New Dimensions Of Market Access

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I. Introduction

Over the last twenty years or so, the evolution of the trade policy agenda has been shaped by two fundamental developments. One was the convergence of living standards and overall technological capabilities among the OECD countries to rough parity in the early 1970s. This convergence, by definition, involved the erosion of American postwar economic and technological dominance. The other major development was what is now termed “globalization”—the increasing economic linkage among countries by trade, by financial flows and, most recently, by an unprecedented surge in foreign direct investment.

The trend toward increased economic linkage of economies with comparable living standards and technological capabilities has engendered a push for deeper policy integration—more extensive coordination and even harmonization of domestic policies and institutional arrangements and practices. While this deeper integration is intended to reduce policy friction, integration itself has produced new international frictions that, at an extreme, one might call “system friction.”

System friction arises from the interaction of different market models or systems and the conflicts inherent in the different cultural legacies and approaches to public policy that characterize them. Such friction is apparent in the interaction of the three dominant models of the market economy that have developed in the United States, Europe, and Japan:

- The U.S. paradigm of a pluralist market economy features aggressive financial markets and a strong consumer and short-term
orientation. Its strength is dynamism and flexibility. Its dominant ethos is private-sector competition and minimal government. Nonetheless, producer interest groups generate an *ad hoc* industrial policy response.

- The continental European models are variants of the *social market economy* and involve more extensive government intervention to rectify presumed market imperfections and to provide public goods. Because the definition of public goods is elastic, the line between the role of the market and the role of the state may sometimes blur.

- The Japanese *corporatist market economy* is unique in its long-term view; its producer orientation; its strategic use of cooperation and competition and blending of macro and micro policies; the close and continuing interface of the state with business; and (at least until recently) its remarkable capacity to adapt to external shocks.

System friction arises in two areas. Differences of taste, preferences, and behaviour of consumers and producers can cause friction, but these are largely cultural in origin and are generally taken as a given, although they may change over time. Friction also arises between legal systems and institutions as they have evolved in each country, and in approaches to government policy in areas such as competition policy, capital market regulation, social policy, the regulation of industrial standards, and consumer protection.

The goal of this paper is, first, briefly to sketch out the main forces driving deeper integration, and then to discuss the trade policy issues which are generated by the resulting system friction. While the paper suggests means of tackling some of these issues on a multilateral basis, there are a number of areas in which it is easier to define the questions than to provide answers. Trade policy is unquestionably moving into uncharted waters; what is not clear is the destination of the voyage.
II. Why Deeper Integration?

Economic Convergence
The first step in understanding the drive toward deeper policy integration is to recognize the role of economic and technological convergence. The decline of U.S. economic and technological predominance has affected international trade policy in several ways. Its most fundamental consequence is that the United States is no longer willing to play the role of sole (or even primary) guardian of the multilateral trading system. This evolution of U.S. attitudes, which is clear and quite understandable, has developed gradually since the late 1960s. Although it was partially masked by U.S. leadership in promoting the Tokyo and Uruguay Rounds of trade negotiations, it emerged clearly in the 1980s as the United States acted unilaterally to retaliate against other countries' "unfair" practices and engaged in trade battles over high tech industries. Equally as important as the change in U.S. attitudes is the fact that there is no alternate champion sitting in the wings.

In attempting to understand the change in broad U.S. policy, it must be recognized that the goals of postwar American trade policy had less to do with the economics of free trade than with the overarching foreign policy objectives of the leader of the Western alliance in the Cold War. The predominance of foreign policy objectives had weakened well before the fall of the Berlin Wall, allowing the view to emerge that many countries were enjoying a free ride on the multilateral system at U.S. expense. In a post-Cold War world, U.S. trade policy will not be overridden by foreign policy, as it often was
in the past. Indeed, as is usually the case with other countries, international economic policy and foreign policy will be indistinguishable in many instances.

The trade policy consequences of technological and economic convergence can be seen most clearly in the high tech battles of the 1980s. The United States objected to government procurement restrictions in the European Union (E.U.) on purchases of U.S. telecommunications equipment and pursued detailed sector-by-sector negotiations with Japan to achieve improved market access for technology-intensive products, such as medical equipment, pharmaceuticals, supercomputers, and telecommunications equipment. These disputes introduced a number of significant new dimensions to the trade policy debate.

The major change was a focus on unfairness—the absence of a "level playing field" for trade—exemplified by asymmetry of market access. The level playing field had always been defined by GATT rules for government behaviour that were intended to constrain erection of border barriers that limited imports, and to encourage equal treatment of domestic and foreign firms in a given market. These rules did not guarantee equal results—that is, symmetrical market success for foreign and domestic firms, overall, or in any particular sector. This new definition of "unfairness," based on the concept of symmetrical access, became the defining characteristic of American trade policy during the 1980s. It was from this broad definition of the "level playing field" that the new policy agenda emerged.

Thus, a new dimension in the debate was the idea that different regulatory practices, different institutions, or even different governance systems, could introduce impediments to access, even if unintentionally. The American system emphasizes statutory regulation, performance standards enforced by strong consumer liability laws and extensive litigation, and the rights of state governments. This system is different in key respects from those of both the E.U. and Japan, particularly in its effects on standards-setting and government procurement practices.

The emerging notion that structural impediments were important barriers to trade became U.S. policy at the end of the 1980s. In bilateral negotiations with Japan, the United States targeted a wider range of generic policies, not just those that were sector-specific. This included not only things that government was doing but also what they were not doing. An example is competition policy (or antitrust policy, in general U.S. parlance) which, by condoning collusive practices, may limit market access for imports and generate international spillover via exports. The expanded purview also
included private sector behaviour, for example in the sphere of corporate governance. In the bilateral Structural Impediments Initiative (SII) and the U.S.-Japanese Framework Talks of the 1990s, the concept of asymmetric access was applied more expansively to cover investment and technology. Building upon earlier sector-by-sector negotiations, the focus now shifted to results-oriented rather than rule-oriented negotiations in individual sectors, such as automobiles.

It is this expanding definition of the “level playing field,” to include a broader range of economic structures and policies, that has become an important force driving deeper integration and, by consequence, system friction. The U.S. role in this evolution is paramount. This is not simply because, as the most important economic player, its disputes with Japan or Europe have important repercussions on the international economy. It is also important to understand that the concept of fairness, or fair competition, is a far more potent political issue in the United States than elsewhere. It is deeply rooted in American history and ideology, embedded in the U.S. Constitution, and exemplified in the earliest antitrust laws. Furthermore, the prevailing wisdom in the United States is that there is only one “legitimate” capitalist system, whereas, in Europe, significant variations in both economic and political systems are accepted, as is the difficult and tedious process of finding ways to adapt to divergence. The trade policy implications of this expanding definition of the “level playing field” require serious attention.

Globalization

Understanding the role of globalization in the drive toward deeper integration requires a rather different focus, specifically on the growing role of the multinational enterprise (MNE) in the international economy. By the end of the 1980s, after the enormous investment surge that occurred during that decade, MNEs accounted for 80 percent of U.S. trade. Equally important, worldwide sales of foreign affiliates of firms from all countries were nearly twice the value of world exports of goods and services, underlining the fact that foreign investment is an essential part of access to foreign markets. Global sales of affiliates are highest for the United States, which has the longest history of multinationalization, but sales are growing especially rapidly for Japan, reflecting the surge in Japanese outward investment in the second half of the 1980s.

In addition to establishing a market presence or an overseas base of operations, investment in the form of strategic alliances between MNEs from the major industrialized countries accelerated in the 1980s, particularly in the form of transnational research and
development (R&D) agreements in advanced technologies. Among the forces motivating this development have been increased R&D costs and the need to monitor technological advances for a growing spectrum of technologies on a global basis.

The investment surge of the 1980s slowed down at the beginning of this decade, but it is now showing signs of picking up, especially with regard to flows to East Asia. This is likely to continue, albeit at a less ebullient pace than during the binge of the 1980s. This is because the growth in foreign investment is motivated by profound structural changes in the world economy, and is both made possible and driven by the revolution in information and communications technology. Firms face competitive pressures to—

- capture global economies of scale and scope;
- customize products to satisfy changing consumer tastes;
- access leading edge technologies; and
- be part of sophisticated, high-quality production and distribution networks, both up- and downstream.

Globalization has also changed the nature of world trade, especially among the developed countries. Trade in manufacturing has been shifting from low to high tech and to intra-industry trade. The latter development reflects increasing specialization by oligopolistic firms, which adds to the fierce rivalry among them in both home and foreign markets.

One of the consequences of these changes is pressure on governments by the MNEs to reduce transaction costs associated with different regulatory regimes, i.e., pressure for deeper integration. In addition, the significant role of MNEs in the global economy encourages policy harmonization because governments fear “footloose” firms—or delocalization. Little investment today is motivated by the need to locate near natural resources or to supply protected local markets. Firms will seek the most harmonious site in terms of communications and transportation infrastructure, access to markets, and policy environment.

Thus, the globalization process itself has given rise to transaction cost and delocalization rationales for deeper integration. Furthermore, since globalization implies the essential complementary nature of trade and investment as routes to market access, especially in technology- and capital-intensive manufacturing and in services, the issue of asymmetry of market access is no longer limited to trade, but applies equally to investment and technology. Thus, globalization feeds back into and reinforces the “level playing field” rationale for deeper integration.
III. The New Policy Agenda

The multiple pressures for deeper integration, and the system friction which emerged during the 1980s and early 1990s, can be described as noises offstage while the main play—the Uruguay Round—was being acted out in Geneva. The transforming world economy and the political shocks which transformed the world polity during that period were creating a new trade agenda which bore only slight resemblance to the Declaration at Punta del Este in September 1986 that launched the Uruguay Round. This is not unusual: in a rapidly changing world, governments often conceive policy in a rear view mirror.

It does, however, suggest the inappropriateness of mammoth, decennial negotiations as the mechanism for making trade policy today. Fortunately, the key triumph of the Round was the institutional strengthening of the GATT through creation of a permanent World Trade Organization (WTO). The new WTO will be subject to greater political oversight and, in principle, should be able to cope more flexibly with rapid change.

But the flexibility necessary to adapt to change will also require a broader range of negotiating modalities and fora. While global agreements will ultimately be struck in the WTO, the new policy issues arising from deeper integration will also be tackled in the OECD, *ad hoc* bilateral or plurilateral discussions, and regional negotiations. It is essential that there be some mechanism to consider the multilateralization of agreements reached in these other fora. Thus, while the Uruguay Round has succeeded in updating and strengthening the rules-based multilateral system, creation of the WTO marks the beginning, and not the end, of that process.
What are the new policy issues which have been spawned over the past decade with which the multilateral trading system must cope? The key issues fall into three areas: effective access; effective presence; and high technology, or high tech. In addition, in order to avoid the “rear view mirror” trap, it is important to include some issues even more recently added to the agenda, such as the environment and labour rights (revived from past debates).

**Effective Access**

As noted above, trade policy traditionally dealt with border measures as the key barriers to effective access to markets. However, by the 1970s, it was widely recognized that actions taken within a country could be important determinants of market access. The Tokyo Round moved inside the border by including such issues as subsidies and government procurement policy. The Uruguay Round ventured much further into the domestic regulatory arena, especially with respect to services, and the services negotiations also established the linkage between the trade and investment modes of market entry. The emerging notion of structural impediments in the 1980s expanded the scope of regulatory barriers to include, *inter alia*, additional aspects of government procurement policy, technical standards, and competition policy. In addition, the mechanism for approving certain R&D subsidies agreed to in the Uruguay Round could make disputes over subsidies, long debated with respect to the Airbus, a more common occurrence (see high tech, below).

**Structural Impediments.** While structural impediments are now clearly part of the lexicon of trade barriers, it is doubtful that agreement is possible on once-and-for-all working definitions of either structural impediments or effective market access. This is unfortunate, because there is an enormous risk in letting the definitions simply evolve and grow uncontrolled. Clear definitions could constrain unilateralist pressures to “harmonize everything” or, failing that, to turn to numerical market-share targets. The best hope is probably that a body of case law can be built up over time on the basis of specific disputes, yielding workable policy guidelines. The OECD could play a role by surveying member countries’ experience in bilateral or regional negotiations and preparing a more comprehensive listing of access barriers as a useful first step.

In tackling structural barriers to effective access, a distinction must be drawn between government and private barriers. The former arise from policies, laws, and regulations enacted and implemented by governments, while the latter derive from industrial structures
and marketing and distribution systems that have evolved over time, influenced as much by the particular social setting of an individual country as by government policy. It is a simpler matter to negotiate changes in government policy and practice that remove restrictions on industrial and consumer consumption of imports than to pursue changes in consumption behaviour that are primarily motivated by factors other than government policy.

**Government Procurement.** With respect to government barriers, the U.S. disputes with both the European Union and Japan underline the need to update and extend the GATT procurement code. The code has proven grossly inadequate for ensuring fair access for imports, especially with respect to high tech goods. An important element of the procurement debate, and equally contentious in its own right, is the matter of technical standards for the design and performance of products. The setting of standards is not just a technical matter because the standards can be used as an instrument of industrial policy to favor domestic producers and complicate entry for foreign products, thereby securing strategic advantage. While codes of behaviour now govern purchases of many high tech products by government agents, they have not been adequate to avert international conflict where workable performance standards are lacking.

The related issues of procurement policy and technical standards are likely to be continuing sources of international friction. It would, therefore, make sense to use them as a test case for resolving the structural impediments-market access problem. To that end, government procurement of high tech products should be the subject of sector-specific negotiations in the WTO. These negotiations would be undertaken on a conditional MFN basis, which is to say that only the participants would pledge or receive Most Favored Nation treatment.

**Technical Standards.** It should also be possible to address these problems for specific high tech products by establishing an internationally-funded performance evaluation centre to develop internationally recognized technical standards. Valuable insights can be gained from programs already underway in Europe and the United States. For example, the E.U. has established a program to develop criteria for setting performance standards for products in technologically advanced sectors. In the United States, Sematech, the public-private semiconductor production consortium, has established an organization to provide funding for semiconductor equipment development, to test the equipment, and to establish
performance standards. This lowers the industry’s cost of adopting new standards and equipment by reducing duplication among manufacturers.

An internationally-coordinated approach would not only reduce friction between national authorities, but would both reduce the need for duplicative national testing and certification programs and capture international economies of scale in complex assessment areas. However, one should not underestimate the difficulties of an international approach. For example, in the area of medical devices, the much more litigious U.S. legal system could well preclude American cooperation unless U.S. law were changed to recognize adherence to the internationally agreed-upon standard as a safe harbor from litigation for U.S. firms.

On the issue of standards, more broadly, the E.U. concept of “mutual recognition” would be a better route to deeper integration and effective market access. The aim of the E.U. regulatory program is equivalence of regulation. It includes three distinct elements: minimal harmonization of national standards and regulation to achieve agreed-upon regulatory objectives; mutual recognition of different country standards and regulation—basically the acceptance of “nonessential” differences; and a binding dispute settlement mechanism. Not surprisingly, the most difficult problems arise in negotiations to determine the minimal harmonization necessary to achieve equivalence.

As the E.U. experience illustrates, these problems are rooted in the substantial differences in country approaches to regulation stemming from “deeply-held national convictions about the dividing-line between market forces and government intervention.” If national authorities gave preference to criteria developed by the internationally funded performance centre proposed above, it should be possible to minimize detailed national design specifications and to avoid differences in national testing requirements which can act as technical barriers to access.

It would be very important to involve companies from all countries in the process of standard-setting. This would not only encourage fair competition but, by providing a forum for the exchange of technical information among producers, users and suppliers, the process itself would be a means of technology diffusion. Of course, a powerful corporation hoping to use a proprietary standard as a strategic tool for market dominance might well decline to cooperate. It is for this reason that a governmental role in promoting international cooperation would be essential.

In this regard, the Uruguay Round Agreement on Technical Barriers to Trade (TBT) represents a marked improvement over the
previous Tokyo Round code. In the Tokyo Round, only 40 countries accepted the rules, whereas the WTO accord will cover all signatories to the Agreement. More specifically, it includes a strong push for transparency, mutual recognition, and international standards, enjoining countries to "play a full part, within the limits of their resources, in the preparation by appropriate international standardizing bodies of international standards for products for which they either have adopted, or expect to adopt, technical regulations."² It should be noted, however, that American participation in these bodies is rather limited because the United States has thousands of industry and local standard-setting organizations and no dominant national institutions. (Canada has recently cited this U.S. "privatization" of standard-setting as a structural impediment to market access.)

Finally, in the government procurement area, there remains the unsolved problem of reciprocity, exemplified by the still unsettled U.S.-E.U. dispute over telecommunications equipment. Both the E.U. and the United States have espoused reciprocity—access as generous as that granted by the other party—as their policy objective, but they have been unable to reach an agreement because of the very significant differences in their regulatory regimes governing telecommunications. It appears that some form of reciprocity, rather than national treatment, must be accepted in this sector, whereby foreign and domestic firms are accorded equal competitive opportunity. However, no guidelines or rules for a sensible policy are apparent. Whatever the final shape of the U.S.-E.U. agreement, its terms should be analyzed in the OECD, and it should serve as the basis for a broader discussion of other complex, cross-cutting issues such as deregulation and the role of subnational (e.g., state and local) governments.

**Private Barriers.** Handling private barriers to effective access presents different problems, owing to the non-governmental nature of the barriers. Disputes between America and Japan, in both the auto sector and the SII, have centred on the Japanese keiretsu—industry groups bound together by cross-shareholding. In the auto sector, a conflict over the failure of Japanese automakers to purchase U.S. auto parts has centred on the role of vertical production keiretsu. These are characterized by links between upstream auto parts suppliers and the final producers of automobiles. The production keiretsu have been criticized by the U.S. side as exclusionary, impeding effective market access, despite that fact that the vertical integration enterprise model of some American companies also has this effect. In the SII, the vertical distribution keiretsu, which link producers
and retailers, were cited as a barrier to imports, an issue that was also raised with respect to auto sales in Japan through exclusive dealership arrangements.

U.S. negotiators argued that the "solution" was tougher antitrust action, but this seems rather implausible. Neither U.S. nor E.U. policy prohibits vertical arrangements. The overall policy approach in the E.U. is to consider market structure as well as efficiency effects on a case-by-case basis, although there are block exemptions for certain types of arrangements. Moreover, many studies of the auto industry have concluded that the long-term supplier-assembler relations of the Japanese keiretsu are a more efficient organizational form than U.S. vertical integration or spot-type procurement from external suppliers.

A much more solid cause for complaint is in the case of collusion in the final product market—that is, among firms producing the same product. So long as competition in final products exists, the efficiency gains of vertical production keiretsu behaviour outweigh their exclusionary consequences. Indeed, as has been broadly acknowledged, the diffusion of the keiretsu mode of operations through Japanese investment in the United States and the United Kingdom has improved American and British industrial performance. Although there appears to be little rationale for the use of competition policy against them, the exclusionary effects of the vertical production keiretsu remain as a source of friction. But these are likely to diminish over time as Japanese firms develop more transparent and inclusive procedures for intercorporate linkages.

The vertical distribution keiretsu are much more clearly a barrier to effective access in the Japanese market, including in the auto industry. Moreover, while exclusive dealing arrangements may offer some efficiency gains in the form of enhanced customer service and information, such gains are outweighed by the very significant exclusionary impact on imports. Some experts have argued that these "vertical restraints can retard the entry of foreign manufacturers. In that respect, the relaxed policies towards these restraints in both the United States and Japan may have artificially raised entry barriers between the two countries."

One way of dealing with these complex, non-governmental structural impediments would be to bring a complaint to the WTO under the little-used "nullification and impairment" article of the GATT—Article XXIII: 1 (b). This section addresses the nullification and impairment of promised trade benefits, not through violation of a specific GATT rule but through "the application by another contracting party of any measure whether or not it conflicts with the provisions of that Agreement." The E.U. issued a complaint against
Japan in 1983 under this broad rubric which, in effect, charged that structural impediments blocked effective market access.

However, the mechanism was never tested, as the E.U. subsequently withdrew its request that a panel review the matter, leaving unanswered whether this would be an effective mechanism within the GATT or WTO to handle impediments to effective access. The distribution keiretsu would be a good test case to pursue now, especially in exploring the potential of the new and strengthened dispute settlement procedures of the WTO. Under the new WTO procedures, it is possible not only to solicit information and technical advice relevant to the issue under discussion, but also to include experts in industrial organization and competition policy as well.

**Strategic Dumping.** While the Article XXIII approach might work for market access, it is limited to the effects of action or inaction by governments in their own markets. Thus, it would not work for more complex strategies, such as strategic dumping, which involve a combination of trade barriers and nonenforcement of competition policy. Strategic dumping essentially involves subsidizing exports through high domestic prices sustained by collusive price behaviour and a protected home market. This is particularly important in industries with significant dynamic economies of scale, those in which costs fall substantially over time as improvements are made, through the learning process, in production. In such cases, high fixed costs resulting from high domestic prices would serve to deter entry, an effect compounded if domestic producers were permitted to reduce their costs through coordinated R&D expenditure. The injury to firms in the country that is target of the strategic dumping includes both the restriction of their exports and the denial of dynamic efficiency gains, which may be cumulative and dispersed over a wide range of products.

There are several options for dealing with strategic dumping. One is "strategic antidumping": a policy of deterrence involving harassment by the importing country in the form of antidumping duties on the offending country’s exports. This is likely to induce investment by the exporting firms into the importing country, as happened during the 1980s when Japanese firms moved into Europe and the United States. Thus, trade policy can inadvertently become investment policy, resulting in additional problems, such as excess capacity or the transplantation of the keiretsu. A second option for dealing with strategic dumping is domestic subsidy. While provision of subsidies could compensate firms for the effects of dumping, the policy could be costly, and would eventually necessitate multilateral negotiations on a new subsidy code.
The third option would be to tackle the root causes of the problem: the exporting country’s trade and competition policy. In order to structure negotiations aimed at removing barriers to access into the exporter’s market, the first step would be to agree on a list of industry characteristics to be considered. This could include the degree of concentration, as measured by exporting firms’ share of home market; exporting firms’ share of world market (which would affect alternative third country producers); extent and nature of barriers to entry of new firms or expansion of existing firms; degree of import penetration; prices in the exporting country’s home market, relative to prices elsewhere, etc. In order to focus the negotiations on eliminating protection where strategic behaviour is taking place, specific industries would then be selected in sectors with oligopolistic structures; high entry barriers; significant static and dynamic economies of scale; and dominance in global markets.

From this agreed-upon industry list, one could then assemble a group of products and, for these, compile a list of specific import barriers. This would then form the basis for a “zero-for-zero” negotiation, i.e., the removal of all border restraints on a reciprocal basis. The negotiations could begin with a small group of countries, including the United States, E.U. and Japan. The participants would have to decide whether the agreement should involve universal MFN or be conditional on participation. If conditional, the agreement should be open to all countries willing to accede to the zero barriers.

For the reasons discussed above, elimination of trade barriers will not, on its own, remove the threat of strategic dumping which also requires action on competition policy in the exporting market. Conflict in this area would be solved by international convergence of competition policies, but convergence, however desirable, will be a lengthy process. One means of speeding this up would be to put bilateral agreements in place (or even to create a supranational authority) to ensure a fair hearing when disputes arise out of charges that weak enforcement of competition policy is spilling over onto the trade front. By means of the transparency and international peer pressure that such a mechanism would create, the process of convergence could well be accelerated.

If such an approach is not pursued, extraterritoriality seems a likely alternative. In 1992, two bills were introduced in the U.S. Senate on this point. One would have amended the Antidumping Act to allow for the collection of triple damages by U.S. firms injured by below-cost pricing of foreign products, if they could prove that foreign dumping resulted from “extracting profits from a closed home market.” The other would have allowed firms to sue, under the Sherman Antitrust Act, those foreign companies “whose
actions violate their own government's law which has not been
enforced.  While both bills failed to pass, similar bills have been
introduced in both the Senate and House more recently. In October
1994, new international antitrust enforcement guidelines were issued
by the U.S. government that would permit both the Department of
Justice and the Federal Trade Commission to prosecute foreign
to companies for anticompetitive behaviour that takes place outside
the United States, if such behaviour impedes American exports.

Market Presence

The second new policy area that has emerged is effective market
presence—market entry not for goods, but for investment. As was
discussed earlier, trade and investment, especially in high tech and
services, are complementary routes to market penetration, with
investment often a more effective mode for gaining access to
technology. While this issue has important trade implications, it
should be recognized that it is but one of many concerns which need
addressing on the investment front. Indeed, a number of proposals
have been advanced for a new, comprehensive approach to investment
policy, either in the OECD or the WTO.

At present, effective market presence is a problem centred on
Japan, and is greatly magnified by the outward surge of foreign
direct investment (FDI) from Japan in the 1980s. An illustration of
the problem can be seen by looking at changes in inward and
outward investment between 1980 and 1990. Over the decade, Japan’s
share of the world’s stock of outward FDI rose from less than 4
percent to just over 12 percent, while its share of the inward stock
declined from 0.7 percent to 0.6 percent. In the rest of the OECD, the
outward and inward shares were roughly equal.

While there are a number of reasons for the low level of foreign
investment in Japan, including the lingering effects of earlier policies
and the high costs associated with the rising yen, the major structural
impediment to effective presence is the intermarket or horizontal
keiretsu or, more broadly, the Japanese corporate governance model.
These keiretsu involve groupings of firms in diverse industries,
centred around a major bank, and are a fundamental aspect of
Japanese capitalism. The lead bank is not only an important source
of capital (although less so now than in the early 1980s) but also
performs other functions with respect to client firms, such as facilitating
access to other banks; assisting in corporate restructuring, if required;
and providing management assistance, if necessary. In addition to
this long-term, reciprocal relationship with the lead bank, cross-
shareholding among member companies is very extensive, providing for tremendous financial stability and resistance to corporate takeovers.

Cross-shareholding is now beginning to erode as a result of the bursting of the asset price bubble of the 1980s, which forced firms to liquidate shareholdings to deal with immediate financial problems. Nonetheless, substantial cross-shareholding continues to make firms resistant to takeover bids. This resistance is strengthened by the long-term stable investment strategies of insurance companies and pension funds, which also reduce the pool of publicly-traded shares. The corporate governance model in Japan is thus resistant to mergers and acquisitions (M&As), the dominant mode of inward foreign investment in other countries, and especially in the United States where active equity markets, in combination with policies such as shareholders' rights, extensive disclosure regulations, and the like, create active markets for corporate control.

Is the Japanese corporate governance model, so clearly exclusionary, also more efficient? Is there, in other words, a parallel between the horizontal keiretsu and the vertical production keiretsu? A judicious answer would seem to be “yes and no.” A reasoned judgment suggests that the Japanese governance model and the Anglo-Saxon model are alternative “economically rational attempts to resolve traditional problems of coordination and control.” The Japanese model seems more effective in reducing transaction costs, and is particularly suited to encouraging a long view which facilitates innovation. The Anglo-Saxon model is a market for corporate control in which the stockholder, as opposed to the stakeholder, is king. The Anglo-Saxon model centres on the game; the Japanese model centres on the players. An “ideal” model would include elements of both, and policy proposals to promote convergence have, indeed, been suggested by both American and Japanese experts.

While convergence of governance models may be desirable, and even probable, it will not be achieved quickly. E.U. efforts to reduce the very wide differences within Europe, most striking between the UK and Germany, have not proceeded very far. It may be that the need for corporations to raise capital in different countries may provide a stronger push to harmonization. The decision of Daimler Benz to comply with U.S. accounting principles, thereby disclosing large financial losses, in order to be listed on the New York Stock Exchange, is an example. While progress is possible, the problem of Japanese structural barriers to effective market presence will remain for some considerable time, and other policy actions will be required if the marked asymmetry is to be reduced.

The Japanese are now well aware of the serious and deep-seated structural impediments to foreign investment in their market.
The largest business grouping in Japan, the Keidanren, prepared a special report in consultation with foreign business which made a series of recommendations to deregulate and liberalize key sectors, including legal services. And investment issues have been included for the first time in the American-Japanese trade negotiations, launched at the Tokyo Summit in July 1993.

Because mergers and acquisitions will not become a significant "port of entry" for foreign investment into Japan for the foreseeable future, the government has launched a number of initiatives to facilitate greenfield investment, including tax incentives to offset the high cost of land. More recently, there has been an apparent policy shift by the government to encourage joint ventures. While there are many reasons for the proliferation of joint ventures, it may be that their promotion offers the Japanese trade ministry, MITI, the easiest and fastest policy response to foreign pressure.

Despite the efforts described above, no clear-cut policy approach has emerged to solve the effective presence problem or to reduce the marked investment asymmetry between Japan and the rest of the world. This discussion suggests a gradual, evolutionary approach. While that may not be fully satisfactory, it is far preferable to the alternative of aggressive unilateralism and creeping cartelization.

High Tech Policy Issues

Government and corporate responses to the high cost of developing and commercializing new technologies and the constant need for innovation to outpace the competition have made high tech a policy battleground. Governments have responded by providing public support for R&D on new technologies. Corporations have banded together in consortia to share R&D costs and increase their access to technology and, in some cases, firms have simply pirated products and technologies, appropriating intellectual property developed by others.

Intellectual Property Rights. The inclusion of intellectual property rights (IPRs) in the agenda of the Uruguay Round was the first signal of the impact of accelerating technology change on the international economy. However, this action was less a function of the central role of IPRs in generating high tech trade friction than of effective lobbying by the American pharmaceutical industry, concerned with patent piracy in developing countries. Patent protection is important for industries with a long product-life cycle because it ensures a return on investment over time. This is critical for industries producing fine chemicals and, in particular, pharmaceuticals.
For most other high tech industries, R&D issues loom larger because lead time in discovering new technologies and bringing them to market is more important in securing a payoff to the innovator. Nonetheless, the Uruguay Round breakthrough is extremely important because it reduced frictions in the negotiations arising from developed country complaints that piracy of intellectual property tilted the "level playing field." While the Uruguay Round agreement addressed this problem, it achieved little in the way of harmonization of intellectual property rules. It is likely that future conflicts will arise, mainly among the developed countries where there is significant divergence between the U.S. approach and those in the E.U. and Japan. Again, bilateral or plurilateral negotiations could be the first step toward resolving these differences before undertaking further multilateral negotiations in the WTO.

In order to address issues related to R&D, two other policy initiatives should be undertaken as soon as possible to constrain further disputes in the high tech area. The first concerns joint public-private research consortia which proliferated during the 1980s and have taken on new prominence in the United States as part of its new industrial policy agenda. The second would address R&D subsidies.

Research Consortia. Public-private research consortia are a means of funnelling public funds into industry research and permitting competing firms to share the costs and benefits of R&D, even if they would otherwise be prohibited from joint operations. In the 1970s and early 1980s, research consortia were mostly associated with Japanese industrial policy. They were then adopted by the EC, and later by the U.S. Some purely international projects have begun, as well. Because national programs are intended to assist domestic firms, a major source of contention emerged in the 1980s over membership of foreign subsidiaries in consortia. In response, the E.U. has spelled out conditions for foreign firm membership and Japan has undertaken a new policy of encouraging foreign participation, although no clear guidelines have been enunciated. The United States seems to be moving in the opposite direction, explicitly excluding foreign subsidiaries.

Since R&D consortia are likely to proliferate, and because many firms are seeking strategic alliances in order to get around exclusion from national programs (illustrating the futility of "techno-nationalism" in a globalizing economy), some agreement on guidelines for foreign participation are urgently required. The logical forum would be the OECD, which has played a major role in the area of innovation policy. In addition, rules are needed for the purely
international projects in science and technology, governing issues such as sharing of costs and benefits, and intellectual property rights. International projects with multinational participation could serve as a positive response to the problem of asymmetry in knowledge diffusion.

**Subsidies.** The second policy initiative that should be undertaken relates to the Uruguay Round agreement on R&D subsidies. The agreement provides a mechanism for securing “green light” status for “basic” industrial research and some forms of development activity after notification to and review by the Subsidies Committee. While the new approach reflects a dramatic turnaround in American policy, it is likely to lead to continuing disputes over the definition of what is “basic” and what is “applied” industrial research and, therefore, what should be exempt from countervailing duties (i.e. “greenlighted”). Since even scientific and technology experts are unlikely to agree about definitions (for one thing, differences across industries are so great that rules for one may make no sense for others), the WTO Committee looks set for a lot of fruitless haggling.

This is yet another field where the OECD can play a role. For over thirty years, the OECD Directorate for Science, Technology and Industry has collected data on human and financial resources devoted to R&D, and has developed extremely detailed definitions for collecting and measuring these resource inputs. These definitions and methodology should form the basis for the Subsidy Committee reviews, data collection, and the WTO dispute settlement procedure. Indeed, just as science advisory groups may be called in for disputes over the environment, the need for expert advice is likely to arise on innovation policy issues in the fractious area of R&D subsidies in future years. While this proposal may not solve all the complex definitional issues involved, it would promote constructive, plurilateral debate that should foster progress toward eventual harmonization while constraining serious and destabilizing bilateral friction.
IV. Conclusions

This menu of options for post-Uruguay policy issues is all rather messy. That there is no nice, clear, simple framework for the range of new trade issues reflects a messy real world, one that is changing too fast for any template to constrain.

Despite the complexity of the agenda, it is important to the future of the trading system that the new trade issues be subjected to multilateral discipline. Because a great deal of work is necessary before that can be accomplished, the task must be taken up with some urgency. It is therefore worth reviewing the work program in terms of issues that could be taken up directly by the WTO, those best pursued in the OECD first, and those requiring work bilaterally or plurilaterally before consideration in multilateral fora. As a starting point, the WTO should move ahead on—

- *updating government procurement rules*—by pursuing negotiations on specific high tech products among interested countries on a conditional MFN basis, as a first step toward revising and extending the full GATT procurement code; and

- *limiting strategic dumping*—by launching negotiations on a sector-specific, conditional MFN basis aimed at identifying all import barriers affecting selected products and working toward their complete elimination.

In addition, to the extent that a "nullification and impairment" complaint is brought under Article XXIII against practices such as the Japanese vertical distribution *keiretsu*, the WTO should use the opportunity to make progress on *non-governmental structural barriers*, using its new and strengthened dispute settlement procedures.
The **OECD** should draw upon its extensive work program on issues on the trade agenda in order to provide information and further discussion on—

- **structural barriers to access**—by surveying member countries’ experience in bilateral and regional negotiations and preparing a comprehensive list of barriers that would serve as a baseline for broader WTO discussions;

- **establishing rules for access to joint public-private research consortia**—by pursuing agreement on guidelines for foreign participation in national consortia, as well as rules for sharing the costs, benefits and intellectual property rights of purely international projects; and

- **facilitating implementation of the Uruguay Round agreement on R&D subsidies**—by providing data and expertise developed by the OECD Directorate for Science, Technology and Industry to the WTO so that Subsidy Committee reviews and dispute settlement procedures will be well informed.

There are, in addition, some issues that are not yet ready for multilateral consideration and are best pursued in **bilateral or plurilateral negotiations** among the interested parties. These include:

- **government procurement of telecommunications equipment**—because there is no ready alternative to the reciprocity of market access being sought in U.S.-E.U. negotiations, the issue should be resolved bilaterally and the results analyzed by the OECD for use in broader multilateral discussions—for example, they might serve as the basis for consideration of the role of subnational government units including state and local governments;

- **adoption of international technical standards**—in order to limit the role that national standards can play as instruments of industrial policy, establish an internationally funded performance evaluation centre to develop standards, drawing upon the experience of existing national programs and involving companies from many countries;

- **ensuring fair enforcement of competition policy**—in order to ensure a fair hearing when trade disputes arise out of weak enforcement of national competition policy, pursue bilateral agreements and eventually even the creation of a supranational authority to hear cases; and

- **harmonizing national rules for intellectual property rights**—because WTO enforcement will be difficult until harmonization of rules
has been achieved, pursue bilateral or plurilateral discussion on harmonization before pursuing the issue in the WTO.

This is an exceedingly complicated menu. What is worse, it has left out some important new cuisine. The WTO agenda will also include the environment and (probably) some version of labour rights/social clause/human rights. These issues also arise from deeper integration, but from a very different source than the forces generated by governments or MNEs. The main actors here are non-governmental organizations (NGOs), linked by E-mail around the world. This is deeper integration by internet; deeper integration by information. These are not “distributional coalitions,” as Mancur Olson called traditional trade lobbyists, that are primarily concerned with the distribution of the pie. These might be called “transformational coalitions,” who are dedicated to fundamental changes in economic and political behaviour.

The trade linkage is neither central to addressing the problems of the environment or human rights nor is it the only intersect for these coalitions. However, it is one of major concern to governments and multilateral institutions, in part, because of the fear of collusion between the coalitions—what has been called the “Baptist Bootlegger” model. The cross-linkage between trade and domestic policy in the case of environmental standards has already been confronted in the GATT and in NAFTA. But that is the tip of the iceberg. The full implication of transformational coalitions living in cyberspace has not yet begun to be thought through. Working that one out should keep the trade policy community busy for years to come!
Endnotes

1 For an excellent summary of the E.U. approach as a model for an international code, see Jacques Pelkmans and Niall Bohan, "Towards an Ideal GATT TBT Code?" Centre for European Policy Studies, Brussels, December 1992 (mimeo.), p.7.

2 Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, December 15, 1993.

3 See William S. Comanor and Patrick Rey, "Competition Policy Towards Vertical Restraints in a Global Economy," Competition Policy in a Global Economy Project, April 1994 (mimeo.).

4 This is recommended by Japanese industry associations clearly as a response to American complaints. See, for example, the comprehensive analysis and proposals of the Tokyo Chamber of Commerce and Industry, Building a New Corporate Network: Report on Research into Corporate Keiretsu, Tokyo, April, 1993 (p.26).


7 Inside U.S. Trade, Washington, May 8, 1992, p.8. In April 1992, the Justice Department announced that it would, in appropriate circumstances, challenge foreign business conduct that harmed U.S. exports when the conduct would have violated U.S. antitrust laws if it had occurred in the United States.

8 Ibid, April 8, 1994, p.3.


10 There are, in fact, a large number of mergers and acquisitions in Japan, but they are overwhelmingly among very small domestic firms. See Hiroyuki Odagiri, "Mergers and Acquisitions in Japan and the Antimonopoly Policy", Competition Policy in a Global Economy, Project, April 1994 (mimeo.).

11 W. Carl Kester, "American and Japanese Corporate Governance Converging to Best Practice?" Harvard Business School, February 1993 (mimeo.),

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