry of Finance and Bank of Japan before undertaking any investment transaction.[35] This gives *keiretsu*[36] early warning of mergers and acquisitions and, because of extensive cross-shareholding,[37] gives shareholders an opportunity to challenge foreign purchases of Japanese companies.[38] Additionally, the Japanese Fair Trade Commission imposes approval requirements on technology

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30. U.S. INT'L TRADE COMM'N, PUB. NO. 2291, PHASE I: JAPAN'S DISTRIBUTION SYSTEM AND OPTIONS FOR IMPROVING U.S. ACCESS 87 (1990) [hereinafter JAPAN'S DISTRIBUTION SYSTEM].

31. *Id.* In 1992, some of these regulations were repealed, but the Japanese government reserved the right to reject any investment that is not available on a reciprocal basis to Japanese investors in America. In addition, it reserved the right to reject any investment posing "a threat to national security." Lawrence, *supra* note 15, at 86 n.1.

32. Gaikoku kawase oyobi gaikoku boeki no kanri ni kansuru horitsu (Foreign Exchange and Foreign Trade Control Law) Law No. 228 of 1949, *as amended* (1968), *translated in* 5 EIBUN-HOREI SHA LAW BULLETIN SERIES AA.

33. JAPAN'S DISTRIBUTION SYSTEM, *supra* note 30, at 91.

34. *Economic Group Urges Measures*, *supra* note 17, at 1898.

35. *Keidanren Says Government Measures to Help Foreign Bidders Are Inadequate*, 11 Int'l Trade Rep. (BNA) No. 1, at 11, 12 (Jan. 5, 1994).

36. For a description of the two types of *keiretsu*, horizontal and vertical, see *infra* notes 98-102 and accompanying text.

37. The most notable barrier to foreign direct investment in Japan is extensive cross-shareholding among Japanese companies. D'ANDREA TYSON, *supra* note 27, at 7. Cross-shareholding prevents the acquisition of Japanese businesses by would-be foreign investors. *Id.*

38. *See infra* note 89 and accompanying text.

transfers from foreign companies to their Japanese subsidiaries.[39]

Other formal government barriers to foreign direct investment include a ten-year deficit carry-over period for foreign-affiliated firms,[40] a ten percent withholding tax on dividends paid by subsidiaries in Japan to their overseas parents,[41] and inefficient intellectual property protection for foreign companies.[42] In addition, U.S. attorneys do not have the same opportunities in Japan as Japanese attorneys have in the United States. In the District of Columbia and New York, for example, Japanese lawyers may practice U.S. law as foreign legal consultants and form partnerships with U.S. lawyers.[43] To a limited extent, U.S. law firms can now form partnerships with Japanese law firms, but in reality this development is only a "small step toward liberalization."[44] U.S. law firms can play a constructive role in direct investment, both as a form of direct investment themselves and as investment facilitators capable of mastering the intricacies of Japanese law.[45] Thus, the Japanese restrictions on foreign at-

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39. *Japan—Destination Japan*, Market Reports, Sep. 19, 1994, *available in* LEXIS, ASIAPC Library, MKTRPT File.

40. *USIA Foreign Press Center Briefing Topic: U.S.-Japan Framework Talks*, Federal News Service, Jan. 20, 1995, *available in* LEXIS, EXEC Library, FEDNEW File. Deputy Assistant Secretary of State Alan Larson explained the U.S. position regarding a loss carry-forward provision, also known as a deficit carryover period. A loss carry-forward provision allows a firm to carry forward into future tax years losses it incurs as a result of start-up costs. *Id.* In 1994, the Japanese government increased the deficit carryover period from seven to ten years. *Id.* Since the deficit carryover period is 15 years in the United States, U.S. negotiators have requested that the Japanese government increase their period to 15 years as well. *Id.*

41. *Economic Group Urges Measures*, *supra* note 17, at 1899.

42. *See* Roziana Hamsawi, *Malaysia: Ministry Lists 6 Cases of Unfair Japanese Practices*, Business Times (Singapore), July 21, 1994, *available in* LEXIS, ASIAPC Library, ALLASI File (noting a Malaysian report identifying Japan as one of the countries on the "Special 301 watch list" from which the United States seeks stronger intellectual property protection). For an explanation of the differences between U.S. and Japanese intellectual property protection, see *infra* notes 128-33 and accompanying text.

43. Donald L. Morgan, *Regulation of Foreign Lawyers: Modest Changes to be Made*, East Asian Executive Reports, June 15, 1994, *available in* LEXIS, ASIAPC Library, EASIAN File.

44. *Countries Seen Continuing to Seek Liberalized Trade in Legal Services*, 11 Int'l Trade Rep. (BNA) No. 32, at 1247, 1248 (Aug. 10, 1994).

45. *Japan—Country Marketing Plan FY'94*, Market Reports, Sept. 15, 1994, *available in* LEXIS, ASIAPC Library, MKTRPT File. The United States wants Japan to liberalize its laws to permit U.S. attorneys to hire and work with Japanese attorneys. The Japan Federation of Bar Associations and the Ministry of Justice oppose any such liberalization, while Keidanren, the Japan Federation of Economic Organizations, supports liberalization. *Id.*

torneys are another barrier to large-scale foreign direct investment.

2. Informal Barriers

While formal barriers greatly discourage U.S. direct investment in Japan, informal barriers are also responsible for the investment gap. Informal barriers consist of cultural and business practices, and natural market forces. The interlocking corporate relationships between Japanese businesses, or *keiretsu*, represent a significant informal barrier to foreign direct investment.[46] *Keiretsu* create barriers primarily through cross-shareholding.[47] This effectively prevents foreign investors from purchasing controlling interests in Japanese companies, and prevents foreign firms from establishing an investment foothold in Japan.[48]

Because U.S. investors have great difficulty acquiring Japanese companies,[49] they are forced to rely on "greenfield" startups,[50] where an investor starts a business from scratch. In addition, *keiretsu* discourage foreign direct investment by quashing foreign shareholder rights.[51] Foreign investors are unable to exercise control over Japanese businesses, even when they are substantial shareholders.[52]

In analyzing Japanese investment barriers, it is important to note that the Japanese have made concessions concerning *keiretsu* transactions. The United States and Japan recently addressed this issue in the Structural Impediments Initiative,[53] and, as a result, the Japanese Fair Trade Commission will moni-

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46. *Economic Group Urges Measures*, *supra* note 17, at 1899.

47. JAPAN'S DISTRIBUTION SYSTEM, *supra* note 30, at 90. "Practices such as cross-shareholding may keep as much as 70 percent of total stocks in Japan from changing hands." *Id.*

48. *Japan—Country Marketing Plan FY'94*, *supra* note 45, pt. V.B; *see infra* text accompanying notes 103-04.

49. Lawrence, *supra* note 15, at 87.

50. *Id.* Greenfield investments usually involve higher startup costs than a merger or acquisition. *Id.* at 92.

51. One commentator identified a possible cultural explanation for the refusal to recognize foreign shareholder rights. "[T]he Japanese concept of a firm places less emphasis on the role of stockholders and more emphasis on the rights of other stakeholders—in particular, employees and management." *Id.* In addition, the Japanese word for "takeover bid" (*nottori*) can also mean "hijack." *Id.*

52. For further discussions of foreign shareholder rights in Japan, see *infra* notes 116-18 and accompanying text.

53. Lawrence, *supra* note 15, at 101. In July 1989, President Bush and Prime Minister Uno began the Structural Impediments Initiative (SII) to identify and solve structural problems in both countries. The SII was later used to

tor *keiretsu* practices and try to eliminate restraints that hinder fair competition.[54]

A more fundamental barrier to foreign direct investment, and perhaps an underlying reason for *keiretsu* cross-shareholding protection techniques, is Japanese culture. Whereas takeovers of businesses and corporations by foreigners are commonplace in the United States, they are rare in Japan. In Japan, the corporation is a kind of family, and the employees are members of that family.[55] When a foreigner (*gaijin*) purchases the corporation, it is seen as a sign of weakness, and the "family" is disgraced.[56] The loyalty of Japanese employees to their companies even interferes with friendly mergers.[57] These cultural phenomena demonstrate a xenophobia with respect to foreign direct investment in Japan.

Despite *keiretsu* and the complexities of Japanese culture, some argue that the true reason for low levels of foreign direct investment in Japan is market forces, over which neither the Japanese government nor the business community exert any direct control. These market forces consist primarily of high real estate costs and the high value of the yen relative to the U.S. dollar.[58] Thus, the conclusion is that these two forces make it economically imprudent to purchase assets in Japan. Foreign investors pass up Japan in favor of lower real estate, labor, and startup costs in neighboring East Asian countries.

Two facts rebut the market forces argument, however. First, the high value of the yen is insignificant in the context of foreign direct investment. As most direct investment in Japan is profitable and dependable, higher investment costs lead to higher investment returns, and higher yen profits naturally

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address Japanese barriers to foreign direct investment. *Japan—Country Marketing Plan FY'94*, *supra* note 45.

54. Lawrence, *supra* note 15, at 101; *see also* Seita & Tamura, *supra* note 9, at 121 n.26.

55. JAPAN'S DISTRIBUTION SYSTEM, *supra* note 30, at 90.

56. *Id.*

57. Lawrence, *supra* note 15, at 92-93. "[T]he loyalty felt by employees and management to large firms in a system (often characterized by lifetime employment) stands in the way of even friendly mergers in which companies lose their identity." *Id.*

58. During early 1995, the U.S. dollar's value has been very low relative to the Japanese yen and the German mark. Alan S. Cullison, *Dollar Sinks Against Yen on Comments Japan Isn't Likely to Cut Discount Rate*, WALL ST. J., Apr. 10, 1995, at C16 (citing the dollar's fall to a post-WWII low of ¥83.68 on April 7).

translate into higher dollar profits.[59] Second, although real estate costs are extremely high in some areas of Japan, they are reasonable in others.[60] Real estate prices in rural areas are less than one-tenth of those in the largest urban centers (Tokyo and Osaka).[61] More foreign based firms are finding hospitable factory settings in Japan's rural areas, and are taking advantage of the special subsidies and incentives that local governments offer.[62]

Such incentive programs differ greatly from the open hostility faced by foreign direct investors in the past. Historically, the Japanese government actively prevented foreign direct investment through a complex body of laws and regulations. Indirectly, the government's inaction discouraged foreign direct investment by allowing discriminatory *keiretsu* practices to continue. Currently, the difference between Japanese inward and outward direct investment continues to be great. Foreign direct investment in Japan shows no sign of increasing and Japanese outward investment shows no sign of decreasing.[63] Nevertheless, Japanese attitudes toward foreign direct investment seem to be changing as part of a new effort to lure foreign direct investment.

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59. Sterngold, *supra* note 1, at D17; *see also* Simon Mansfield, *Japan: Survey—Deep Pockets Needed For Foreign Business Entrants*, Australian Financial Review, Oct. 17, 1994, *available in* LEXIS, AUST Library, ALLNWS File (citing data from MITI, showing that in 1993, foreign companies enjoyed a 3% profit margin while Japanese companies enjoyed only a 1.8% profit margin).

60. Nobuyuki Oishi, *Rural Charm, Low Cost Beckon Foreign Investors*, NIKKEI WKLY., June 27, 1994, at 3.

61. *Id.*

62. *Id.* A MITI panel report on foreign investments in Japan noted that outlying areas not only offer lower land and labor costs but also are attractive markets in themselves. *Id.* For example, the panel claimed that Hokkaido's market exceeds the gross national product of Denmark. *Id.*

63. In April 1994, foreign direct investment in Japan totaled $295 million, and decreased to $74 million in May. *Foreign Investors Resume Purchases of Japanese Securities in May, Data Show*, International Business & Finance Daily (BNA), July 6, 1994, *available in* LEXIS, FEDSEC Library, BNAIBF File. In April 1994, Japanese direct investment overseas totaled $2.385 billion, and decreased to $1.943 billion in May. *Id.* In June 1994, foreign direct investment in Japan totaled $351 million, and decreased to $339 million in July. *Foreign Investors Sell Japanese Securities in July, Data Show*, International Business & Finance Daily (BNA), Sept. 6, 1994, *available in* LEXIS, FEDSEC Library, BNAIBF File. In June 1994, Japanese direct investment overseas totaled $4.606 billion, and decreased to $2.069 billion in July. *Id.*

B. RECENT EFFORTS TO ATTRACT FOREIGN DIRECT INVESTMENT

Japanese attitudes toward foreign direct investment changed for several reasons. First, the Japanese recognized that greater participation by foreign companies in Japan encouraged Japanese companies to restructure and become more competitive.[64] Second, foreign direct investment created jobs. The Japanese saw foreign direct investment as a means to replace jobs being relocated in cheaper labor markets throughout Asia.[65] Third, threats of economic sanctions by foreign governments became more concrete.[66]

In response to these trends, the Japanese government publicly devoted itself to recruiting more foreign direct investment,[67] and passed several laws designed to accomplish this goal. For example, in 1992 the Japanese government passed The Provisional Law for Import Promotion and Direct Foreign

64. James Paradise, *Investment Benefits Japan, Says Report*, UPI, Sept. 2, 1994, *available in* LEXIS, ASIAPC Library, UPI File. The restructuring of Japanese corporations lowers domestic consumer prices. A Japanese research institute reported that over the long-term, an increase in foreign investment is likely to benefit Japan by accelerating the development of new leading industries and acting as a catalyst for the creation of more multinational companies and more consumer-driven markets. *Id.* (citing a report by the Long-Term Credit Bank of Japan Research Institute).

65. Oishi, *supra* note 60, at 3. In 1994, the Japanese unemployment rate reached its highest level since Japan began recording unemployment statistics in 1953. Nina Field, *New Zealand: Surge In Building A Boost For Kiwis—The International Economy*, Australian Financial Review, Feb. 2, 1995, *available in* LEXIS, AUST Library, ALLNWS File. As more Japanese businesses move "offshore" to cheaper labor markets throughout Asia, the Japanese economy benefits from the jobs that foreign direct investment creates.

66. On March 3, 1994, President Clinton reinstated "Super 301," giving the USTR authority to identify countries that unfairly burden U.S. direct investment and impose sanctions until the barriers to U.S. direct investment are eliminated. Identification of Trade Expansion Priorities, Exec. Order No. 12,901, 59 Fed. Reg. 10,727 (1994) [hereinafter Trade Expansion Priorities].

67. In 1994, MITI released a White Paper reporting that Japan needed to upgrade its social, economic and other infrastructures to enhance investment opportunities for foreign companies. *Japan Must Enhance Its Investment Appeal: White Paper*, Japan Economic Newswire, May 17, 1994, *available in* LEXIS, ASIAPC Library, JEN File [hereinafter *White Paper*]. The White Paper stated that "[s]uch efforts would eventually contribute not only to expanding direct foreign investment in this country but also to raising the overall living standards of the Japanese people." *Id.* In October 1994, U.S. and Japanese negotiators "agreed on the importance" of foreign direct investment in Japan at a meeting held at MITI. *Japan, U.S. Agree on More Investment in Japan*, Jiji Press Ticker Service, Oct. 13, 1994, *available in* LEXIS, ASIAPC Library, JIJI File.

Investment.[68] Under this law, in 1993, the Japanese government guaranteed its first loan to a foreign company with the express intent of increasing foreign direct investment.[69]

In addition, the Japanese government has brought together government and business leaders to create organizations designed to examine ways to increase foreign direct investment. In June 1993, the Japanese government created the Foreign Investment in Japan Development Corporation (FIND).[70] FIND is a quasi-governmental organization, made up of government officials and business leaders, serving as a centralized point of information for foreign investors and supporting foreign companies that want to invest in Japan.[71] FIND provides the following five services: general advice and information,[72] staff recruiting services,[73] training courses,[74] temporary personnel services,[75] and customized research services at a reasonable cost.[76]

In July 1993, unverified reports circulated regarding a MITI initiative that included "model areas" for foreign direct investments.[77] These areas would offer government subsidized rents for offices, houses and apartments, as well as educational and medical facilities for the exclusive use of foreign firms.[78] Although, these "model areas" have not yet materialized, they

68. The Provisional Law for Import Promotion and Direct Foreign Investment enables the Japanese government to guarantee loans made by the Bank of Tokyo, Ltd., to foreign firms who have operated in Japan for less than five years. The government can guarantee loans of up to $9.4 million. *Japanese Government Fund Gives Loan Guarantee to British Firm*, 10 Int'l Trade Rep. (BNA) No. 45, at 1937 (Nov. 17, 1993).

69. *Id.* On November 11, 1993, the Japanese government guaranteed a five-year $1.22 million loan to Willett International, the Japanese subsidiary of Willett International, Ltd., of London. *Id.*

70. *Japan—Foreign Investment Support Program*, Market Reports, Aug. 17, 1993, *available in* LEXIS, ASIAPC Library, MKTRPT File.

71. *Id.* FIND was created under the 1992 Law on Extraordinary Measures for the Promotion of Imports and the Facilitation of Foreign Direct Investment in Japan. *Id.*

72. *Id.* FIND provides information on regional investment incentives and provides the use of its own staff, which consists of management consultants, lawyers, accountants and other investment professionals. *Id.*

73. *Id.*

74. *Id.* FIND provides training courses to foreign investors on administrative regulations and incentives, as well as business development. *Id.*

75. *Id.* FIND provides temporary secretarial, translation and administrative assistance personnel services at a low cost. *Id.*

76. *Id.*

77. *Japan—Inward Investment Statistics*, Market Reports, Aug. 17, 1993, *available in* LEXIS, ASIAPC Library, MKTRPT File.

78. *Id.*

may provide an important and innovative possibility for U.S.-Japan negotiations in the future.

The 1994 MITI White Paper demonstrates Japan's renewed commitment to expanding foreign direct investment.[79] The White Paper stated that "rules and regulations serving as barriers to foreign direct investment should be eased, corporate research and development activities should be reinforced, and capital market regulations should be relaxed."[80]

In July 1994, the Japanese government set up the Japan Investment Council to help promote foreign direct investment.[81] Given that the Japanese Prime Minister heads this ministerial forum, it is Japan's strongest political commitment to expanding foreign direct investment.[82] Although the investment council provides no tangible services to foreign companies, it is "designed to gather the views of, and problems faced by, foreign investors in Japan."[83]

These programs reflect a new Japanese attitude toward foreign direct investment. The Japanese government acknowledges the benefits of foreign direct investment and believes that recruiting foreign direct investment is in the country's best interest. However, the new Japanese attitude and accompanying programs do not offset a history of discrimination against foreign direct investment, restrictive government regulations, lax enforcement of antimonopoly law, *keiretsu* practices, and weak intellectual property protection.

III. EVALUATION OF JAPANESE BARRIERS TO FOREIGN DIRECT INVESTMENT

Japanese programs to recruit foreign direct investment have failed to address the fundamental reasons for the lack of foreign direct investment in Japan—restrictive governmental regulations and anticompetitive business practices. There is concern that the new programs, while showing political support for increased foreign direct investment, serve no more than a public relations function.[84] As statistics show, the recent Japanese efforts to recruit U.S. direct investment have, so far, failed

79. *White Paper, supra* note 67.
80. *Id.*
81. *Government Sets Up Investment Council*, Jiji Press Ticker Service, July 15, 1994, *available in* LEXIS, ASIAPC Library, JIJI File.
82. *Id.*
83. *Id.*
84. In July 1992, the investment committee of the Tokyo-based European Business Community criticized efforts by MITI to encourage foreign direct in-

to close the investment gap.[85] The Japanese government must not only repeal existing formal regulations, but also expand and more strictly enforce laws against informal anticompetitive business practices.

A. REGULATION OF FOREIGN DIRECT INVESTMENT

Japan regulates foreign direct investment more than most countries.[86] Marked differences between foreign direct investment regulation in the United States and Japan largely explain the direct investment gap.[87] The Foreign Exchange and Foreign Trade Control Law[88] severely hinders foreign investors by requiring them to adhere to burdensome administrative investment procedures.[89] Individual industry regulations hinder foreign investors to an even greater extent.[90]

Transnational variation in equity investments by foreign direct investors provides convincing evidence of the extent to which restrictive regulations can affect investment decisions.[91] In countries with few discriminatory regulations, such as Can-

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vestment as serving public relations purposes, rather than providing concrete help for foreign investors. *Japan—Inward Investment Statistics*, *supra* note 77.

85. *See supra* note 63 and accompanying text.

86. *Economic Group Urges Measures*, *supra* note 17, at 1898. In a 1992 report, Keidanren, the Federation of Economic Organizations of Japan, admitted that "Japan has considerably more regulations on business than most other countries. This undoubtedly obstructs the entry of new firms." *Id.*

87. In Japan, mergers and acquisitions must be approved by the Japan Fair Trade Commission (JFTC) under the Anti-Monopoly Law, and tender offers must be filed with, and approved by, the Ministry of Finance. Paul M. Healy & Krishna G. Palepu, *International Corporate Equity Acquisitions: Who, Where and Why?*, *in* FOREIGN DIRECT INVESTMENT 238-39 (Kenneth A. Froot ed., 1993). This differs from U.S. foreign investment regulation. *Id.* In the United States, mergers and acquisitions are subject to antitrust regulations, though these regulations have rarely been enforced. *Id.*

88. *See supra* notes 32-37 and accompanying text.

89. *Economic Group Urges Measures*, *supra* note 17, at 1898. Although 1992 amendments to the Law have simplified foreign investment procedures, investors still must consult with the Ministry of Finance and the Bank of Japan regarding the details of an investment. "Such practices lack transparency and tend to result in excessive intervention by authorities, and . . . should be corrected," said the 1992 Keidanren report. *Id.* While the JFTC has recently narrowed the scope of the types of contracts covered by this requirement, "the notification requirement has been used to challenge foreign direct investment that is disadvantageous to Japanese companies." *Japan—Country Marketing Plan FY'94*, *supra* note 45.

90. *Economic Group Urges Measures*, *supra* note 17, at 1898. The 1992 Keidanren report stated that individual industry regulations are "actually more responsible for restricting foreign investments than is the Foreign Exchange Control Law." *Id.*

91. Healy & Palepu, *supra* note 87, at 242.

ada, Italy, the Netherlands, Spain, the United Kingdom and the United States, foreign investment averages eighty-one percent of domestic investment.[92] In contrast, in countries with more burdensome regulations, such as Australia, France, Japan and Sweden, foreign investment averages twenty-eight percent of domestic investment. This data suggests that the discriminatory regulations in these countries discourage foreign investment.[93] Unlike Japan, U.S. regulations have not significantly discriminated between domestic and foreign investors, except where national security interests are concerned.[94]

Beyond eliminating restrictive investment regulations, the Japanese government must also reform its tax laws that burden foreign direct investment. For instance, Japan must lower the withholding tax on dividends paid by a subsidiary in Japan to its overseas parent.[95] Another barrier to increased foreign direct investment is the high pro forma corporate tax rate.[96] High corporate tax rates encourage foreign investors to invest in countries with lower rates. In response to the burdens of the Japanese tax system on foreign direct investment, the United States and Japan have discussed Japanese tax reform.[97]

To effectively lessen the investment gap, it is important that the Japanese government offer more than government programs to assist foreign investors. The Japanese government must go to the source of the investment gap and repeal or modify the discriminatory regulations that initially created it.

92. *Id.*

93. *Id.*

94. Before 1988, no special U.S. regulatory restrictions on foreign intercorporate equity investments existed. *Id.* at 241. After 1988, investments with national security implications were subject to administrative review. *Id.* By contrast, Japan required government notification and approval for foreign acquirers of stakes exceeding 10%. *Id.* Once approved, a transaction had to be completed within 30 days through a Japanese broker. *Id.*

95. *Economic Group Urges Measures*, *supra* note 17, at 1899. The 1992 Keidanren report urged that Japan reduce, from ten percent to five percent, the current withholding tax on dividends paid by a subsidiary in Japan to its overseas parent, consistent with the Model Convention of the Organization for Economic Cooperation and Development (OECD). *Id.*

96. Joel Slemrod, Tax Cacophony and the Benefits of Free Trade 21 (July 1994) (unpublished manuscript, on file with the *Minnesota Journal of Global Trade*). Currently the Japanese pro forma corporate tax rate is set at 51%, compared to 38% in the United States. *Id.*

97. *Japan, U.S. Agree on More Investment in Japan*, *supra* note 67.

B. KEIRETSU

Within Japan's economy, two types of *keiretsu* exist: vertical and horizontal. A horizontal *keiretsu* consists of a grouping of companies in different industries, commonly centered on a major bank.[98] A vertical *keiretsu* is a grouping of companies within a single industry or a limited number of related industries.[99] A vertical *keiretsu* is dominated by one firm, usually a large manufacturing company, and consists of the dominant firm together with its subsidiaries, affiliates, and associated firms (such as suppliers).[100] To thrive in the Japanese economy, horizontal *keiretsu* developed subtle mechanisms of collaboration, like extensive cross-holdings of stock, and vertical *keiretsu* developed close links through exchanges of equity.[101] *Keiretsu* severely hinder foreign direct investment by blocking the acquisition of Japanese companies.[102]

Strong incentives exist within *keiretsu* to prevent even one member from coming under foreign control.[103] Due to the tightly knit nature of a *keiretsu*, allowing foreign control of even one link of the *keiretsu* chain threatens the non-transparency and effectiveness of *keiretsu* buyer-supplier networks and the collusive, arguably anticompetitive, decision-making processes.[104]

The Economist Intelligence Unit, an on-line trade strategy service for U.S. investors, states that "[f]oreign investors [in Japan] are perceived as a threat to the extent that they try to exert

98. Seita & Tamura, *supra* note 9, at 121 n.24; *see* Lawrence, *supra* note 15, at 93.

99. Seita & Tamura, *supra* note 9, at 121 n.24.

100. *Id.*; *see also* Lawrence, *supra* note 15, at 93.

101. *See* Lawrence, *supra* note 15, at 100-04 (discussing the attributes of *keiretsu* within the Japanese economy).

102. *See id.* at 87 (stating that "[s]tatistically significant evidence suggests, indeed, that *keiretsu* linkages inhibit FDI in Japan").

103. *Japan—Country Marketing Plan FY'94*, *supra* note 45; *see also* Lawrence, *supra* note 15, at 105 (stating that "[t]he expansion of stock cross-holdings among *keiretsu* members and other Japanese firms during the 1970s was an explicit device to prevent foreigners from buying Japanese companies").

104. The Japanese defend *keiretsu* practices with "two diametrically opposed arguments." Lawrence, *supra* note 15, at 101. Some argue that *keiretsu* have no significant economic effects and are no different from arrangements in other countries (i.e., vertical integration and conglomerates). *Id.* at 101-02. Others argue that *keiretsu* are a fundamental aspect of Japanese economic success. *Id.* at 102. The close links between assemblers and suppliers in vertical *keiretsu* enhance the transfer of technology and permit reliable supply while preserving corporate flexibility. *Id.*

active control over a local firm's management."[105] "Minor ownership stakes for simple investment purposes are completely welcome and open,"[106] but mergers and acquisitions and hostile takeovers are not.[107] U.S. direct investment in Japan is primarily in majority-owned Japanese companies. Throughout the rest of the world, the exact opposite is true. Worldwide, U.S. investors invest more in majority-owned U.S. companies.[108] Clearly, U.S. investors do not have the same investment opportunities in Japan as they do throughout the rest of the world.

Keiretsu block foreign acquisitions of Japanese firms in several ways. One important method is through extensive cross-shareholding between *keiretsu* companies and owners.[109] Although less significant than during the period of Japan's "bubble economy" (1987-90), cross-shareholding remains prevalent in Japan.[110] For example, Japanese companies depend more on banks than do U.S. companies.[111] A merger or acquisition involving a Japanese company will not succeed if the controlling Japanese bank disagrees with it.[112] Japanese banks therefore

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105. *3.2 Incoming Direct Investment*, Financing Foreign Operations, July 1, 1994, *available in* LEXIS, ASIAPC Library, FINFOR File.

106. *Id.*

107. JAPAN'S DISTRIBUTION SYSTEM, *supra* note 30, at 90 (noting one Japanese business person's opinion that "to sell a company in Japan is considered shameful, in much the same way as an ancient warlord would kill himself before surrendering his castle, or as a captain would choose to go down with his ship").

108. Lawrence, *supra* note 15, at 89-90. In 1990, U.S. majority-owned companies accounted for 78% of worldwide U.S. foreign direct investment assets. Only 34% of U.S. foreign direct investment assets in Japan were in U.S. majority-owned companies. *Id.*

109. JAPAN'S DISTRIBUTION SYSTEM, *supra* note 30, at 90. The USITC report stated that:

> Banks, for example, may own blocks of shares in companies to which they lend, or insurance companies and brokerage firms may buy stocks as a method of promoting long-term business relationships. This can have the result of keeping stock prices high and making it difficult for outsiders to buy into the Japanese market.

Id.

110. Kiyoshi Mori, *Industrial Sea Change: How Changes in Keiretsu Are Opening the Japanese Market*, 12 BROOKINGS REV. No. 4, at 20, 23 (1994) (stating that the conditions in Japan's stock market that encouraged cross-shareholding have not changed substantially).

111. JAPAN'S DISTRIBUTION SYSTEM, *supra* note 30, at 90. "The average debt-equity ratio of Japanese companies of about 80:20 makes them more dependent on banks than U.S. firms, with an average debt-equity ratios [sic] much closer to 50 percent." *Id.* "As a result of cross-shareholding, banks hold more than 40 percent of all stock listed on all Japanese stock exchanges, other companies 30 percent, and individuals only a little more than 20 percent." Mori, *supra* note 110, at 22.

112. JAPAN'S DISTRIBUTION SYSTEM, *supra* note 30, at 90.

possess a greater capacity than their American counterparts to prevent unfriendly foreign direct investments.[113]

A result of cross-shareholding among Japanese companies is that less than one-half of Japanese corporations' stock is publicly traded.[114] Cross-shareholding strengthens the link between suppliers, buyers and financiers, thus making Japanese markets less transparent and more difficult for foreign direct investors to crack.[115] Additionally, the *keiretsu* structure compromises the rights of foreign shareholders. In 1989, T. Boone Pickens, a Texas oilman and takeover specialist, owned twenty-six percent of a Japanese automobile parts manufacturer (Koito Manufacturing Company).[116] Although he was the largest shareholder, Pickens failed to gain representation on Koito's board of directors, and was refused basic financial and operating information.[117] Koito's action resulted in a considerable U.S. political response and renewed U.S. scrutiny of *keiretsu* dealings.[118]

Since no international investment code exists, these Japanese practices do not violate any international legal obligations.[119] However, some *keiretsu* practices violate U.S. antitrust law,[120] and some violate Japanese law.[121] To increase foreign

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113. *Id.* One foreign participant in a failed takeover attempt of the Minebea Ball Bearing Co. complained that he "could not find a single Japanese bank or securities house to help in any capacity with his bid." ARON VINER, INSIDE JAPANESE FINANCIAL MARKETS 90 (1988).

114. D'ANDREA TYSON, *supra* note 27, at 279. In contrast, most U.S. companies' stock is freely available in the U.S. securities market. *Id.*

115. *See* Lawrence, *supra* note 15, at 102.

116. Farnsworth, *supra* note 52, at D6.

117. *Id.* In defense of its actions, Koito explained that under Japanese law stockholders are not entitled to receive detailed financial information about a company. *Id.*

118. Seventeen U.S. senators complained in a letter to Carla A. Hills, the then-U.S. Trade Representative, that "Koito, like other major Japanese corporations, is dominated by a cartel-like group of corporate and financial institutions. This informal, but nonetheless powerful, structure effectively limits the ability for foreign shareholders to exercise any meaningful rights." *Id.*

119. Lawrence, *supra* note 15, at 105.

120. *See* Ronald J. Ostrow, *U.S. Aims New Antitrust Policy Abroad*, L.A. TIMES, April 4, 1992, at D1 (announcing a U.S. Department of Justice amendment to its antitrust enforcement policy, enabling the Department to challenge foreign businesses that blocked access to their home markets); Yoshikuni Sugiyama, *U.S. Toughens Trade Surplus; Broaden International Use of Antitrust Laws*, DAILY YOMIURI, Apr. 5, 1992, at 1 (stating that the new policy will apply to Japanese enterprises found to have harmed their U.S. counterparts by actions that violate U.S. antitrust laws).

121. "In a particularly noteworthy case in 1989 (Shuwa versus Chujitsuya), the court found that efforts to dilute Shuwa's shares by an exchange of stocks at

direct investment, the Japanese government must strengthen and enforce its Antimonopoly Law to curb anticompetitive business practices.

C. ANTIMONOPOLY LAW

Japan's reluctance to enforce its Antimonopoly Law[122] is a major point of friction between the United States and Japan. The Antimonopoly Law is the primary law regulating competition in Japan, and U.S. officials cite its lax enforcement as a barrier to direct investment.[123] Weak enforcement of the Antimonopoly Law permits *keiretsu* to maintain anticompetitive business relationships.[124] Japan permits *keiretsu* ties between manufacturers and distributors that would be prohibited under U.S. antitrust law. The Antimonopoly Law is ineffective because the Japanese government has failed to enforce it and because the Japanese government has granted so many exemptions from it.[125]

During the 1991 Structural Impediments Initiative (SII) talks, the Japanese government assured the United States that *keiretsu* firms would not hinder fair competition in the future.[126] American officials have since complained, however, that the Japanese government has failed to honor its promise.[127] To increase foreign direct investment, Japan must strengthen the Antimonopoly Law, eliminate the exemptions, and enforce its prohibitions.

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low prices between two targets was unfair. This was the first time a Japanese court declared an antitakeover practice unfair." Lawrence, *supra* note 15, at 94.

122. Shiteki Dokusen no Kinshi to Kōsei Torihiki no Kakuho ni Kansuru Hōritsu (Act Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade), Law No. 54 of 1947 (as currently amended), *translated in* THE FAIR TRADE COMMISSION OF JAPAN, JAPANESE COMPETITION LAW: ACT CONCERNING PROHIBITION OF PRIVATE MONOPOLY AND MAINTENANCE OF FAIR TRADE (1991).

123. Seita & Tamura, *supra* note 9, at 119-20.

124. *Id.* at 120-21. For example, a manufacturer can require its associated retailers to deal exclusively in its products, thereby discriminating against the goods produced by a foreign company in Japan. *Id.* at 121 n.22.

125. *Id.* at 122. Seita and Tamura state that "[s]eparate laws provide many legal exemptions from the AML [Antimonopoly Law] for cartel behavior," and that "[w]hat was initially given on the one hand to curb anticompetitive behavior—the AML—was later balanced on the other by a desire to prevent harm to the Japanese economy—the exemptions from the AML." *Id.* at 123.

126. *Id.* at 121 n.26.

127. *Id.* at 122.

D. INTELLECTUAL PROPERTY PROTECTION

Japan does not provide adequate intellectual property procedures for U.S. direct investors.[128] The United States provides more timely intellectual property protection for foreign investors than does Japan.[129] While the U.S. Patent Office will issue a patent in about eighteen months,[130] it can take five to six years for the Japanese Patent Office to grant a patent.[131] During this period no effective legal protection exists.[132] In Japan, registration of a trademark takes an average of four years, while registration in the United States takes an average of thirteen months.[133]

Although Japanese intellectual property laws do not specifically discriminate against U.S. interests, they generally make Japan a less attractive market for research and development. In high technology industries, technology is "new" for a very short period. Without more timely intellectual property procedures, technological innovations become outdated by the time they are patented. To attract foreign direct investment, Japan must improve its intellectual property procedures.

Restrictive government regulation, *keiretsu* practices, inadequate enforcement of the Antimonopoly Law and insufficient intellectual property protection all contribute to the huge investment gap between the United States and Japan. Any effort to increase U.S. direct investment in Japan, and correspondingly decrease the U.S. trade deficit with Japan, must first recognize and address these barriers to give U.S. investors the same opportunities in Japan that Japanese investors have in the United States.

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128. *Japan—Country Marketing Plan FY'94*, *supra* note 45, pt. V.A.2 (Intellectual Property Section) (stating that "Japan has been on the 'watch list' under the 'special 301' provisions of the 1988 Trade Act each year since 1989, due to legal deficiencies and practical problems in patent, copyright, and trademark protection").

129. *Id.*

130. *Id.*

131. *Id.*

132. *Japan—Destination Japan*, *supra* note 39.

133. *Id.* During the four-year period, trademarks are legally unprotected unless the owner can prove that the trademark is "well-known in Japan and that consumers will be confused by the use of an identical or similar mark by the unauthorized user." *Id.*

IV. A PROPOSAL TO INCREASE U.S. DIRECT INVESTMENT IN JAPAN

The severity of the current trade and investment imbalances requires a comprehensive agreement on foreign direct investment. Currently, there is no international agreement that regulates foreign direct investment between the United States and Japan. The contracting parties of the General Agreement on Tariffs and Trade (GATT)[134] addressed international investment in the Trade Related Investment Measures (TRIMS) agreement as part of the Uruguay Round.[135] Unfortunately, TRIMS does not address foreign direct investment per se. While the TRIMS agreement prevents governments from imposing "buy domestic" laws and "imported goods" quotas on foreign direct investors,[136] it does not provide a means to eliminate Japanese barriers to direct investment. American negotiators must look outside the GATT for a solution.

Apart from the SII and each country's best efforts to deter anticompetitive practices, there is no bilateral agreement between Japan and the United States that harmonizes the regulation of anticompetitive practices.[137] Even if such an enforceable agreement did exist, harmonizing national differences in competition policy will not equalize access to Japanese markets because differences in stock ownership and cross-shareholding will

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134. General Agreement on Tariffs and Trade, *opened for signature* Apr. 15, 1994, *in* GATT SECRETARIAT, THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 21, GATT Sales No. 1994-4 (1994) [hereinafter GATT 1994]. The Final Act of the Uruguay Round and the Marrakesh Agreement Establishing the World Trade Organization (the WTO Agreement) were signed at the Marrakesh Ministerial Meeting in April 1994. The WTO Agreement includes the GATT 1994, which is based on the text of the original GATT 1947 as amended.

135. Agreement on Trade-Related Investment Measures, *opened for signature* Apr. 15, 1994, *in* GATT SECRETARIAT, THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS at 163, GATT Sales No. 1994-4 (1994) [hereinafter TRIMS]. TRIMS prohibits investment measures related to trade in goods which are "inconsistent with the obligation of national treatment provided for in Article III:4 of the GATT 1994" because they "are mandatory or enforceable under domestic law or administrative rulings" and require "the purchase or use by an enterprise of products of domestic origin or from any domestic source." *Id.* Annex (*Illustrative List*). TRIMS also prohibits investment measures which are "inconsistent with the obligation of the general elimination of quantitative restrictions provided for in Article XI:1 of the GATT 1994" because they restrict "the importation by an enterprise of products used in or related to its local production." *Id.*

136. *Id.*

137. *See* D'ANDREA TYSON, *supra* note 27, at 279 (arguing that in the absence of a bilateral agreement, the United States is forced to rely upon "extraterritorial application of national anti-trust regulations").

remain.[138] Despite this, it is important that Japan eliminate its barriers to U.S. direct investment. U.S. negotiators must provide an incentive for Japanese officials to act.

A. Section 301 And Its Operation

On October 1, 1994, after fifteen months of often bitter talks, U.S. negotiators obtained Japanese trade concessions in the areas of telecommunications, medical equipment, insurance and glass products.[139] To obtain these concessions, U.S. negotiators threatened trade sanctions under the Section 301 trade provision.[140] Section 301, revived by President Clinton on March 3, 1994, allows the USTR to threaten sanctions against Japanese exports unless agreements are reached.[141] In fact, because the two countries failed to reach an agreement to increase Japanese purchases of American cars and car parts, President Clinton responded with limited trade sanctions.[142] The overall success of these negotiations shows that a credible threat of trade retaliation is sometimes necessary to obtain concessions from Japan.[143]

The United States can use Section 301 to eliminate foreign investment barriers as well. Section 301 provides that if the

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138. *See supra* notes 109-15 and accompanying text.

139. Thomas L. Friedman, *U.S. Gains Access To More Markets in Japanese Deal*, N.Y. TIMES., Oct. 2, 1994, § 1, at 1.

140. 19 U.S.C. § 2411 (1988). "Super 301" modifies Section 301 of the 1988 Trade Act. Trade and Tariff Act of 1974, 88 Stat. 1978, 19 U.S.C. § 2411 (Supp. IV 1986). For purposes of this Note, the differences between Super 301 and Section 301 are negligible. For an explanation of the differences between Super 301 and Section 301, see Judith H. Bello & Alan F. Holmer, *The Heart of the 1988 Trade Act: A Legislative History of the Amendments to Section 301*, 25 STAN. J. INT'L L. 1 (1988).

141. Trade Expansion Priorities, *supra* note 66.

142. Friedman, *supra* note 139, § 1, at 1.

143. One commentator reviewed the effect of Section 301 on trade negotiations, and noted the following:

> By providing leverage in the form of a credible threat of retaliation, Section 301 has enhanced the ability of the United States to negotiate and enforce agreements to eliminate unfair trade practices and to gain access to Japanese markets for U.S. exports. It has become one of the most effective weapons that the United States has in its negotiating arsenal to overcome the great reluctance of the Japanese to enter into trade agreements.

Jean Heilman Grier, *The Use of Section 301 to Open Japanese Markets to Foreign Firms*, 17 N.C. J. INT'L L. & COM. REG. 1, 2 (1992). *See also* THOMAS O. BAYARD & KIMBERLY ANN ELLIOT, RECIPROCITY AND RETALIATION IN U.S. TRADE POLICY 34-35 (1994) (noting the argument that "Japan should be compelled to show results—to either import more US goods or face certain retaliation").

USTR determines that an "act, policy or practice"[144] of a foreign country "is unjustifiable and burdens or restricts United States commerce,"[145] action shall be taken "to obtain the elimination of that act, policy, or practice."[146] Under this authority, the President can authorize the USTR to impose trade sanctions until Japan eliminates foreign direct investment barriers. Section 301 authorizes the USTR to "suspend, withdraw, or prevent the application of, benefits of trade agreement concessions"[147] or "impose duties or other import restrictions on the goods of . . . and fees or restrictions on the services of, such foreign country for such time as the Trade Representative determines appropriate."[148]

B. POSSIBLE ADVERSE EFFECTS OF THE USE OF SECTION 301

Imposing sanctions against Japan could be costly. Section 301 sanctions may violate the GATT.[149] If the United States retaliates with sanctions against Japan, Article XXIII provides that the contracting parties may authorize Japan to suspend concessions made to the United States.[150] Despite these risks,

144. 19 U.S.C. § 2411(d)(3)(B) (1988). Section 2411(d), entitled "Definitions and special rules," states that for purposes of this subchapter:

> (3)(B) Acts, policies, and practices that are unreasonable include, but are not limited to, any act, policy, or practice, or any combination of acts, policies, or practices, which—
>
> (i) denies fair and equitable—
>
> (I) opportunities for the establishment of an enterprise,
>
> (II) provision of adequate and effective protection of intellectual property rights, or
>
> (III) market opportunities, including the toleration by a foreign government of systematic anti-competitive activities by private firms or among private firms in the foreign country that have the effect of restricting, on a basis that is inconsistent with commercial considerations, access by United States goods to purchasing by such firms.

145. 19 U.S.C. § 2411(a)(1)(B)(ii) (1988). For purposes of this subchapter, the term "commerce" includes, but is not limited to, "foreign direct investment by United States persons with implications for trade in goods or services." 19 U.S.C. § 2411(d)(1)(B) (1988).

146. 19 U.S.C. § 2411(b)(2) (1988).

147. 19 U.S.C. § 2411(c)(1) (1988).

148. 19 U.S.C. § 2411(c)(1)(B) (1988).

149. BAYARD & ELLIOT, *supra* note 143, at 71-72 (identifying incidents when Section 301 retaliation violated U.S. GATT obligations).

150. Article XXIII, entitled "Nullification or Impairment," states in relevant part, that if "any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired," and if "the CONTRACTING PARTIES consider that the circumstances are serious enough to justify such action, they may authorize a contracting party or parties to suspend the application to any other contracting party or parties of

the United States must be willing to bear the cost of GATT violations for the use of Section 301 trade sanctions.

Idle threats of trade sanctions provide no incentive for countries to take Section 301 negotiations seriously.[151] For example, since 1988, the USTR has initiated Section 301 action for foreign direct investment violations against India[152] and South Korea.[153] In response, India agreed to "consider easing some limits on foreign investment,"[154] and South Korea, although formally agreeing to lower its investment barriers, ignored Section 301 threats.[155] It is apparent from these two cases that the mere threat of sanctions under Section 301 failed to increase U.S. direct investment in India and South Korea. Had the United States proceeded to impose sanctions, however, it is likely that Section 301 would have achieved very different results.

In theory, the potential negative results from the use of Section 301 against Japan undermine its intended purpose. First, Japan may stop responding to highly publicized threats under the provision as Section 301 may violate the GATT.[156] Second, Section 301 commits the President to deadlines that could seriously compromise his ability to conduct negotiations with Japan in other areas.[157] Third, GATT violations erode U.S. credibility

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such concessions or other obligations under this Agreement." GATT 1994, *supra* note 134, art. XXIII(1), (2).

151. BAYARD & ELLIOT, *supra* note 143, at 321 (arguing that if the United States refuses to move forward with sanctions, Section 301 will lose its credibility among U.S. trading partners).

152. *Id.* at 164-70.

153. *Id.* at 177-81.

154. *Id.* at 169.

155. *Id.* at 180.

156. *Id.* at 320. During recent trade negotiations between the two countries, Japan refused to accept quantitative targets for measuring progress under trade agreements. In February 1994, after the breakdown of the U.S.-Japan framework negotiations, Yoshihiro Sakamoto, director-general of MITI, warned that "if the US were to impose sanctions against Japan, and its action [sic] were found to be in breach of Gatt rules, Japan could retaliate against the US." Michiyo Nakamoto, *Japan Warns U.S. It May Retaliate*, FIN. TIMES, Mar. 1, 1994, at 4.

157. BAYARD & ELLIOT, *supra* note 143, at 321.

> The super 301 deadline can put the president in the undesirable position of having to decide whether to designate a priority unfair trading country or practice precisely when he is negotiating with that country on other US priorities. One can easily imagine a super 301 deadline falling in the midst of delicate negotiations . . . with Japan on aid to the former Soviet Union, with both Japan and South Korea on sanctions against North Korea . . . .

Id. at 321-22.

in multilateral and regional trade negotiations.[158] Finally, Section 301 action and Japanese retaliation would further strain our economic and diplomatic relations. As trade experts point out, the United States and Japan are more than just economically interdependent.[159] Maintaining favorable diplomatic relations with Japan is a crucial part of U.S. foreign policy.

C. STRATEGIES TO INCREASE U.S. DIRECT INVESTMENT IN JAPAN AND LOWER THE TRADE DEFICIT WITH JAPAN

An alternative to Section 301 is to continue negotiating with the Japanese government toward a bilateral investment agreement. By May 1995, as part of the U.S.-Japan framework talks, negotiators are scheduled to successfully conclude four "rounds" of talks with an agreement aimed at increasing U.S. direct investment in Japan.[160] The potential agreement provides more financial assistance to U.S. investors through the Japanese Development Bank, enacts labor policy reform (so Japanese employees of U.S. companies would not lose their pensions when taking a new job with a Japanese employer), increases the deficit carry-over period from ten to fifteen years, and promotes U.S.-Japanese industry-to-industry contacts.[161]

While the proposed framework agreement would be a positive accomplishment, it covers nothing new. Japanese negotiators will, once again, agree that foreign direct investment is a "good thing." Both sides will agree to work together to increase levels of U.S. direct investment in Japan. And once again, both sides will fail to address the institutionalized barriers that created the investment gap. Ideally, a bilateral investment agreement will harmonize U.S.-Japanese investment regulations, antimonopoly laws, corporate tax policies and intellectual property procedures. Because the U.S.-Japan framework talks have not addressed some of these fundamental issues, the benefits derived from the talks will be limited.

158. *Id.* at 322. The authors state that "Super 301 is universally reviled by US trading partners, who associate it with the worst excesses of US aggressive unilateralism: that is, the labeling of countries as unfair traders and of specific practices as unreasonable when there is no violation of international rules or agreements." *Id.*

159. Indeed, maintaining friendly U.S.-Japan relations is important because the countries are politically interdependent. For example, from a security standpoint, Japan depends on the presence of American security forces in Southeast Asia. In turn, we depend on Japanese financial assistance for military action (e.g., the Gulf War).

160. *USIA Foreign Press Center Briefing Topic*, *supra* note 40.

161. *Id.*

Although the use of Section 301 is precarious, it is important to point out that the United States has imposed these sanctions against Japan only twice,[162] and that the "real force behind Section 301 that provides the United States with negotiating leverage is not the actual imposition of sanctions, but the *threat* of such sanctions."[163] Also, because the United States did not conduct the U.S.-Japan Framework talks under Section 301, there is no threat of sanctions should the negotiations fail, and it will be difficult to monitor and enforce whatever agreement the two sides reach. Congress explicitly armed Section 301 with several monitoring requirements to "bolster the enforcement" of agreements.[164] Under Section 301, if the Administration determines that an agreement is not being met, "action under Section 301 would be expected to provide Japan with the necessary impetus to fulfill its commitments."[165]

Section 301 can only be used to monitor and enforce agreements negotiated under Section 301.[166] Because the framework talks are not being conducted under Section 301, it will be difficult to enforce the resulting agreement in any significant way. Thus, while there is a question about whether the Japanese are agreeing to anything significant in the framework talks, there is also a question about whether they will bother adhering to the agreement.

Finally, the most effective way to reduce the U.S. investment and trade deficits with Japan is to conclude the framework talks, and expand the resulting agreement through continued negotiation. These further negotiations should be conducted under Section 301, and the United States should then use the provision to monitor and enforce any resulting Japanese concessions.

CONCLUSION

Currently a large gap exists in the direct investment levels between the United States and Japan. These levels directly affect the balance of trade between the two countries. To help re-

162. The United States has imposed Section 301 sanctions against Japan once with regard to semiconductors, and once involving leather and leather footwear. Grier, *supra* note 143, at 38, 39 n.236.

163. *Id.* at 39.

164. *Id.* at 37. "[I]t seems clear that a primary use of Section 301 for the foreseeable future will be to ensure that Japan fulfills its obligations under newly-negotiated trade agreements." *Id.* at 36.

165. *Id.* at 37.

166. *Id.*

duce the U.S.-Japan trade deficit, the United States should make efforts to increase its level of direct investment in Japan. Historically, Japan has discriminated against foreign direct investment by creating and permitting the existence of formal and informal barriers to foreign direct investment. While it has recently attempted to lure foreign direct investment, Japanese programs do not compensate for the barriers that initially created the investment gap.

The Japanese barriers most responsible for the investment gap with the United States are official government regulations, unfair *keiretsu* business practices, lax enforcement of the Antimonopoly Law, and inefficient intellectual property procedures for foreign direct investors. To effectively reduce the investment gap, Japan should repeal the laws and regulations that discourage U.S. direct investment, strengthen and more fully enforce the Antimonopoly Law, improve its intellectual property procedures, and expand government programs designed to lure foreign direct investors.

To encourage the Japanese government to implement these reforms, the United States could threaten trade sanctions against Japanese products with Section 301. Some argue that Japanese officials will not make substantial investment concessions without facing the threat of U.S. trade sanctions. On the other hand, others argue that action under Section 301 is unpredictable, GATT illegal, and could result in retaliatory Japanese measures.

In spite of these contingencies, the United States should use Section 301 to arrive at a binding bilateral agreement with Japan on foreign direct investment. Upon completion of such an agreement, the United States should further use Section 301 to assess, monitor, and enforce the resulting Japanese concessions. Only when U.S. direct investment in Japan increases will the U.S. trade and investment deficits decrease. Furthermore, only when the fundamental Japanese barriers to U.S. direct investment are lowered will U.S. investors enjoy the same kind of opportunity Japanese investors enjoy in the United States.