Japanese Postwar Attitudes towards International Trade and Investment

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I. THE CURRENT CRISIS

When introducing Japan, scholars often take pains before beginning to point out that Japanese history, politics, society and culture are replete with paradoxes and contradictions. The terms paradox and contradiction also aptly describe Japan’s international and economic posture in the postwar period. Japan has aggressively exported high-quality finished goods and has energetically sought investment opportunities throughout the world; at the same time, it has maintained a domestic economy which by comparison to this aggressive export posture appears immune to imports and foreign investment. This is as anomalous as the Japanese businessman who wears a suit and tie and works in a modern, Western-style office building, but who returns home at night to relax in a light summer kimono on tatami straw mats. Americans involved with Japanese-American economic relations have often been irritated and frustrated by the difference between the way Japan approaches the world and the manner in which Japan allows the world to approach it. On a more profound level, these same Americans have been troubled because this disparity threatens in the long run to undermine the foundations of the strong economic and political partnership which has developed between the United States and Japan since the end of World War II.

Recent events have brought this troublesome disparity into sharp focus. The most important of these events has been the United States’ bilateral trade deficit with Japan, which amounted to more than eight billion dollars in 1977.¹ This accounted for roughly forty percent of the United States’ entire trade deficit for 1977. Predictions for the United States’ bilateral trade deficit with

Japan for 1978 run from 13 1/2 billion dollars to 15 billion dollars. Since 1971, when the Bretton-Woods Fixed Rate system was abandoned, the dollar has declined from 360 yen to the dollar to almost 210 yen, a reduction of forty-two percent. Furthermore, more than half of this decline has occurred since January 1978 and recent efforts to prop up the dollar have managed to raise the rate to only 206 yen. These events led to the direct criticism of Japanese trade policies by the Secretary of Commerce, Mrs. Kreps, and by the United States Ambassador to Japan, Mr. Mansfield. While Secretary Kreps led a trade delegation of American businessmen to Tokyo for the express purpose of increasing American exports, American newspapers were charging Japan with protectionism, and retaliatory protectionist sentiment in Congress appeared to be at a postwar high.

Japan has responded to this international pressure with few concessions. In the trade talks between United States Ambassador Strauss, the President's Special Representative for Trade Negotiations, and Japan's Economic Minister Nobuhiko Ushiba, in the spring of 1978, Japan balked at even relatively minor concessions on the import of beef and citrus fruits, and negotiators were unable to make any meaningful progress towards the goal of solving the large trade imbalance between the two countries. In response to criticism, a Japanese official could even be heard to repeat the old cliche that "Japan must export to live." To Japan's credit, it has made some unilateral tariff reductions and relaxed exchange controls. However, it is unlikely that these will have a significant long term impact on Japan's trade surplus with the United States.

Belatedly, when Japanese political and business leaders recognized the seriousness of the problem and the deep feelings it generated, they embarked on speaking tours of the United States and ran full-page newspaper advertisements explaining Japan's position, hoping to defuse American impatience. Often these explanations sounded inadequate, emphasizing the higher rate of growth in the United States, the weak export orientation of the American econ-

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omy and the high level of oil imports into the United States.\textsuperscript{8} Although each of these explanations had substantial merit and made clear that Japan should not be a scapegoat for many of the United States’ problems, it did not explain why the Japanese economy had for so long remained virtually closed not only to trade and investment of the United States, but also to that of the entire industrialized world. The anger and resentment of the United States, Japan’s most important trading partner, was being met with what an American observer had privately characterized on a prior occasion as “studied avoidance” of international problems, issues and obligations.

2. HISTORICAL PERSPECTIVE

History in part explains Japan’s reluctance to embrace the international economic order of free trade and investment at home with the same enthusiasm that it has successfully evidenced abroad. Geographically isolated from Asia, Japan was able to enjoy the benefits of Asian civilization, yet it was able to avoid direct conflicts with other societies and ethnic groups. Geography enabled the Japanese to achieve a separate and independent identity and made it possible for them to assimilate foreign cultural influences in unique ways which fit easily into the existing society. Direct foreign intervention in the Japanese domestic society was not only unwelcome but was practically unknown. Not surprisingly, Japan has eagerly borrowed Western knowledge, techniques and institutions, but at the same time has stubbornly resisted Western influence which has threatened to compromise Japanese independence or dislocate the indigenous social order.

In the sixteenth century, Japan actively traded throughout East Asia and enthusiastically received Western traders and Christian missionaries. However, when Western religion, trade and politics were perceived to constitute a serious threat to the newly established political order of the Tokugawa Shogunate, the Shogunate banned Christianity. It forbade the Japanese from trading overseas and permitted trade only with the business-minded Dutch. Furthermore, the Shogunate confined Dutch traders to a small island in the port of Nagasaki far from the new capital of Edo, which later became the modern Tokyo. From the early seventeenth century until the mid-nineteenth century, Japan continued its evolutionary development more isolated from foreign influence than ever before.

\textsuperscript{8. Id.}
In 1853, Commodore Perry sailed into Tokyo Bay at the head of a flotilla of warships and demanded, on behalf of the United States, that Japan open itself to free trade. This ended Japan's isolation. Japan was forced into a series of unequal treaties and suddenly faced the prospect of Western domination and possible colonization. Japan's hostility to this Western intrusion culminated in the overthrow of the existing government and the collapse of the feudal social and political order. Struggling to stave off foreign domination, conservative samurai revolutionaries took the helm of government and leadership in business in order to modernize Japan. Their success is exemplified by the fact that the economic patterns which were firmly established during that period still survive today.

Japan industrialized in order to preserve its independence and autonomy. However, industrialization of Japan created an economy which now is dependent on imports for necessary raw materials, food and energy, and upon exports and export markets to pay for these necessary imports. Therefore, industrialization has ironically resulted in a precarious dependence on the international economy from which Japan cannot escape. In its more than one hundred years of trade, Japan has experienced chronic foreign exchange shortages. On three occasions in the postwar period alone, foreign exchange difficulties have been severe enough to temporarily slow Japan's growth rate.

More dramatically, despite all their postwar success and riches, the oil embargo of 1973-1974 made the Japanese feel exposed, weak, and vulnerable. Furthermore, the subsequent quadrupling of oil prices virtually halved Japan's rate of growth. These historical experiences influence Japanese thinking more decisively than does the current payment surplus, which the Japanese may even regard as a temporary aberration in the larger pattern of their history. From this perspective, business and government leaders alike have difficulty imagining a Japanese economy even more open to international trade and even more dependent on the international economy.

The early Japanese government and business leaders shared the goals of rapid modernization and forged an alliance between business and government which survives to the present day. Their cooperative efforts successfully modernized Japan before the war,

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10. W. Lockwood, Japan's "New Capitalism" in Lockwood, supra note 8, at 447, 449-50 [hereinafter cited as Japan's "New Capitalism"].

and since the war they have rebuilt Japan and placed it in the front ranks of modern industrialized nations. As Professor Lockwood has pointed out, the framework for the close relationship of business and government exists without much statutory authority and consists of a complex network of established business, personal and institutional relationships that are uniquely Japanese. Business and government leaders are uncertain of how foreign business can be assimilated into the tightly knit web of informal connections that bind government and business together, and it is feared that foreign business would upset the finely-tuned balance of various economic components that has made Japan so successful.

The character of this relationship has also been decidedly nationalistic. For the early modern Japanese entrepreneurs, business was not only the road to power and riches but also constituted participation with government in a patriotic task whose goals were modernization, preservation of Japan’s autonomy, and eventual equality with the West. After the war, Japan was foreclosed from using military means to achieve independence and equality. Success in business and international trade remained as the only avenue for reasserting Japan’s dignity and influence in the world.

The nationalistic orientation of the Japanese business and government community has minimized Japan’s reliance on the West in the process of modernization. Borrowings abroad during the early modern period were limited and quickly repaid. Western advisors were replaced as soon as their Japanese counterparts could absorb the technical and scientific knowledge these advisors imparted. In the postwar period, Japan has endeavored to obtain superior Western technology on the least costly terms possible and with minimum foreign involvement. In large measure, these policies have been successful. However, as a result, Japan is poorly prepared to accept at home the free interchange of trade and investment that should be the concomitant of its policies abroad.

Japan’s refusal to rely on foreign capital has also caused government and business to work closely to channel Japan’s limited resources into those particular industries which are perceived to have the most promise for Japan’s future. In the past, industries such as silk and textiles were emphasized. More recently, steel, automobiles, shipbuilding, and electronics have benefited from government policy. This has led, however, to uneven growth and the creation of a two-tier economy characterized by a dominant tier of internationally competitive industries serviced by an inefficient second tier of

12. *Japan’s “New Capitalism”*, supra at 490.
small manufacturers, service-oriented businesses and a multilayered distribution system. Anyone who has lived in Japan is familiar with this second tier through the goods sold domestically in the numerous "mom 'n pop" stores. This second tier of industry which sells mediocre products at high prices would be poorly equipped to compete domestically with a retail marketing giant such as Sears with American goods at American prices. Furthermore, the close business-government relationship makes government agencies susceptible to pleas from these inefficient producers for protection, and legislation has been enacted to protect these inefficient enterprises.

From the perspective of free trade and investment, the important components in Japan's domestic economic and political equation are: dependence on imports, foreign exchange shortages, the clublike nature of business-government relations, the nationalistic orientation of business, the vulnerable second tier of the economy, and Japanese insularity and striving for autonomy. All these historical currents combine to make Japan instinctively and stubbornly adverse to genuine concessions in the areas of foreign trade and investment. Foreign businessmen and lawyers have complained about statutes, regulations and restrictions which bar the passage to successful trading and investing in Japan. However, these prohibitions represent only the tip of an iceberg of emotional resistance against trade and investment by foreigners in Japan and against complete integration of Japan's domestic economy with the world economy.

3. POSTWAR HISTORY OF CAPITAL LIBERALIZATION

Although the postwar international economy is based upon concepts of free trade, free investment and free exchange as expressed in the General Agreement on Trade and Tariffs (GATT), the International Monetary Fund Charter (IMF) and the Organization of Economic Cooperation and Development Code (OECD), Japan has in the past raised many legal obstacles to effective integration with the international economy. In the area of trade, many of these obstacles are not well understood and can be as varied as the products

13. DAN F. HENDERSON, FOREIGN ENTERPRISE IN JAPAN, LAW AND POLICIES 104 (1978) [hereinafter cited as HENDERSON].

13.1. See, for example, Law Concerning the Regulation of Business Activities of Large Entrepreneurs to Protect Opportunities for Business Activities by Small and Medium Enterprises, Law No. 74 of 1977.
which traders attempt to bring into Japan in addition to tariffs and import quotas. There have been charges of unreasonable standards of purity, unnecessarily detailed inspections, bureaucratic stalling and pettifogging, and straightforward legal harassment. Secretary Kreps has directed the Commerce Department to catalogue these non-tariff barriers to trade, and the results of this study may show what has been alleged for many years—namely, Japan's protectionism.

To observers who witnessed the attempts of American and Western European investors in the 1950's, 1960's and early 1970's, to surmount the obstacles Japan erected to foreign investment in Japan, the current situation is familiar. Then foreign businessmen and officials were strenuously urging Japan to open itself to foreign investment so that they could take advantage of investment opportunities. Today, foreign businessmen and officials are likewise vigorously imploring Japan to allow the sale of foreign goods freely in Japan so that they can take advantage of trade opportunities. In both cases, they have met stiff resistance from Japanese businessmen and governmental officials but in the former case progress was eventually achieved. If the free flow of capital and technology are corollaries of free trade and are but pieces of the whole cloth of an open international economy, we may assume that in the history of Japan's treatment of foreign investment there is a clear record of Japan's response to the challenge of a free international economic order. This then can serve as a guide to understanding Japan's reactions in the current situations. Furthermore, it is the legacy of Japan's trade and investment policies during these years that has set the stage for the current imbalance in economic relations between the two countries. In examining the history of Japan's post-war policies, some understanding can be arrived at of how the two countries reached their present positions.

Since 1950, Japan has regulated foreign investment under the Law Concerning Foreign Investment [hereinafter referred to as the Foreign Investment Law]. In essence, the statute requires that investment in a Japanese enterprise established under Japanese law be validated by the government. Without validation, profits cannot be remitted out of Japan under Japan's foreign exchange laws.

14. Law No. 163 of 1950 (as amended), art. 2. It should be noted that the Foreign Investment Law does not apply to the establishment of a branch of a foreign entity in Japan. There are no explicit controls regulating branch establishment in Japan, but the Foreign Exchange and Foreign Trade Control Law (Law No. 228 of 1949, as amended) has been utilized by restricting inward and outward remittance of funds to achieve a similar, although not identical, form of regulation.
Validation, however, includes a foreign exchange license and for practical purposes a guarantee that profits can be remitted. The statute is purposely vague as to the procedure for validation and the standards by which validations are to be granted or withheld. These matters are left for resolution by Cabinet order and ministerial ordinance.

The purpose of the statute, when it was enacted, was to regulate the flow of investment into Japan in order to protect both Japan's precarious international balance of payments and foreign investors' reasonable expectations that profits could be repatriated. It states the following:

The purpose of this Law is to create a sound basis for foreign investment in Japan by limiting the induction of foreign investment to that which will contribute to the self-support and sound development of the Japanese economy and to the improvement of the international balance of payments, by securing remittances arising from foreign investment, and by providing for adequate protection for such investments.\(^{15}\)

Reflecting the unfavorable balance of payments when it was enacted, the Foreign Investment Law provided for periodic reports to the Cabinet on the international balance of payments and for steps to be taken in the event of an emergency.\(^{16}\) Underlying the statute was also the understanding that Japan was economically prostrate after World War II and direct government intervention in the process of capital and technical induction was necessary to prevent powerful and technologically superior American and foreign companies from overpowering their Japanese counterparts.

At the same time, it recognized that the nature of the problem was temporary when it stated the following:

Foreign investment in Japan shall be permitted to be as free as possible, and the system of validation pursuant to the provisions of this Law shall be relaxed and eliminated gradually as the necessity for such measures decreases.\(^{17}\)

The statute envisioned relaxation of standards and eventual repeal, but the different Japanese and foreign perceptions of when this should occur generated considerable controversy and friction between Japan and its trading partners.

Parallel to the restrictions on foreign investment, the Foreign

\(^{15}\) Id. art. 1.
\(^{16}\) Id. arts. 4-5.
\(^{17}\) Id. art. 2.
Investment Law also requires validation of license and technical assistance agreements by foreign licensors to Japanese licensees.\textsuperscript{18} Without validation or a separate foreign exchange license, royalty payments cannot be remitted out of Japan. In contrast to foreign investment, foreign technology was urgently needed by the Japanese, because Japan had been effectively isolated from Western technological progress during the war. If it were to compete effectively against Western nations in the international area, licensing of technology was important. The guarantee that royalties could be repatriated, which validation provided, was thus an important inducement to potential foreign licensors.

Under the Foreign Investment Law and the orders and ordinances adopted under it, potential foreign licensors and foreign investors were obliged to undergo an arduous and complex validation process only partially prescribed by statute and largely subject to bureaucratic discretion. Usually, presentation of an application for validation was preceded by informal negotiations with officials of various ministries over the contents of the application, the terms of the technical assistance contract, or the nature and scope of the proposed investment. After submission of the application and review by the Bank of Japan, it would then be passed on to the appropriate ministries for further review and evaluation. During this entire process informal negotiations continued with the government in effect becoming a third party with whom the potential foreign investor or licenser was required to negotiate. The government perceived its role as protecting the Japanese party to the transaction and wrung concessions from the foreign party which the Japanese party could not win alone. After modification of the application and the terms of the proposed investment or license so that it met the requirements of various reviewing officials, the application was forwarded to the Preliminary Screening Committee of the Foreign Investment Council, an interministerial body, for further review and finally to the Foreign Investment Council itself for approval. Once granted, the validation imposed severe limitations on the scope of business and future activity. A change in the line of business or the nature of operation would usually require repetition of the same process. Sometimes the foreign investor would be required to enter into a formal undertaking with the government limiting future activity outside of the preapproved limits.

Cabinet orders, ministerial ordinances and internal regulations governed much of this process, but even more was left to official

\textsuperscript{18} Id. art. 10.
discretion. Although the regulations did not publicly set forth maximum royalty rates or percentages of ownership, practitioners in Tokyo who specialized in representing foreign enterprises knew with reasonable certainty what was likely to be accepted and what was likely to be rejected. For example, royalty rates in excess of five percent and ownership interest in excess of fifty percent were unusual. Furthermore, they followed shifts in official opinion closely to determine what new concession or what new demands the government might make. The broad scope of discretion exercised by Japanese officials was galling to foreign lawyers accustomed to Western, especially American, law which circumscribed official discretion with exacting standards. It was not so different from what could be expected in any underdeveloped country concerned with powerful outside business influences, but by the early 1960s it was incongruous in an economically revived Japan. By then, Japan had recovered from its post war economic depression, and it was able to compete with the other industrialized nations. Full recognition of Japan's recovery occurred in April 1964, when Japan graduated into the front rank of industrialized nations by becoming a full member of the OECD. Full OECD membership meant that Japan not only acquired the benefits of membership but also undertook, toward the other members, responsibilities which included liberalization of capital movements.\footnote{OECD Code of Liberalization of Capital Movements, Article 1(a). Japan did lodge reservations to the Code as it was entitled to do, and "direct investment" was among the categories reserved. Nonetheless, the overall significance of OECD membership placed a heavy burden on Japan to comply not only with the letter but also with the spirit of OECD membership. It has also been argued that the Treaty of Friendship, Commerce and Navigation Between the United States and Japan, Apr. 2, 1953, 4 U.S.T. 2063, T.I.A.S. No. 2863, imposed obligations on Japan to liberalize that were as significant as its OECD commitments. However, Japan's resolve to liberalize crystalized in the context of its OECD membership, not the treaty.}

This was more easily said than done. Through the validation process, Japan has been able to acquire new technology at low prices. Furthermore, through the validation process, Japan had been able to limit foreign equity participation and keep Japanese business largely free from foreign domination and control. Although the administration of the Foreign Investment Law went far beyond its original intent, it fit well into the Japanese experience of assimilating foreign cultures without challenging the nation's identity or fracturing its established social patterns. It also fit well into the nationalistic thrust of Japanese modernization. Carefully regulated exposure of the Japanese business world to foreign technology and capital posed few thorny questions of foreign encroachment, in-
increased international vulnerability and fierce domestic competition outside established well-known routines.

It is not surprising that Japan first moved backwards away from liberalization in contemplation of liberalization. Until 1964 foreign investors in Japan could, despite the Foreign Investment Law, establish a company without government approval so long as they were able to invest in yen and were willing to forego the guarantee that profits could be repatriated. That alone was sufficient to prevent many investors from organizing what were called yen-base companies, but it was an avenue for establishing a wholly-owned subsidiary in Japan for those who had long term objectives and foresaw improvements in Japan's international payments. In 1967, the Japanese government announced that it would no longer permit organization of yen-base companies by foreign parties without validation. This move was widely perceived as an attempt to blunt the effects of Japan's anticipated liberalization.²⁰ There was no foreign exchange rationale for requiring validation of yen-base companies, and this move demonstrated how the Foreign Investment Law had been transformed from an instrument for protecting Japan's foreign exchange into one of protectionism generally. It also showed how difficult it would be for Japan to fulfill liberalization commitments.

Japan's reluctant attitude had been evidenced earlier when it became a member of the OECD. Japan had agreed that it would "disapprove applications [for validation] only in exceptional cases where serious detrimental effects to the economy were to be feared."²¹ However in interpreting this language, the Ministry of International Trade and Industry [hereinafter referred to as MITI], one of the most influential ministries in the validation process, stated that "the basic policy shall be to permit capital induction so long as there is no particular interference with the national economy".²² At least as perceived by MITI, Japan's commitment still gave it considerable flexibility, especially when viewed from the perspective of Japan's long term historical interests. Japan had, however, made a commitment to liberalization, and some public action to fulfill this commitment was necessary if only to satisfy the complaints of Japan's trading partners, especially the United States.

²⁰ HENDERSON, supra note 13, at 255.
In 1967, three years after becoming an OECD member, Japan announced a program whereby liberalization of capital investments was introduced in a series of steps or rounds. The announcement in 1967 constituted only the first of these steps, but it also established the framework in which liberalization was to be defined. There were several important points. First, the essence of liberalization was neither elimination of the validation requirement nor eventual repeal of the Foreign Investment Law. Instead, liberalization meant relaxation of the standards of approval and simplification of the process. This relaxation and simplification was called "automatic" validation, although "less discretionary" would have been a more accurate term. The usual time for validation was to be shortened, government review was to be more cursory and negotiation between government officials and foreign investors was to be eliminated or at least minimized. Validation as it had been conducted was now called "case by case screening." Liberalization in this fashion was accomplished solely through modification of regulations and internal procedures without disturbing the statutory framework.

Second, the investments eligible for automatic validation were restricted. Investment in existing Japanese enterprises, except on a portfolio basis, was not eligible. Furthermore, the industries open to investment through a new enterprise were limited to designated categories. This classification was further divided into industries which were open to a maximum of fifty percent participation and those in which up to one hundred percent ownership was permitted.

Third, several conditions were made prerequisites to application for validation on an automatic basis. They prohibited automatic validation where investment in a new enterprise was a disguised takeover of an existing business through contributions in kind, transfers or leases. Furthermore, a business was not to be allowed to expand beyond the scope of the originally permitted activity without further approval. If the industry were only open to a fifty percent foreign investment, it was required that the Japanese investors have coequal control and that this control not be diluted by requiring greater voting requirement for corporate decisions than required by the Commercial Code. Likewise, Japanese interests were required to have at least an equal number of directors on the board and these directors were required to be Japanese citizens. Furthermore, in the case of an industry open only to a fifty percent investment, one of the Japanese investors was required to be in the

same business as the new company and to have at least one-third interest in the company. Finally, as provided by the OECD Code, an application for foreign investment could be refused automatic validation if it were determined to be extremely detrimental to the interests of Japan.

The context in which most foreign companies invested in Japan made these various restrictions unattractive. Until recently, most foreign companies found that the most profitable way to do business in Japan was to exploit technological superiority through manufacturing in Japan. The Japanese, for their part, were eager to acquire foreign technology. The simplest way to exploit the technology was to license it to an existing Japanese entity. However, the government was concerned by the prospect of technologically superior foreign companies using the lever of technology to strike unfair bargains which would burden Japanese industries with restrictive conditions, broad grant backs of technology, and excessive royalties. To prevent this, the government severely limited the terms and the royalties foreign licensors could impose in license agreements. As a result of this policy, a transfer of technology usually becomes financially attractive only when it could be tied to an equity participation in the Japanese licensee. This gave the licenser an opportunity to participate in profits as well. Therefore, foreign investment in a new Japanese company was often only an adjunct of a technology transfer. The transfer could either be through a contribution in kind of the technology for stock or a direct capital investment coupled with a license agreement. Where ownership was shared with a Japanese party, as was usually the case, the enterprise was labeled a joint venture.

In addition to being an explicit part of validation on an automatic basis, these conditions were often implicit in the standards by which proposed foreign investments were reviewed in general. They were also consistent with Japan's nationalistic economic goals. By requiring at least equal ownership and control for Japanese and by severely restricting investment in existing enterprises, they maintained Japanese control of Japan's own domestic industries. By further requiring that the Japanese party to the investment already be in the same line of business and by limiting the evolution

24. Under the Japanese Commercial Code, contributions-in-kind were extremely complex. Shoho (Commercial Code), Law No. 48 of 1899 (Japan). To avoid this, the company was usually organized with Japanese capital. It then purchased the technology from the prospective foreign investor who used the proceeds to purchase his stock. Although not strictly a contribution-in-kind, the term seems an appropriate shorthand way of describing the process.
of the business, they ensured the assimilation of the new entity into the existing framework of business and government relationship.

These same conditions, however, made a Japanese joint venture company prone to failure, whether approved by an automatic validation or through the more elaborate requirements of case by case screening. By not allowing investment in existing enterprises, risks were increased since the new enterprise had to recruit management and employees, obtain production facilities and create a distribution network. It often relied on its Japanese partners for management, employees, facilities and distribution. This allowed the Japanese party to dominate the new company. By requiring that the Japanese party be in the same line of business as the new company, the Japanese stockholder was probably a competitor or potential competitor of the foreign party, and the new joint venture company. Insofar as the Japanese were only interested in the technology and perceived no long term benefit from continued cooperation with the foreign party, the Japanese party could manage the company for its own benefit, siphon off profits through unfair arrangements for production or sales, or in some cases even adopt the technology and compete directly with the new company. Likewise, requiring co-equal control prevented the foreign participant from having control over corporate action and deprived him of practical remedies. Therefore the Japan partner often had little interest in the success of the joint venture. By further limiting the new company to its original line of business, it was less likely that the new enterprise could evolve and grow in a normal way. Instead it was more likely to become less profitable as the technology on which it depended became obsolete. The foreign party’s advantage often lay in the importance of continuing future transfers of knowledge and improved technology. Where a product was successful and the interest of Japanese and foreign parties could be kept in a healthy balance, successful joint venture enterprises could emerge. Just as likely if not more so, was the failure of the Japanese joint venture. In many cases, joint venture companies formed under these restrictions have been dissolved or the foreign participant’s interest has been sold to the Japanese party. Often in these cases the foreign party continued to license its technology, but without equity participation. It is worth noting in this context that the three most profitable foreign enterprises in Japan, IBM-Japan, Coca-Cola-Japan, and Nestle-Japan, are not joint ventures but are wholly-owned subsidiaries able to operate free from of many of these limitations.25

The final condition, that automatic validation could be denied where it was determined that it would be extremely detrimental to the interests of Japan, although acceptable under OECD Code, was an avenue by which Japan could retreat from its liberalization program whenever domestic political hostility to a particular investment was intense enough to warrant protective measures. Because of the close relationship between business and government, many feared that the government would be unduly susceptible to business pressure and would invoke this protection more than necessary. Furthermore, this condition emphasized that even automatic validations were ultimately discretionary. As liberalization has evolved, the government has not often found it necessary to use this reasoning to exclude a proposed investment.

After 1967, there were two additional rounds of liberalization, the second in 1969 and the third in 1970. Within the framework announced in 1967, each round expanded the number of industries open to fifty percent and one hundred percent investment. Each round was preceded by intense lobbying by business and bitter interministerial debate over which industries should be newly included. The industries finally opened were of apparently little interest to foreign business. One knowledgeable observer estimated that by the middle of 1971 after three rounds and four years of liberalization that, at most, $1,000,000 had been invested under automatic validations. The success of business in excluding any categories of interest attests to the strength of the relationship between government and business. Until 1971, Japan had apparently subordinated liberalization to its traditional interests.

The international business and diplomatic community was not blind to the lack of real progress during the first three rounds. Its dissatisfaction with Japan’s efforts to fulfill its commitments to liberalize was made known in clear terms. This discontent was exacerbated by Japan’s international trade and payments surpluses, especially with the United States, which even at that time were large. Therefore, by 1971, Japan was under heavy pressure to liberalize genuinely. In early discussions concerning the fourth round, the government formulated a program of fifty percent liberalization. Certain industries were to be excluded from the application of the fifty percent principle and others were to be open to foreign control and ownership up to one hundred percent. However, unless excluded, an industry was to be theoretically open to at least a fifty percent foreign investment. The familiar struggle between business and government and between ministries within the government was intensified since the industries which could be excluded were
limited in light of the international criticism of Japan. After months of negotiating and lobbying, the fourth round of liberalization was announced on August 3, 1971. In it, the Japanese government adopted "in principle" fifty percent liberalization. Unless stated otherwise, all industries were now open to automatic validation of up to fifty percent foreign ownership. At the same time, 220 industries were designated as open to foreign control. Certain industrial categories remained closed to investment except through validation obtained on a case-by-case screening basis. These categories had been reduced to the following seven industries: (1) oil refining and sales; (2) electronic computers and peripheral equipment; (3) data processing; (4) leather products; (5) retail sales involving eleven or more stores; (6) agriculture, forestry, and fishery; and (7) real estate. Furthermore, investment in certain additional fields was impliedly restricted in the belief that even the OECD Code did not require liberalization in these areas. These were industries such as communications, transportation, energy and national defense.

The framework established in 1967 was still intact. Investment in existing enterprises continued to be restricted, and the preconditions to applications for approval on an automatic basis continued to apply. It was uncertain at that time how the 1971 program would be applied. There had been enough juggling of numbers and bitter controversy preceding this round of liberalization to cause some observers to wonder, in light of the previous three rounds, whether the 1971 round was another in a series of exercises in futility.

In retrospect, the 1971 round of liberalization must be regarded as a genuine step forward. Although it did fall far short of complete liberalization, potential foreign investors found that it was often possible to obtain automatic validations under the streamlined procedures in approximately one month. It was still difficult to be precise in predicting government action, but obtaining validations had been simplified for practical purposes in many cases. Reflecting the change in mood, the process of acquiring a validation on a case-by-case screening basis also became easier after the 1971 round of liberalization.

The momentum of the fourth round carried the government

26. Id. at 245.

27. The government did undertake measures to prepare Japan for freer foreign investment. These included strengthened enforcement of Japan's Anti-Monopoly Law, Law Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade, Law No. 54 of 1947, as amended, with respect to international transactions and measures assigned to other domestic industries which faced increased competition. The most notable of these efforts was in the computer field.
into further consideration of complete liberalization in late 1972 after further intense government-business negotiations. On April 27, 1973, the Japanese government announced the fifth and final round of liberalization in a brief Cabinet decision. It stated that in light of Japan's economic strength and the importance of avoiding protectionism abroad, Japan would from May 1, 1973, "adopt the one hundred percent liberalization principle stipulated in the OECD Code." This decision provided that inward investment would be approved automatically except in certain situations. For the first time investment in existing enterprises was eligible for automatic validation, unless it was "unclear" whether the enterprise had consented to the acquisition. Finally, certain fields were to be completely liberalized at a future date specified in the decision. The most notable was the computer industry which was to be completely liberalized as of April 1, 1976. Of the pre-conditions to automatic validation, only one appeared to have any remaining validity. That was that the proposed investment not have an extremely detrimental effect on Japan. Certain industries continued to be open to investment only on a non-liberalized basis. However, the number had now been reduced to five: they were (1) primary industries related to agriculture, forestry and fisheries; (2) mining; (3) oil; (4) leather products manufacturing; and (5) retail trade operations in excess of 50% with less than 11 outlets. The other restricted industries implicitly continued to be closed under general OECD principles. Although a typical Japanese compromise between the competing domestic interests and international pressure could be discerned in this announcement, Japan appeared to have largely lived-up to the spirit of the OECD Code by 1973.

No one could have predicted the Arab-Israeli war in late 1973, the Arab oil embargo and the quadrupling of oil prices in early 1974. These events disrupted both the Japanese and international economies, and Japan entered a period of recession and high inflation. Thereafter, currency adjustments and the high relative value of the yen made Japan one of the most expensive and least attractive nations in which to invest. Furthermore, the technological gap between Japan and other countries, especially the United States, had been narrowed, and there was less technology that could be profitably exploited. Therefore, after 1973, large scale foreign interest in investment in Japan largely evaporated.

It is difficult to assess the genuine impact of the 1973 round in this context. For the investment which now occurs, it is generally

28. Henderson, supra note 13, at 94.
expected that most applications for validations will be given a routine review and that approval can be secured in approximately two weeks. Therefore, validation no longer appears to represent a serious obstacle to investment. The validation requirement has occasionally been utilized to halt an investment which poses an apparent threat to established Japanese concerns. In one celebrated case, Dow Chemical was unable to get a validation for a plant in Japan as a result of protests by large domestic producers who complained of a depressed domestic market and dire financial situations. Although the record is inconclusive it generally supports the proposition that foreign capital for practical purposes can now freely enter Japan.

Even if foreign investment controls are largely history, the effects of a quarter century of restriction on foreign trade and investment are still very much present. During this long period American and other foreign companies, with a few notable exceptions, have been unable to exploit inherent advantages, to invest in domestic companies and wholly-owned subsidiaries and to play a significant role in the Japanese market and the Japanese economy. Overcoming this heritage must be a long-term process.

4. PROSPECTS FOR THE FUTURE

In 1965, Professor Lockwood wrote, "(i)n short, when the Japanese bargain abroad for markets today they do so as a powerful, prosperous people no needier of markets than many others. They can hardly plead for trading opportunities abroad unless they are prepared to grant reciprocal benefits at home." This statement is still relevant today. When written, these words referred to the completely protectionist nature of the Japanese policy, both as to trade and capital movements. Today they could refer as well to the trade imbalance which, in part, is the result of Japan's protectionist history.

Apparently, Japan is moving toward an open trade policy, and official statements recognize the need for change. In a White Paper published in 1978, MITI acknowledged that Japan's large trade surplus can only be reduced through increased internationalization of the Japanese economy, especially through emphasis on increased imports of manufactured goods. Similar sentiments were recently addressed by Mr. Shenji Fukukawa, Director of the Policy Planning

Office, Ministerial Secretariat of MITI. Furthermore, some observers believe that trade restrictions are a thing of the past. If MITI's public position signals a genuine change in attitude, the prospects for eventual progress in trade liberalization are good. There are some indications that this may already be occurring. Japan has unilaterally eliminated or reduced certain tariff and trade barriers and allowed the imports to increase at a rapid rate. At the same time trade representatives to Japan have encountered continuing resistance to the import of finished and manufactured goods. Japanese businessmen are heard to ask why Japan should import goods which it can manufacture at home, and government bidding procedures apparently appear to favor domestic suppliers.

The dichotomy in Japanese attitudes was apparent in a recent Wall Street Journal advertisement entitled Dialogue with Japan, in which representatives of Japanese industry responded to questions posed by American readers. In response to a question about Japanese imports costing Americans jobs, Mr. R. Hosokawa of the Mainichi Newspaper delivered a persuasive argument for the comparative advantage of importing low cost goods and warned against the danger of protectionism. However, in responding to another question concerning Japanese restrictions on beef imports, Dr. H. Kato, Professor of Economics at Keio University, took a different position. He answered by reminding readers of the importance of the people employed in the beef industry in Japan, and he proposed that import restrictions be lifted gradually only after the Japanese beef industry had sufficiently rationalized production so that it could meet import competition. The inconsistency of these two positions is apparent, and they suggest that many Japanese still do not perceive free import trade as the inevitable corollary of open export markets.

Several lessons learned from the history of Japan's capital liberalization can be applied to predict the course of trade liberalization. First, domestic political considerations make relaxation and removal of restrictions difficult. Second, Japan is likely to respond to persistent and sustained international business and diplomatic pressure. Third, under this pressure, Japan will probably make concessions, albeit reluctantly and gradually. Fourth, even after the removal of restrictions, it may take many more years to rectify the

34. Dialogue with Japan, supra note 7.
economic distortions and imbalances that have developed in the relatively protected atmosphere of the past.

On a private level, the foreign lawyer should be careful in studying trade liberalization to discern the import of changes in statutes, regulations and official conduct, not only from a legalistic perspective, but also in the perspective of the shift in current Japanese policy. This shift should be seen against the backdrop of the history of Japan's modernization, postwar economic expansion and progress toward economic integration with the international economy. A lawyer should also be alert to the possibility that trade liberalization may be retarded if external events threaten Japan's trading position or if a reduced payments deficit causes countries such as the United States to shift attention to other matters. He must also consider the potential dangers clients may face in dealing with different points of view within the Japanese government in a time of policy change.

On a national and diplomatic level, both Japan and the United States must continue to regard correction of the large trade imbalance as a serious problem. Trade representatives such as the United States Assistant Secretary of Commerce, Mr. Weil, have commented that the Japanese believe that the United States' threats of protectionism are bluffs in the poker game of trade negotiations between the two countries. If Japan believes that with time and patience the United States and other countries will lose interest when attempts at rapid solutions fail, then U.S. policymakers must match Japanese persistence and undertake a long term commitment to finding needed solutions. This must be done with the understanding that in light of Japan's many years of trade and investment restrictions, solutions to the present imbalance will be long term ones to which the United States should be committed. They should also realize that powerful domestic political considerations in Japan make rapid progress unlikely. Policymakers should not lose sight of these long term solutions even in the midst of formulating palliative measures to cope with the current situation.

Japan's trading partners must be patient and persistent. The Japanese for their part must overcome their chronic insecurity and be persuaded of the benefits at home, as well as abroad, of free trade and an open international economic order. They must recognize the quid pro quo which is essential to this structure so that they may voluntarily accept the commitments of GATT, OECD and IMF, not only in the letter, but also in the spirit in which they were written.