THE LIMITS OF THE GATT: PRIVATE PRACTICES IN RESTRAINT OF TRADE

Coalition for Open Trade
(COT)
1991

CONTENTS

> **"[I]f trade is to increase as a result of the lightening of government restrictions, the governments concerned must make sure that it is not restrained by private combinations."**

-U.S. Proposals for an International Trade Organization (1945) [1]

I. INTRODUCTION

With the reduction in tariffs and other formal trade barriers in the post-War period, international trade has grown dramatically. The world has prospered. It would be folly, however, to believe that the movement of goods, services, and capital is entirely free.

As formal, government-imposed barriers have been eliminated, the importance of informal and private barriers has grown. Of particular and growing importance to U.S. manufacturing industries are the many anticompetitive practices that are ignored, accepted or, in some cases, sanctioned by major trading nations.

This paper provides an overview of these practices and the ways in which they limit international trade and otherwise harm U.S. interests. It then preliminarily explores some possible responses. The purpose of this paper is to place these issues squarely on the U.S. trade policy agenda to encourage resolution. The various types of anticompetitive practices are described by category. Although the categories frequently overlap, this organization provides a useful method of studying restrictive business practices. The focus, for the most part, is on developed countries, since it is the anticompetitive activities taking place in these countries that most distort world trade. Most of the restrictive practices documented below, however, can also be found in the many less developed countries (LDCs). While the commercial policies of LDCs often include formal anti-import measures which render private restrictions superfluous, in some cases import-restricting measures are carried out by or through private companies. Local producers, for example, may be given approval rights over imports or a monopoly on import distribution. In any event, LDCs typically lack the vigorous antitrust enforcement (indeed, they may lack antitrust laws entirely) so necessary to an open international trade environment.

The paper's focus on foreign trade barriers is not a denial that the United States has barriers of its own. Foreign participation in the U.S. economy is limited in some areas by law, such as in broadcasting and nuclear energy. Private anticompetitive activities also exist in the United States. But U.S. antitrust and competition policies have been strictly enforced, and there has been no claim that U.S. private restrictive practices are adversely affecting international trade.

Even a cursory review of trade flows and industry concentration ratios makes clear that U.S. antitrust efforts have been considerably more effective than those of our major trading partners. This asymmetry has generally worked to the benefit of foreign producers (albeit not foreign consumers). Where the effect of private anticompetitive activities on international trade is concerned, U.S. commercial interests have been the net losers from inadequate global antitrust enforcement.

II. PRIVATE PROCUREMENT

A major problem facing companies seeking to do business abroad is the existence in foreign markets of large industry groupings, bound together by cross-shareholding, common directors, and other ties. The most prominent examples of such industry groupings are Japan's keiretsu and Korea's chaebol. These business and industrial groupings, while not necessarily illegal under Japanese and Korean law, work to exclude outsiders because their members purchase within the group whenever possible. Entry into these groups by foreigners is very restricted.

***Keiretsu* Nature.** The largest and best-known *keiretsu* are *kinyu* (financial)*keiretsu.* There are six of these: Mitsui, Mitsubishi, Sumitomo (these three are successors to the pre-war *zaibatsu*), Fuyo, Sanwa and Dai-Ichi Kangyo.[2] There are also *ryutsu* (distribution) and *kigyo* (industrial or enterprise) *keiretsu*. Among the best-known *kigyo keiretsu* are Toyota, Nissan, Nippon Steel, Hitachi, and Matsushita.[3]

Keiretsu are often described as vertical or horizontal. This distinction refers to the direction of company relationships within the group. In the case of a vertical *keiretsu*, the activities of the member companies revolve around a large primary company, often a manufacturer. By contrast, a horizontal *keiretsu* is a conglomerate of companies involved in a diverse range of business activities and industries. Typically, horizontal *keiretsu* are organized around trading companies or banks. Some horizontal *keiretsu* include vertical subgroups as part of the horizontal grouping. This phenomenon can be seen in Figure 1, which shows the various vertical sub-groups comprising the horizontal Mitsubishi *kinyu keiretsu*. Figure 2 details a typical *kigyo keiretsu*: that of NEC.

Each *keiretsu* is composed of companies with tightly knit inter-relationships, partly as a result of interlocking ownership. On average, 23 percent of the shares of a *keiretsu* member are held by other companies in the same *keiretsu*. Among the large shareholders, the percentage of internalization of ownership is even higher. Mitsui, Mitsubishi and Sumitomo provide good examples: 55 percent to 74 percent of the shares held by each group's top twenty shareholders are held within that group.[4] As a result of these extraordinarily stable shareholdings, an estimated 70 percent of the stock listed on the Tokyo Stock Exchange does not change hands.[5]

The chief executive officers of core *keiretsu* members participate in a Presidents' Council *(shacho-kai),* and meet regularly to report on new products, resolve disputes, or discuss group-wide projects. One Japanese businessman who preferred to remain anonymous described the relationships among Japanese firms as follows:

> Over 90 percent of the companies in Japan are small or medium-size businesses. In some sectors they're not as tightly controlled as in manufacturing, but if you look closely, almost all of them are dominated by some large company.[6]

In essence, the Japanese economy is dom-inated by a limited number of closely integrated conglomerates which often serve to exclude outsiders from the Japanese market.

Keiretsu purchasing practices. The central truth of *keiretsu* purchasing behavior is captured by an oft-repeated statement of a Japanese businessman:"We buy first within our group, then within Japan and only as a last resort from foreigners."[7] In its First Annual Report on the Structural Imped-iments Initiative (SII), the U.S. delegation stated: "the U.S. Government believes that keiretsu relationships often tend to foster preferential group trade, anti-competitive activity, and impede foreign direct investment (FDI)."[8] Even the GATT Council has drawn attention to "the difficulties exper-ienced by foreign suppliers in establishing their products on the Japanese market because the anti-competitive practices of certain Japanese firms were not adequately addressed."[9]

The operation of the *keiretsu* system can best be judged by looking at specific examples. The auto parts sector is one in which *keiretsu* purchasing practices are especially significant. As the Auto Parts Advisory Committee, a national advisory committee created by the Fair Trade in Auto Parts Act, concluded in 1990:

> The most important *keiretsu* forms in the automotive industry include: inter-market groupings involving vehicle producers with a broad range of commercial and financial firms; intra-market, or vertical groupings of Original Equipment Manufacturers (OEMs) and their subsidiaries and affiliates; cooperative associations of suppliers created by OEMs; and specialized distribution groups. . . . Because of this long-established sourcing pattern, it is extremely difficult for any outside (U.S. or Japanese) supplier to become a major supplier to a major Japanese vehicle manufacturer with which it

> has no previous business relationship.[10]

Enforcement of restrictive procurement practices by the groups is highly effective. Companies are cautious about engaging in business outside of the group. For example, in one reported incident, a U.S. construction contractor had to dress the em-ployees of a Japanese subcontractor in the con-tractor's uniforms to prevent the subcontractor's normal Japanese contractor from finding out that the subcontractor was doing work for a U.S. firm.[11]

Role of trading companies. A unique feature of Japanese import trade is the extent to which it is dominated by trading companies, many of which are affiliated with *keiretsu*. The trading companies' share of Japan's total imports, already large, has been growing sharply in recent years. In the late 1980s, the top nine general trading companies were handling about three-quarters of Japan's imports.[12] In fact, the trading companies have even "taken on some of the coordinating and `flagship' roles performed in the pre-war years by the zaibatsu holding companies."[13] Despite the size and prominent role of the trading companies, however, it is actually their weakness that underlies the negative effect on imports into Japan. The U.S. International Trade Commission (ITC) has cited the "group affiliations of the trading companies," and has noted that their financial ties to other *keiretsu* members

> limit the trading companies' freedom of action. These giant firms often find themselves constrained in what products they can import, under what terms they will be sold, and how much market share they can seek for those imports. . . . Some observers have suggested that control by Japanese firms over U.S. bilateral trade flows has impeded U.S. suppliers from reaping the full benefits of Japan's current import boom, and from establishing the type of long-term relationships which are crucial to sustained business with Japanese corporations.[14]

The steel sector is one of many in which the all-important trading companies C and their close cooperation with manufacturers C can lead to the suppression of imports. For example, three employees of a trading company were reported to have been abruptly transferred to other sections of the company for importing steel without the approval of Japanese steel manufacturers.[15]

Effect on trade. To understand the dramatic effects that *keiretsu* purchasing policies have on trade, one must understand the enormous economic power of these groups. According to the ITC, the 193 firms that participate on the executives' councils of Japan's six financial *keiretsu* account for about 15 percent of the total assets of the Japanese economy and 17 percent of total sales. If subsidiaries and affiliates C the *keiretsu* rank and file C are taken into account, the number of firms included increases more than five-fold, to over 1000 (and the percentage of total Japanese assets and sales is accordingly much higher).[16] In heavy industrial sectors, intra-*keiretsu* transactions have been estimated to account for 35 percent to 50 percent of total trade, a figure which excludes transactions with vertical *keiretsu* affiliates. "[T]he overall average internalization including both [horizontal and vertical] keiretsu forms, is likely to surpass 50 percent of firms' total trade."[17]

Considering the extent to which *keiretsu* dominate the Japanese economy, one would expect pre-ferential purchasing arrangements to have a major effect on trade. A recent groundbreaking study of the effects of Japan's *keiretsu* on imports and exports confirms this suspicion. Economist Robert Lawrence of the Brookings Institution found that Japanese industries dominated by horizontal *keiretsu* were marked by low imports. In addition, these horizontal *keiretsu* were not associated with higher export shares. This latter finding, as Lawrence noted, tends to negate the thesis that the low level of imports resulted from the efficiency of local producers. Lawrence concluded that Japan's 1985 manufactured imports would have been as much as $35 billion higher but for the existence of the keiretsu.[18] (He also noted, however, that if import-reducing effects were actually eliminated, the yen would very likely depreciate and offset some of the predicted difference.) Lawrence explained why the *keiretsu*, structure is troubling whether or not there is blatant, detailed evidence of anticompetitive activities.

> The import results could reflect collu-sive behavior by *keiretsu* firms. However, it is not necessary to resort to an intricate conspiracy theory to account for them. It is also not necessary to believe that *keiretsu* firms refuse to deal with outsiders and/or are unresponsive to price differences. There could be discrimination against imports, simply if, everything else being equal, *keiretsu* members prefer to buy from other *keiretsu* members. As the theory of discrimination makes clear, preferences for discrimination need not be absolute.[19]

Prospects. It is not likely that the problems the *keiretsu* present for U.S. exporters will be re-solved any time soon, particularly if the pattern of non-implementation of promised reforms conti-nues. In the first round of the SII, the Japanese government made a number of commitments regarding the *keiretsu* system, including a general statement that it "intends to make Keiretsu more open and trans-parent and to take necessary steps toward that end."[20] As the U.S. delegation noted in its first annual SII report, however, outside of certain lim-ited measures "the GOJ [Government of Japan] has not appreciably furthered the agreed goals of the SII process in the keiretsu area." [21]

Berkeley professor Michael Gerlach draws an apt analogy: "Telling them to dismantle the keiretsu is like telling Americans to rip up their credit cards. It is fundamental to the way business has been done in Japan."[22]

Chaebol

The *keiretsu* may be the most dramatic example of the effects that industrial concentration and restrictive intra-group trading can have on trade, but they are not the only example. In Korea, it is the *chaebol* which dominate industrial activity. A *chaebol* has been defined as "a family-owned and managed group of companies that exercises monopolistic or oligopolistic control in product lines and industries."[23]

The degree to which the *chaebol* dominate the Korean economy is quite remarkable. According to the World Bank, the top ten *chaebol* accounted for over 30 percent of Korean manufacturing in 1982. As the Bank noted, "The rise of oligopolies in particular points to the prevalence of industrial groupings tending to establish dominant positions in a variety of industries . . . ."[24] Unlike the *keiretsu*, the chaebol do not center on a financial institution (a role played by the government).

The effects of the *chaebol* on trade have been studied less than those of the *keiretsu*. There is evidence, however, that the *chaebol* have used their dominant position in the Korean economy to control imports. For example, one press report indicates that when import restrictions on refrigerators were removed in 1988, three *chaebol* obtained control of refrigerator distribution and charged consumers several times the landed price.[25] The negative effects of such pricing practices on import volumes are obvious.

III. CARTELS

There are an enormous number and variety of cartels operating around the world. Sometimes they operate with official sanction, while in other cases they are ostensibly illegal but are allowed to operate nevertheless. These cartels take a variety of forms, including traditional price/production cartels, import cartels, export cartels, and public pro-curement cartels. So long as they benefit from formal or informal import restraints in their own markets, these cartels are capable of (and often successful in) altering trade flows to the disadvantage of foreign firms and workers. In many cases, some of which are discussed below, cartels restrict U.S. exports to (or artificially encourage importation into the United States from) important U.S. trading partners.

European Community

Efforts to strengthen European Community (EC) competition laws and antitrust enforcement have received significant attention over the past few years, and there can be little doubt that these efforts have borne some fruit. Nevertheless, the EC market continues to be characterized by a high degree of private restrictive activity.

It is not uncommon for EC countries, and even the EC itself, explicitly to authorize the formation of cartels. For example, there were over 300 legalized cartels in West Germany as of January 1987. [26] These cartels involved varying forms and degrees of cooperation in industries including machinery, transportation equipment, steel, electronic equipment, and stone and clay. A positive correlation has been found between the existence of these cartels and price increases.[27]

Steel. An extreme example of an officially authorized cartel is one which existed, until relatively recently, in the EC steel industry. An EC steel cartel was formed by the European Commission after the steel industry plunged into crisis in 1974. Under the cartel, the Commission set national production ceilings and minimum prices for some products. Eurofer, a private industry group, coordinated these policies for the industry with the EC, allocating production quotas among member companies and setting prices in excess of Commission-prescribed minimums. The Commission had, and used, the ability to sanction cartel breakers.[28]

Evidence suggests that the steel cartel had an adverse impact on international trade in steel products. Exceptions to production and price controls, for sales outside of the EC, encouraged producers to export excess capacity. Import quotas ensured that EC steel prices were not undercut by imports, enabling EC producers to export surplus production at low prices (cross-subsidized by monopoly rents from domestic sales).[29]

While the formal steel cartel has been phased out, the EC Commission has rejected proposals by EC competition officials to amend or abolish the European Coal and Steel Community (ECSC) Treaty. As a result, EC officials retain the ability to reinstitute production/price monitoring and controls should conditions in the industry once again worsen.[30]

Even without formal cartel arrangements, there is evidence that private anticompetitive arrangements remain in the EC steel industry. It was reported on July 4, 1991, that "European Commission officials, suspecting an illegal steel industry monopoly, have raided the offices of Eurofer as well as those of all the leading European Community steel groups."[31] An EC official explained that "the raids are due to suspicion that all the major firms have been working to control production and de-livery, which can mean controlling prices too.'[32]

EC competition officials in the past several years have also investigated market sharing cartels in the structural, rebar, oil country tubular goods, and stainless flat-rolled sectors. (In the stainless flat-rolled case, *de minimis* fines were imposed because a strong case was made that EC officials were fully aware of the existence of the cartel.)[33] British Steel indicated, in a 1988 financial prospectus, that 17 percent of its turnover consisted of products in which "arrangements" existed.[34] As recently as May 1991, an EC official noted that "[t]he steel industry is particularly prone to market-sharing agreements . . . . [T]here is a tendency to share markets when faced with greater competition.'[35]

Heavy electrical equipment. In spite of their success in other markets, U.S. producers of heavy electrical equipment did not win a single order from an EC purchaser in a country which had a domestic production base between 1975 and 1988. (By comparison, during that period, imports accounted for 10 to 20 percent of U.S. consumption of large power transformers, and 10 to 25 percent of U.S. consumption of steam turbine generators.)[36] While the low level of EC heavy electrical equipment imports is due in large part to "buy national" policies, both the closure of the EC market and the relative success of EC firms in third-country markets are reported to result in part from private restrictive activities.

In this case, the producers' group has a name: the International Electrical Association (IEA). Formed in 1936 in Lausanne, Switzerland and still based there, the IEA is "a grouping of the major electrical companies of Europe; a trade association to some, a cartel to others.'[37] The group is not exclusively European; U.S. companies initially participated, but were compelled (as a result of the U.S. antitrust laws) to withdraw after World War II. More recently, six major Japanese firms reportedly joined the IEA, and by 1979 accounted for 25 percent of the dues collected by the group.[38]

A 1980 report prepared for the U.S. House of Representatives accused the IEA of dumping equipment on the U.S. market with the aim of undermining the U.S. heavy electrical industry. At about the same time, a detailed account of the group's underlying contractual arrangements underscored

> the possibility that the IEA will extend its scope directly to the United States and subject certain product markets via its joint ventures and subsidiaries to some or all of the restrictions in the cartel contracts. . . . [E]ven though United States markets are excluded explicitly from the contractual coverage of the IEA, the agreements among European and Japanese members raise questions of legitimate concern for United States public policy.[39]

The IEA's primary achievement, reportedly, was to keep U.S. firms from winning contracts overseas. This was particularly true in developing countries; IEA members are reported to have bid collusively for projects in the third world, thus blocking U.S. sales. [40] In addition, analysts concluded that the IEA was responsible for declining U.S. exports to the (mostly EC) home countries of its members. "In the presence of the international cartel, it is understandable that the market share of United States exports going to cartelized countries has fallen during the last decade." [41] The situation was summarized in 1979:

> There is incipient evidence that consequences of IEA activities already have been felt. These include: (a) reduction in U.S. exports, (b) loss of U.S. technological leadership and independent domestic manufacturing capability, (c) reduction in potential or actual competition, and (d) the possible extension

> of some aspects of the cartel into the United States.[42]

Recent reports suggest that IEA activity continues. Given the ongoing private practices in this industry, a pending EC Directive supposedly opening the procurement market for heavy electrical equipment may prove disappointing.

> Whatever the truth may be about the present-day activities of the IEA, the heavy electrical industry is suspected of cartelization. At the very least, it is an industry which has strong international links, with a complex web of co-operation agreements backing up actual mer-gers and takeovers. It is perfectly possible that by the end of the 1990s, there will be no more than a handful of major companies in the market. An open procurement system will provide no protection against the operation of cartels; it could even facilitate it. [43]

Soda ash. The European market for soda ash, a chemical used in glassmaking, chemicals, and detergents, has been dominated by two firms recently cited by the EC Commission for abusing their market power: ICI of Britain and Solvay of Belgium. Under a decades-old market-sharing arrangement, ICI was allocated the U.K. and Irish markets, while Solvay was allocated the continental market. Currently, ICI and Solvay hold 90 percent and 70 percent of their respective markets. Although these territorial allocations were theoretically abolished decades ago, the EC Commission in April 1991 found the firms guilty of exclusionary practices and abuse of market power.[44] The Commission imposed on ICI, Solvay, and a third company fines totalling 48 million ECUs (almost $55 million), the largest such fine it has ever imposed. [45]

U.S. producers appear to be ideally situated to supply the European soda ash market. Because of the huge advantage U.S. producers of natural soda ash have over European producers of synthetics, U.S. prices for soda ash are substantially lower than those prevailing in the European market. (Sometimes U.S. prices reach as low as one-half of the European market price.) The elimination of prohibitive dumping duties in 1990 would thus seem to have opened the door to a dramatic increase in U.S. exports.

In fact, such optimism may not be justified. For example, the EC has indicated that it will mon-itor U.S. soda ash prices and will re-impose a duty if it detects any "unfair" activity. [46] Even more troubling is the clear sense of European soda ash consumers that their continued access to domestic supplies depends on limiting purchases from foreigners. In May 1990, Mr. Roger Deschodt, a soda ash "agent" testifying on behalf of his company RODESCO before the EC's Directorate-General for Competition, summarized the problem with the following anecdote:

> One glass customer asked us last year, when he was on the point of renewing his contract with the local Belgian pro-ducer, to look for another source for soda ash and mentioned the U.S. He asked us whether we could look out for product for him from the U.S. He said he couldn't do it himself because he didn't want to sever relations with his present supplier because he could retaliate and increase his price. . . . The individual glass producers are afraid of retaliation from the dominant soda ash producer and if they use agents like myself they don't expose themselves.[47]

Japan

The general attitude toward cartels in Japan, although arguably evolving slowly, is very tolerant. Consider the comments of Konosuke Matsushita, the founder of Matsushita Electronics, who declared in 1966:

> [T]here used to be no opportunity [in the electric appliance industry] for Presidents from each company to meet and talk. As you know, in other big industries, Presidents constantly meet with each other and discuss the direction that should be followed by the whole industry. Quite naturally, questions also come up as to what quantity to produce. But, where electric appliance manufacturers are concerned . . . there used to be no summit talks. This is very strange indeed. I think that responsible men should meet at least once a month and talk about management for the purpose of stabilizing the industry at all times.[48]

The tolerant Japanese attitude is reflected in the existence of mechanisms for the legal recognition of cartels. Japan's Antimonopoly Law, adopted during the U.S. occupation and modeled closely on its U.S. counterpart, has been amended to allow for the creation of "depression" and "rationalization" cartels subject to the approval of the Japan Fair Trade Commission (JFTC).[49] In addition, the Ministry of International Trade and Industry (MITI) has obtained the enactment of "bypass' laws that authorize the formation of cartels under the supervision of agencies responsible for particular industries. By 1983, cartels formed under bypass laws numbered 19,762, in contrast to 265 under the Antimonopoly Law.[50]

According to the recent report of an official Japanese government study group, 68 "areas" were exempt from the application of the Antimonopoly Act as of April 1991. Fifty-six of these cases involve price or production cartels, most (90 percent) of which were "introduced in the period from the late 1940s to the early 1960s." The study group concluded that "exemption of certain cartels from the Anti-Monopoly Act and the official regulation over resale prices of certain products *restrict price competition and block efforts at industrial adjustments.*"[51] (Emphasis added.) The group's recommendation to the JFTC reportedly will call for all cartels blocking structural adjustment to be outlawed.

By some accounts, officially recognized cartels have become a less severe problem in recent years. One analysis, citing JFTC documents, reports that the percentage of manufacturing shipments covered by formal (legal) cartels declined from 28 percent in 1963 to 18 percent in 1973 and estimated that it had fallen still further by 1989. However, the authors candidly acknowledge that "we do not know to what extent legal cartels have been replaced by illegal ones."[52] This observation underscores the problematic record of enforcement C more accurately, the record of non-enforcement C by Japan of the Antimonopoly law against *illegal* cartels. Because treble damages are not available for antitrust violations in Japan, and there are virtually no single-damage actions brought by private parties, antitrust enforcement has been left almost exclusively in the hands of the JFTC.[53] A thorough 1989 analysis noted that a criminal antitrust pro-secution "may be commenced only after accusation by the JFTC itself. To date, the JFTC has rarely initiated criminal proceedings." During 1987, for example, there were no criminal prosecutions at all.[54]

Civil actions by the JFTC, while more common than criminal cases, are too sporadic and carry fines far too low to achieve their supposed deterrent purpose. In 1987, for example, the JFTC investigated 194 cases and found 118 violations of the Antimonopoly Law. Very little, however, was actually done in these cases. The JFTC issued six recommendations (to desist from conduct violating the Act) and 112 warnings, while a total of 54 persons in six price cartel cases were ordered to pay fines totalling $1.2 million.[55]

There has been some improvement. For example, the number of formal JFTC recommendations increased to 7 in 1989 and to 22 in 1990.[56] In 1990 the assessment of surcharges totaled a record $71 million, and the number of warnings increased to 18 from 12 in 1989.[57] Moreover, the statutory surcharge level has been increased from between 0.5 percent and 2 percent of the sales involved in a violation to between 1 percent and 6 percent.[58] While encouraging, however, these changes are wholly inadequate to deter collusive behavior by Japanese firms. The U.S. Government has sharply criticized Japan's performance in this area, noting in particular the inadequacy of the statutory fines and the low level of public and private enforcement.

By no means has the Japanese government's role been limited to inadequate policing. In many cases, the government has directly encouraged or even required cartelization, including collaboration on price, production, or research. MITI official Kosuke Yamamoto, in the course of describing the differences between MITI and the U.S. Department of Commerce, put the matter bluntly: "Unless we get industry together on something, we simply cannot implement a decision.'[59] Michiyuki Uenohara, formerly director of research and development at NEC and now a high-level adviser to the company, explains why MITI's active role persists.

> R&D resources in the world are scarce; even big companies scream for these resources. If we don't collaborate, we can't advance. It's too expensive even for NEC. MITI is the third party needed to coordinate industry.[60]

Japanese import cartels have been reported in a number of industries, particularly raw materials sectors. In some cases these import cartels are officially authorized. More frequently, however, import cartels are simply tolerated or tacitly encouraged by the Japanese Government. The GATT Secretariat recently drew attention to Japan's Export and Import Transaction Law, noting that

> it permits, under certain conditions, importers to form cartels with a view to regulating import prices, quantities and other factors so as to avoid excessive import competition or for other specified purposes. The cartels must be approved by the Minister of International Trade and Industry, in consultation with the Fair Trade Commission. Upon appro-val, the cartels are exempted from appli-cation of the Japanese Anti-Monopoly Law.[61]

Export cartels, in which Japanese producers collude on supply and pricing decisions in foreign markets to minimize competition among themselves while energetically competing against foreign producers, have also been reported in some sectors. Finally, and most notably in the construction sector, collusive bidding for public contracts is reportedly carried out by public procurement cartels.

Silicon and polysilicon. In the 1980s, Japan, reportedly through a policy of industrial targeting, achieved a position of dominance in the production of silicon wafers and polysilicon, the basic building materials of the semiconductor industry. The High Purity Silicon Issues Study Group, formed in 1983 and consisting of MITI and representatives of the silicon industry, developed a series of strategic re-commendations calling for expansion of domestic production, entry of new companies into the poly-silicon field, capital investment in foreign makers, joint R&D projects, standardization of wa-fer pro-duction, and strengthening of ties with down-stream users. A 1985 Report by this Group noted that

> it is difficult to say precisely what form cooperation should take between the sili-con industry and down-stream indus-try. However, it is clear that there must be serious discussions between the two industries about where the line dividing their responsibilities should be drawn.[62]

What followed was a massive MITI-led expansion in silicon, at a time when the market was already depressed, leading one U.S. observer to comment:

> Is the world so short of silicon wafer capacity that all this new MITI-induced investment is necessary? Hardly. . . [T]he new Japanese push is inspired not by visions of an untapped market but by a national decision that Japan ought to try dominating this already well-established market.[63]

At the same time, Japan engaged in a huge capacity expansion effort in polysilicon. Worldwide capacity in 1985 was about 4500 metric tons a year, which was roughly commensurate with world demand. Between 1985 and 1987, Japanese firms added approximately 2500 metric tons of capacity while world demand grew by only 500 tons. The result was oversupply and a collapse in the world price. By 1989, it was reported that world polysilicon plants could "churn out more of the silver-gray stuff than anyone needs.'[64]

Union Carbide, a U.S. pro-ducer of polysilicon, filed in a U.S. district court an antitrust complaint containing specific allegations of anticompetitive actions by Japanese silicon firms.[65] These allegations, however, were never explored by a court. Before the case could go to trial, Union Carbide's polysilicon operation was acquired by one of the alleged conspirators, Komatsu Electronic Metals, and the complaint was withdrawn.

With the Carbide sale, Japan's world market share in polysilicon rose to 45 percent, and the U.S. share fell to 30 percent (actually less, since one of the two remaining U.S. firms was partially owned by Japanese producers). In the words of one observer, these developments "put the U.S. on a potential course to silicon oblivion.'[66] These fears proved to be well-founded when, in 1989-90, Japanese companies purchased the silicon operations of their largest U.S. competitors. Following these purcha-ses, three Japanese firms C Shinetsu Hundotai, Osaka Titanium, and Mitsubishi C became the largest manufacturers of silicon wafers in the world. The Japanese share of the world merchant wafer market had grown to 72 percent.[67]

Semiconductors. In cooperation with MITI, Japanese producers of Dynamic Random Access Memory (DRAM) chips in the mid-1980s are re-ported to have pursued a coordinated production and trade stra-tegy. Following an extremely costly period of dumping and price suppression, which succeeded in driving once-preeminent U.S. firms from the mar-ket, the Japanese producers reportedly agreed to curtail output and thereby stabilize prices. Despite a DRAM glut and massive overcapacity, these agreements generated significant increases in the price of DRAMs to consumers.

Immediately prior to the 1986 U.S./Japan Semiconductor Agreement, with most U.S. firms driven from the market, there was little competitive brake to these price manipulations. According to one Japanese account, "each company refrained from price-cut competition and stepped in to increase the price one after another, therefore pro-spects for drastic improvement of each company's profit for 1986 is certain [sic].'[68] Arrangements among producers were also, in part, facilitated by the Government of Japan, through the MITI guidepost system (under which the Ministry "predicted" output and pricing decisions).

Japanese dumping in the DRAM market, to-gether with problems in other semiconductor pro-duct markets, gave rise to tremendous bilateral trade friction, trade litigation, and ultimately the 1986 Semiconductor Agreement. The Agreement, however, only partially alleviated trade pressures. In particular, the opening of the Japanese market which was promised to the U.S. industry did not fully materialize. Then-Senator Pete Wilson (R-CA) concluded in 1988 that "Japan is following the too-well-beaten path of protected home markets and concerted anti-competitive behavior." [69] A second Semiconductor Agreement was negotiated and signed on June 11, 1991.

Soda ash. In 1973, in conjunction with a decision to change their method of production, four Japanese soda ash producers entered into a secret agreement designed to enable them to regulate the flow of imported soda ash into the Japanese market while they struggled to regain international competitiveness. Acting through the Japan Soda Industry Association (JSA), they created a restrictive system to allow for the importation of U.S. soda ash to cover shortfalls in domestic production.

- U.S. soda ash was imported via designated trading companies, with the imported product divided in an agreed ratio for resale through the member companies' own distribution networks.
- Together with trading company affiliates, the JSA established the Toko Terminal, Japan's only facility dedicated to the handling and storage of imported soda ash. The JSA's control of this facility, in which U.S. firms had been precluded from purchasing a stake, en-abled it to control the flow of soda ash into Japan.
- The Japanese producers reportedly exerted pressure, directly and through their trading company affiliates, on Japanese soda ash consumers (predominantly glassmaking enter-pri-ses) not to attempt to procure imported soda ash through independent channels C that is, from a source other than the producers' group itself. The principal form of pressure, reportedly, was the threat that if a consumer brought imported soda ash from an independent source, that consumer's supplies could be cut off by domestic producers.[70]

  The JFTC has investigated the Japanese soda ash industry on two occasions. In 1983 it found the existence of an illegal cartel, whose activities it ordered to cease.[71] However, effective corrective measures were not enforced, and U.S. industry sources indicated that the Japanese producers continued to regulate imports on a joint basis. In 1987, in a second investigation, the JFTC found the existence of certain practices which "could become problematic depending on circumstances," and formally admonished Japanese soda ash producers to "take care not to violate the Antimonopoly Law."[72]

  Of particular concern was the Japanese consumers' practice of requesting pre-clearance from their traditional Japanese supplier before purchasing U.S. soda ash. U.S. sources also reported instances where Japanese distributors and consumers were threatened with commercial retaliation by Jap-anese soda ash producers and their affiliated trading companies if they continued to handle and use for-eign soda ash.[73] There is recent evidence of some form of regulation of total import volume.

  > At the end of 1988, an order was placed by a trading company which was in-ordinately concerned whether the order would be counted as part of the U.S. total for 1988 or 1989 B a concern which is commercially irrelevant, but quite re-levant if someone is trying to administer a quota.[74]

  Construction. *Dango* (bid-rigging or, literally, "conference") is the Japanese practice by which construction companies, before submitting bids on a contract, jointly decide which company will win. The companies then bid according to the agreement, with the preselected winner submitting the lowest bid. Profits are later shared among the group.

Dango is prevalent in the public construction sector. In one reported incident, a Japanese news-paper obtained an internal document of the Ministry of Construction listing those firms which were "likely" to be awarded specific contracts in the coming fiscal year. This document proved accurate in 43 of 45 cases. A number of analyses, however, have concluded that *dango* is also widespread in the private construction market. One commentator concluded that *dango* "is especially strong in private construction projects, making it virtually impossible for foreign companies C especially newcomers C to take on major Japanese private jobs."[75] The results of *dango* are predictable: for 1990, the U.S. share of the Japanese construction market (about $300 million) compared very unfavorably C particularly in view of the competitiveness of U.S. construction firms C with the $3.3 billion worth of contracts which Japanese firms were estimated to have in the United States.[76]

In addition to restricting market access for U.S. firms, *dango* has directly affected the U.S. Government. Japanese construction firms have been investigated for rigging bids at U.S. military bases. The firms involved C over 100 firms in one case C settled with the U.S. Government and were cited by the JFTC as well.[77] Most recently, NEC Information Technologies agreed to pay the U.S. Treasury $34 million for overcharges during the period 1981-88.[78]

Over the past few years, the United States has negotiated several agreements with Japan intended to improve market access for U.S. construction firms. As long as Japanese firms are able to collude on construction bids, however, each U.S. firm must compete with the entire Japanese industry rather than with each Japanese firm individually. Securing the right to bid on projects, therefore, may not yield satisfactory results unless *dango* itself is attacked directly and energetically by the Government of Japan.

Amorphous metals. In March, 1990, Allied Signal filed a Section 301 petition alleging a number of anticompetitive activities aimed at blocking imports into Japan of Allied's product Metglas and the electricity transformers into which Metglas was incorporated. (Metglas is an amorphous metal substance which, when used in place of steel as the core of an electricity transformer, can generate energy savings of up to 70 percent.) According to the company, the Japanese government delayed the approval of patents, organized joint research, granted subsidies to the domestic industry, and, most importantly, successfully encouraged Japanese electric utilities (the primary customers) to boycott Allied's transformers. These measures were designed, Allied alleged, to allow Japanese companies to dev-elop a product to compete with Metglas.

Allied's chairman Edward L. Hennesy, Jr. called the measures a "textbook example of Japanese industrial targeting of cutting-edge technology."[79] Another Allied spokesman was even more blunt: "The Japanese government organized and led a cartel of Japanese industry whose goal was to develop amorphous metal technology and to thwart our efforts to patent and market our technology in Japan."[80] After several months of rancorous bilateral negotiations conducted under threat of a Section 301 investigation, Japanese companies agreed to purchase specified quantities of transformers from Allied over a thirty-month period.[81]

Machine tools. A petition filed with the USTR in 1982 alleged the existence of anticompetitive activities in the machine tool industry, conducted primarily through the Japan Machinery Exporters Association (JMEA) and the Japan Machine Tool Builders Association (JMBTA).[82] Formed in response to the first of three laws for the promotion of the machinery industry, this alleged machine tool cartel was said to have pursued a predatory export strategy it bankrolled with mono-poly rents extracted from the Japanese market.

The petition noted that the group enjoyed formal immunity from the Antimonopoly Law for its price-fixing activities, and informal (but equally effective) immunity for MITI-guided anticompetitive practices aimed at securing export markets. The primary goal, according to the petition, was "capturing a major share of the main export markets, especially the United States."83 Japanese success in pursuing this goal, together with other factors, eventually led to a U.S. request for voluntary export restraints as part of a Reagan Administration program to revitalize the U.S. machine tool industry.

Forest products. Cartel policies are said to affect Japanese purchasers of forest products in Japan and in other countries. One knowledgeable industry representative (in a confidential conversation) reported that at times of rapid increase in the price of logs in the U.S. Pacific Northwest, all of the U.S.-based Japanese purchasers would be recalled to Tokyo on the same day. Upon their return to the United States several days later, prices would stabilize at lower levels.

Coordinated import behavior also characterizes the paper industry. The Japan Paper Importers Association, established in 1981, reportedly has extensive control over imports, with the stated goal of "maintain[ing] an `orderly market' in Japan."[84]

This list of Japanese cartels, despite its length, is illustrative rather than exhaustive. Cartelization is the most pervasive and, from the standpoint of those who would export to Japan, probably the most pernicious anticompetitive practice occurring in Japan. (Actually, cartelization in Japan is not so much a practice as a way of life. The cartels themselves engage in anticompetitive "practices," such as price-fixing.)

The Structural Impediments Initiative (SII) holds out an opportunity for counteracting the influence and activities of Japanese cartels. However, the SII has been only marginally successful so far, and it will require a considerably strength-ened commitment from both sides to generate quantifiable results.

Cartels and Import Suppression

To be successful in setting home-market prices, cartels must block out foreign entrants who otherwise would be attracted by high cartel prices. While legally sanctioned import cartels are in a position to limit or exclude imports directly, unofficial cartels can achieve sim-ilar results by inducing dependent suppliers or purchasers (1) to refuse to deal in imported goods or (2) to fix the price of foreign goods at high levels that drive down the competitiveness of imports. It is for this reason that cartels in foreign countries are frequently accompanied by some form of restraint on imports.

IV. DISTRIBUTIONAL (VERTICAL) RESTRAINTS

Extensive producer control of distributors in a given sector, whether achieved by contract, cross-shareholding, or vertical integration, can severely restrict imports C provided that, as is often the case, imports are handled by the same distributors. Pro-ducers in a number of countries that are important U.S. trading part-ners have the ability either to prevent local distributors from dealing in imports (including U.S.-produced goods) entirely, or to require distributors to resell imports on terms which reduce their competitiveness. In such circumstances, U.S. producers, unless they can find some means of circumventing these controlled distributors, may find that they can export their products only with the "permission" of producers in the importing country.

Japan

Japan's extraordinarily inefficient and costly distribution system provides the best example among developed countries of distributional import restrictions. This system is often both the result of anticompetitive activities and a major impediment to increased competition. Robert Lawrence has concluded that distribution problems are "associated with, but not exclusively confined to keiretsu arrangements" and that

> [f]oreign firms play a remarkably small role in selling their own products in Japan and . . . are typically paid only world market prices. Most of the rents from foreign products are earned by Japanese distributors. . . . Indeed a distribution system with high markups on foreign goods is the private-sector equivalent of a system of high-tariffs. The distributors rather than the government collect the revenue.[85]

The cost of distribution has remained high despite the massive post-1985 appreciation of the yen and the corresponding drop in some yen-de-nominated prices.

> [N]ot all industries are exposed to competitive international trade or even to brisk competition. The strong yen has not put much pressure on distribution and other services, nor has it hurt businesses protected by import controls, price supports, or entry restrictions.[86]

Various methods are used to restrict competition among distributors in Japan. These include: (1) massive horizontal integration at the retail level (Matsushita controls a vast retail network of 24,000 stores that sell Matsushita products almost exclu-sively),[87] (2) specific contractual restrictions on whom a dealer can trade with and the territory in which a dealer may sell, and (3) a number of practices intended to make dealers financially dependent upon domestic producers and thereby easily induced to restrict their purchasing behavior.

Paper. The Japanese paper industry provides a clear example of producer-controlled distributors capable of acting to limit imports. The trading companies which handle the vast bulk of imported paper are connected to the major Japanese paper suppliers by an extraordinarily complex web of debt and equity ties.[88] "Paper agents," distributors who buy directly from mills, "often are not independent. In the paper industry, they are virtually all tied directly to Japanese manufacturers like the paper giant Oji which, together with its several affiliates, dominates most of the domestic market.'[89]

The JFTC itself has observed that supply patterns are rigid, at least in part, "because of close relationships between paper manufacturers and companies in the distribution sector, as seen in the fact that the major agencies each have a main manu-facturer with which they deal.'[90]

Further distributional barriers arise from pa-per sector pricing and credit policies. *Atogime*, or after-the-fact price readjustment, allows paper suppliers and distributors to work out prices long after contracts are closed, and leaves distributors who hope to show a profit from one period to the next dependent upon existing suppliers.[91] This practice, which essentially amounts to a system of discretionary rebates, has been condemned by the U.S. Government[92] and by the JFTC.[93] Equally pro-blematic is the widespread use of promissory notes at different stages of paper distribution. These notes keep financially weak distributors in business and leave them completely dependent on the suppliers who honor their notes. The U.S. Department of Commerce found, in dealing with a similar system of ppromissory notes in the distribution of solid wood products, that "with this type of supplier financing, it is easy to understand the strong iinfluence that suppliers can exert on their customers [i.e., distributors]. Changing suppliers risks alienating a major source of credit."94

Soda ash. The JFTC found in 1987 that horizontal market-regulating arrangements by Japanese soda ash producers were no longer taking place. However, U.S. soda ash firms continue to find that Japanese soda ash consumers affiliated with the Japanese producers' group are generally unwilling to increase purchases of U.S. soda ash regardless of commercial considerations such as price and quality. In some cases this reluctance may simply reflect long-standing commercial relationships, but these consumers are vulnerable to a cutoff of domestic supply if they switch to an imported source. The past decade has yielded some reports of a threatened interruption of supply by a domestic producer.[95]

Semiconductor-based equipment. The distribution system also restricts exports to Japan of more complex manufactured products. Distribution barriers in such circumstances are doubly pernicious, because they also suppress the importation of products "upstream" from the products directly at issue. Two prominent Japan scholars, writing in 1986, drew attention to an example of this phe-nomenon, noting that

> evidence suggesting anticompetitive behavior in the marketing of office computers and other products utilizing microchips has been uncovered by the FTCJ. The commission has released a report on the increasing "capture" of wholesalers, a recent rise in producers' stockholdings in distribution outlets, and the transfer of management personnel between manufacturers and sellers. While the percentage of wholesalers dealing exclusively with one manufacturer is not high (34 percent), the FTCJ discovered that contracts signed between producers and dealers contained "restrictions regarding retail prices, sales area, retailers to whom the products could be sold, and other matters, restrictions which conflict with the intent of the Antimonopoly Act." Accordingly, the FTCJ "advised" the implicated firms to eliminate these clauses.[96]96

Automobiles. In the words of the U.S. International Trade Commission, "The Japanese automobile industry is one of the most frequently cited examples of a strong distribution keiretsu, and one in which exclusive dealing has often been viewed as pervasive."[97]

Until recently, supplier-dealer contracts often required Japanese automobile dealers to trade exclusively in the manufacturer's nameplate. (By comparison, the vast majority of U.S. dealers are "dual dealers.") While these and other similar express contractual provisions have been largely eliminated, the underlying practices continue as a practical matter because of the power producers hold over their distributors.

A number of auto industry financial practices, including producer financing, are responsible for

Japanese auto dealers' inordinate dependence upon producers. Among the most pernicious is the practice of variable rebates. One well-documented study explained how the Japanese rebate system has been utilized to foster anticompetitive behavior.

> There are reportedly 500 names for different types of rebates, the most important relating to the proportion of an outlet's total sales constituted by the affiliated brand and to adherence to the suggested retail price. Rebates were offered to distributors on a case-by-case, confidential basis and were often given for "loyalty," "cooperation," and "effort." . . . A variant of the rebate was the practice of selling merchandise to distributors at varying prices. As all outlets resold at a uniform price, this was an effective way to reward and punish affiliates.[98]

Because of the extraordinarily high price of land in Japan, in recent years most foreign car manufacturers have found it prohibitively costly to set up their own exclusive dealerships. As a result, imports have been impeded. Very recently, as a result of considerable pressure applied over a period of years, some Japanese auto makers have indicated a willingness to make their distribution networks available to U.S. firms.99 It remains to be seen whether these offers will yield tangible results. The problem of private restrictions in the Japanese distribution system was summarized in 1990 by the Director of the Price Research Division of the Economic Planning Agency's Price Bureau.

> Some of the obstacles to competition in distribution are government regulations, such as the restrictions on the construction of large retail stores and the licensing of liquor stores, but others stem from traditional business systems and practices. The vertical affiliations among businesses in distribution and the systems for setting list prices, returning unsold goods, and offering rebates all took root within a specific socioeconomic context, one where producers and distributors place high value on harmonious human relations and long-term business deals. These and other features of the distribution sector are rational in their own way, but they are also capable of hindering competition.[100]

Other

Rebates and bonuses, which can create an extremely effective vertical restriction when awarded in a discretionary manner, are utilized to discourage imports in other countries as well. For example, the Norwegian government intervened in 1990 to modify an arrangement under which Norway's only two suppliers of construction steel would grant bonuses to the country's five largest steel distributors in exchange for a guarantee that they would not buy steel outside Norway and Sweden. Even under the revised arrangement, the distributors can continue to treat the local producers as their "main suppliers."[101]

V. ABUSE OF MARKET POWER

Tying is the practice of conditioning sales (or purchases) of a product in which a firm has market power on sales or purchases of other products. Thus, a dominant supplier of pens might "leverage" its pen market power into the pencils market by refusing to sell pens to any firm which does not also purchase its pencils. This practice, and other similar abuses of market power, are in many instances illegal under the U.S. antitrust laws.

One example of the risks of tying and other market power abuses can be found in the semiconductor industry. A number of U.S. semiconductor manufacturers alleged a few years ago that Japanese firms tied purchases of semiconductor products dominated by Japan to purchases of other products or otherwise attempted to "leverage" market power. As reported by then-Senator Pete Wilson, these allegations included:

- Offering to sell DRAMs to a U.S. company only if that company would transfer proprietary technology to the Japanese DRAM manufacturer.
- Canceling DRAM shipments to a U.S. company hours after talks terminated on a completely unrelated business arrangement that did not conclude as the Japanese firm wished.
- Threatening to cut DRAM shipments to a U.S. firm unless it purchased custom chips (ASICs) from a Japanese supplier.[102]

Additional complaints of a similar nature were recently reported by the General Accounting Office.[103] These complaints are all the more troubling when considered in light of the strong sense of U.S. observers that the product-market dominance on which Japanese tying efforts were based was "ill-gotten" to begin with. In other words, Japan's dominance in DRAMs C which some firms have apparently tried to leverage into other markets C was itself widely thought to have resulted from other anticompetitive activities.

Moreover, the willingness of chip suppliers to use a strong market position to seek concessions in unrelated areas had implications for national security. The possibility that Japanese manufacturers could refuse to provide U.S. firms with top-of-the-line chips has been raised in studies of foreign dependence in national security-related industries[104] and is again under consideration in the aftermath of the Gulf War.[105]

VI. SHAREHOLDING AND SHAREHOLDERS' RIGHTS

Until the early 1980s, Japan applied a series of investment laws that effectively precluded foreign companies from launching successful hostile takeovers in Japan. Although these laws have been abolished, foreign companies continue to find it very difficult to invest in, much less take control of, Japanese corporations. In the eyes of some observers, these difficulties arise from the existence of a series of "extralegal" barriers based on a combination of business structures and social values.[106] While these barriers may not always be insuperable, they create hurdles which only a lucky and determined few seem able to leap.

Often, it is the very structure of the Japanese corporate economy, and particularly the extensive system of cross-shareholding, that serves to impede foreign participation in the Japanese economy. One commentator has noted that "there are already so many natural barriers to takeovers that legal restrictions are hardly needed."[107]

> The main non-legal barrier to acquisitions is the shareholding pattern in Japan's corporate world which is relevant in two respects. First, shares held in stable shareholders' hands are unavailable to the public. A large number of these shares resting in the hands of these stable shareholders leave fewer shares floating, making it difficult for outside investors to purchase enough shares to

> carry out a tender offer. Second, corporate shares in Japan are often cross-held. . . . Such shareholding patterns also leaves [sic] less floating shares available for the potential investors.[108]

The inability to purchase control of a Japanese company is, in other words, simply one piece of a familiar puzzle. "The keiretsu ties are the single most important characteristic of the Tokyo Stock Exchange. It is not the Japanese culture that prevents an M&A market from developing; it's the keiretsu system."109

The low level of private shareholding means that tender offers are particularly difficult to make. According to statistics compiled by the Tokyo Stock Exchange, individuals account for approximately 20 percent of the ownership of listed companies. "Thus, it is likely that even if all individual shareholders accepted a tender offer, an acquiring company will still have only 20 percent of the target company's shares."[110]

Even assuming that a foreign company can obtain significant shareholdings in a Japanese company, its ability to have an impact on the company's management may not be assured. In part, this situation reflects hostility towards foreign participation in management of Japanese companies. Until recently, the charters of many Japanese companies prohibited foreigners from becoming members of the board. In 1968, a Japanese court held that a charter provision requiring all officers and directors of Toyota to be Japanese citizens was permissible under the Japanese Constitution. [111] Today, however, the greater restriction rests in the relative inability of shareholders to participate meaningfully in the operation of Japanese companies.[112] As an example of the attitude held by management, many major Japanese companies hold shareholders' meetings on the same day, a practice which obviously discourages the effective exercise of shareholders' rights.

The experience of T. Boone Pickens illustrates the difficulties that foreigners encounter when seeking to penetrate the closed Japanese system. Despite owning 26 percent of the stock of a Japanese auto parts company (Koito), Pickens was unable to obtain a seat on the company's board of directors. By comparison, Toyota C in whose *keiretsu* Koito lies - owns 19 percent of the stock and appoints three members of the board.[113]

The trade effects of this restrictive shareholding system, while not obvious, are nevertheless significant. First, U.S. companies must be able to control C that is, to own C their own distributorships in order to sell effectively in Japan. Perhaps even more important, the most direct way for the private procurement decisions of Japan-based multinational corporations (MNCs) to become more rational C so that like other MNCs they will base purchases on commercial considerations rather than on loyalty C is for their ownership to be internationalized. The Japanese shareholding system, by blocking internationalization, preserves discriminatory purchasing patterns and therefore depresses the sale in Japan of imported products.

The prospects for improvement in this area appear particularly bleak. A blue-ribbon panel of experts on government and banking recently concluded that "any effort to unwind cross-shareholding `may risk demolishing the base of the Japanese management system' and `must be avoided by all means.'"[114]

VII. PATENT ABUSE

Manipulation of the intellectual property laws has allowed some foreign companies to gain unfair advantages over innovative U.S. suppliers. While weak intellectual property protection primarily reflects a governmental decision rather than private restrictive activity, there are instances where private firms have abused existing laws in a concerted or otherwise anticompetitive manner.

Japan

In Japan in particular, there have been a number of problems with abuse of the patent system by large firms seeking to force the licensing of new technologies. The most prevalent of these abuses is the practice of patent flooding (i.e., filing scores of patents with very minor modifications from an important new patent and then, through threats of litigation, forcing the original patentee to cross-license).

In one particularly egregious case of patent flooding, a small U.S. company called Fusion Technologies has been involved in a lengthy battle with Mitsubishi concerning Fusion's patent on a high-power ultraviolet industrial drying lamp. After the grant of a Japanese patent on Fusion's revolutionary technology, Mitsubishi filed nearly 300 patent applications copying and surrounding Fusion's patent. After extensive negotiations, it became clear that Mitsubishi was seeking to force Fusion into an expansive, and expensive, cross-licensing agreement.[115]

Government delays or other hurdles in obtaining recognition of intellectual property rights have also served to abet efforts by foreign companies to thwart outsiders. In the case of amorphous metals discussed above, for example, Allied Signal filed a composition patent in 1973 and a process patent in 1977. These applications were not approved until 1984 and 1989, respectively. (It was reported in 1990 that the average wait was five to seven years.)[116] Since a Japanese patent expires twenty years after it is filed, more than half the expected life of these patents was eliminated. Allied claimed that the delay was part of a carefully structured Japanese Government effort to nurture Japan's domestic amorphous metals capability by granting subsidies and encouraging a boycott of Allied's product.[117]

The Japanese patent system is a subject on the SII agenda. The Government of Japan has, in fact, agreed to bring the patent examination period C now averaging 37 months C down to 24 months within five years.[118] Still, as the U.S. delegation pointed out, it was not clear whether improvements made in the first year after this promise was announced had actually reduced the time required to obtain a patent in Japan.[119]

VIII. OBJECTIVE INDICATORS AND EFFECTS OF ANTICOMPETITIVE PRACTICES IN FOREIGN MARKETS

It has already been noted that anticompetitive practices abroad typically coincide with (indeed, necessitate) restraints on imports to keep out foreign entrants who otherwise would be attracted by supra-competitive profits. Local firms may accomplish their goal of restraining imports through concerted private activities, government actions, or both. This direct connection to import restraints is, from the perspective of the international trading system and U.S. industry, the most troubling aspect of private foreign anticompetitive activities.

The absence of non-domestic firms can be an indication of import restraints. The electronics markets in Japan, the United States, and the EC provide an example. In Japan, only one foreign firm (IBM) supplies more than one percent of the total electronics market; by comparison, four non-U.S. firms supply more than one percent of the U.S. market, and six non-EC firms supply more than one percent of the EC market (Figure 3). In consumer electronics, there are no foreign suppliers in the Japanese market with more than a one percent market share, while in the EC there are six, and in the United States, eight such foreign suppliers.[120]

In order to fully comprehend the harm caused by anticompetitive activities, however, a number of effects and indicia other than direct import restraints must also be identified. There is a need for objective criteria by which observers and policy makers can know when it is likely that anticompetitive activity is afoot. Certain trading patterns and statistical anomalies are so tied to restrictive practices C and so difficult to explain without reference to restrictive practices C that they can be used as benchmarks for trade policy even when specific anticompetitive activities cannot be documented. Moreover, these phenomena illustrate *indirect* connections between restrictive business practices and suppressed sales of imports. This section examines three indicators of private restraints on trade: stable market shares, high foreign prices, and industrial concentration.

Stable Market Shares

One important indicator is unusual market share stability. Anticompetitive activities allow individual companies to lock in market shares (and allow entire domestic industries to continue supplying a fixed percentage of apparent consumption) regardless of the competitive merits of the products concerned. Moreover, where there is no plausible explanation for such rigid patterns, it is very likely that restrictions of some sort are involved. Unusual market share stability, in short, generally indicates the presence of anticompetitive activities and is a proper subject of concern whether or not specific anticompetitive activities can be cited and documented.

In this context, a number of seemingly unconnected statistics can and should be pieced together.

- Sumitomo Metal Industries, Ltd. and Kawasaki Steel Corp, long-time rivals for the third ranking among Japanese steelmakers, have had remarkably stable shares since 1973. Neither's production of crude steel has exceeded the other's by more than 0.36 percent.[121]
- Asahi Glass sells half of the glass in Japan, Nippon Sheet sells about 30 percent, and Central Glass has 20 percent of the market. These shares have been constant since 1965.[122]
- According to a 1984 study by Japan's Fair Market Commission, four major oligopolistic industries - beer, whiskey, steel, and glass - have maintained constant market shares since 1965.

  [123]

- Toyota's market share in the Japanese auto market has varied by just 2.3 percent from 1984 to 1990. (General Motors' share of the U.S. auto market declined considerably during that period C from 43 percent to 35 percent.) NEC's share of the Japanese market for integrated circuits also remained stable, beginning the 1984-to-1990 period at 20.5 percent and ending it at 21.0 percent. (Intel, by contrast, increased its North American market share from 7.4 percent to 11.1 percent.)[124]

The comparatively large variation over time of market shares in the United States - an indicator that competitive forces play a much greater role here than in Japan - is illustrated in Figure 4.

High Prices Abroad

Anticompetitive activities C particularly, but not solely, cartelization C tend to raise prices in restricted markets above prevailing world prices. Local producers, in order to protect their high-priced sanctuary, have an incentive to block imports entirely or to see that they are priced at an uncompetitively high level. Unless imports are simply blocked, artificially high prices must be charged for imported goods just as for goods which are produced locally; otherwise, those engaged in anticompetitive practices cannot continue to extract monopoly rents. This imperative is the usual cause of price differentials which exceed transportation costs.

The high foreign price of imported goods suppresses the consumption of those goods both directly and indirectly.

- High prices push overall consumption of a good below the "equilibrium" level (i.e., the level of consumption that would result from the free interplay of supply and demand. Consumers demand less of a good as its price grows higher.) This decrease in consumption can affect imports - which are typically "marginal" purchases - disproportionately.
- Because of transportation requirements and other factors, import transactions are more dependent than domestic sales on certain services and infrastructure. The high prices charged abroad for these items can affect imports disproportionately.
- Sales of imported products suffer when those products are available only at prices which far exceed (1) the price at which their producers would like to sell them and (2) the price those goods would command in the United States or other home markets.

While there are a number of specific "anticompetitive practices" C many of which are discussed in this paper - by which prices for U.S. and other imported goods are kept artificially high in foreign markets, these practices have a common result. So long as imports from the United States and other countries are priced at uncompetitively high levels, they cannot be expected to penetrate foreign markets to any significant degree. Just like inordinately stable foreign market shares, therefore, significant price differentials are worthy of close U.S. Government attention whether or not they can be directly linked to specific anticompetitive practices. More often than not, anticompetitive practices lie behind them.

The most dramatic evidence of high foreign market prices is contained in a recent government survey conducted by Japan and the United States and submitted to the SII negotiators as reference material. That survey found that the prices on identical goods were, on average, 39 percent higher in Japan than in the United States.125 The survey's "case study" on capital goods led to an unambiguous conclusion.

> The prices of capital goods in Japan were significantly *higher* than in the U.S. for a majority of the products surveyed. The price level for these products was higher than can be accounted for even with the addition of local fees and transportation costs. Two explanations for this price difference were put forth by the respondents to the price survey.

- Japanese markets are more oligopolistic than U.S. markets, and established Japanese firms can exercise market power, restricting entry of new competitors.

- The Japanese distribution system is more complex and layered than the U.S. distribution system. In fact, products imported into Japan face two more distribution layers than products manufactured in Japan.[126]

The U.S. Department of Commerce has attributed U.S.-Japanese price differentials to "exclusionary business practices" and the "frequent absence in Japan of free, open and competitive markets," while the U.S. SII delegation has stated that "the continued very large price gap indicates the need for more energetic implementation of the full range of SII commitments."[127]

Industrial Concentration

A third indicator of anticompetitive activities is a generally high level of concentration in important industrial sectors abroad. This phenomenon is related to (but should be considered separately from) the phenomenon of stable market shares discussed above. Concentration has a number of potentially trade-distorting side effects, among which two predominate: (1) the scarcity of suppliers makes new market entrants (often, selling imported goods) more noticeable, and thus prevents them from competing "quietly" on the basis of price and quality; and (2) in a sector with a relatively small number of local firms, it is easy for those firms to coordinate export behavior or to collaborate in controlling imports.

An examination of industry concentration ratios in major industrial sectors in the United States and Japan provides a sharp contrast between the two markets (Figure 5). For example, in the integrated circuit sector, the top three firms in Japan control 55 percent of the market, while in the North American market, the top three firms account for only 27 percent of domestic sales.[128] A Japanese business school professor, reviewing data from the late 1970s, recently concluded that Japan's "degree of concentration is roughly double that in the United States."[129]

Dumping

Also troubling from the perspective of world trade is the potential for anticompetitive activities in foreign markets to lead to dumping - an expensive unfair trade practice which is far easier to undertake when a company has some assurance that the home market will be profitable (i.e., will yield monopoly rents) as a result of the collusive behavior.[130] Anticompetitive activities abroad make dumping in the U.S. market not only more likely, but also more sustainable and more effective.

IX. ANTICOMPETITIVE DIRECT INVESTMENT IN THE UNITED STATES

In addition to anticompetitive activities abroad which affect U.S. commerce, the last decade has seen the growth of such activities by foreign companies within the United States and in third countries as well. In some cases the effect of foreign investment here is itself anticompetitive - a situation which is in theory remediable through the U.S. antitrust laws (but which current practice too often leaves uncorrected). In other cases, restrictive business practices are "exported" to the United States by the foreign companies that come here to do business.

Discriminatory Purchasing

A study by Mordechai Kreinin, an economist from the University of Michigan, found that 20 of the 22 U.S. subsidiaries studied used internationally competitive bids for purchases of machinery, components, and materials. Similarly, 17 of 20 European firms used internationally competitive bidding. By comparison, only 5 of 20 Japanese companies did so. Kreinin found that most Japanese firms "never even considered" internationally competitive bids; "in most cases they go directly to Japan and buy Japanese equipment, either from the parent company or from its traditional suppliers in Japan."[131]

This disparity has important implications for U.S. investment policy. A tendency to prefer traditional foreign suppliers can have the anticompetitive effect of restricting purchases from U.S. suppliers even after a foreign producer has located a plant in the United States. The impact can be extremely damaging to U.S. companies.

The extension of the *keiretsu* structure into the United States can be observed in the auto industry, where Japanese automakers have been followed into the United States by their traditional parts suppliers. Although the total domestic content of transplant autos has been growing, the volume of purchases from U.S. firms has grown at a much slower pace. While Japanese auto production in the United States has been widely welcomed, observers have noted

> a pattern, so far little-noticed, that makes this Japanese development far different from U.S. investment abroad . . . . a pattern of vertical development, literally a separate Japanese economy inside the American economy, with virtually every step C financing, construction, suppliers, distribution C under Japanese ownership or control, as with the Toyota construction here.[132] (Emphasis added.)

Supplying the auto transplants (with parts, construction services, and even with capital) has turned out to be a primarily Japanese activity. A recently released study by researchers at the University of Michigan carefully documents the purchasing patterns of transplants, and finds that they favor Japanese suppliers. For example, 58 percent of Toyota's U.S. suppliers are Japanese-owned, and another 28 percent are U.S./Japan joint ventures. Honda of America also buys primarily from Japanese suppliers. Transplants account for 46 percent of the dollar value of cars built by Honda in Ohio, with sales from Japan covering another 38 percent. Only 16 percent is estimated to come from "traditional" U.S. suppliers.[133] The study predicts that the annual U.S. auto parts deficit with Japan will climb from $10.5 billion in 1990 to $22 billion in 1994 and that the overall bilateral automotive trade deficit will grow in the same period from $31 billion to $46 billion annually.[134]

Even the seemingly positive trend toward greater Japanese importation of manufactured goods is colored by the fact that many of the "imports" come from Japanese foreign subsidiaries ("transplants") which appear to discriminate in favor of Japanese inputs. In 1989, for example, approximately 25 percent of U.S.-made cars exported to Japan were produced in the United States by Honda. (Ironically, these U.S.-built Hondas were left-hand drive C one of the alleged reasons why U.S. car companies cannot sell in Japan.) Japanese efforts to foster close East Asian trade ties may also turn out to be centered on intra-company trade, particularly among Japanese-owned and affiliated firms in Southeast Asia.

Increased Concentration in U.S. Markets

In some cases, foreign investment in the United States may result in more concentrated (and therefore less competitive) U.S. markets, to the detriment of U.S. consumers and downstream businesses. This concern is strongest when the investment takes the form of an acquisition of a U.S. company by one of its foreign competitors, rather than the creation of new capacity in the United States.

The sale of an important U.S. producer of semiconductor manufacturing equipment (Semi-Gas) to its major Japanese competitor, the most recent example of this phenomenon, passed through the national security review process and was stalled only by the last-minute intervention of the Antitrust Division in January 1991. The Department of Justice has since failed in its bid to obtain a preliminary injunction, and the sale has reportedly been consummated. This case underscores two concerns: (1) the United States lacks a coherent policy for reviewing foreign acquisitions of U.S. inventors and makers of sensitive technology products, and (2) even when a case is brought, it is difficult to get foreign acquisitions overturned on antitrust grounds.

Also troubling is the Union Carbide polysilicon case, in which a Japanese firm purchased a U.S. competitor that was in the midst of pursuing a private antitrust action against an alleged Japanese polysilicon cartel. The case was quickly dropped, while the transaction had the effect of increasing the world market share of Japan's major producers from 30 percent to 45 percent. Acquisitions in 1989-90 of the silicon operations of other U.S. firms brought the Japanese share of the world merchant wafer market to 72%.[135]

In a third example, extensive documentation of the activities of the International Electrical Association reveals that entry by IEA members into the U.S. market has often taken the form of acquisitions and mergers with long-term anticompetitive consequences. An exhaustive study of this organization aptly summarized the danger to U.S. producers of heavy electrical equipment: "In effect, the United States firms have become distributors for their former overseas rivals."[136]

Investment Screening by the Japanese Government

It has been suggested that even in the purchase of U.S. investments the Japanese are engaging in concerted practices to reduce competition. Where foreign investment by Japanese firms is concerned, the Government of Japan may be practicing an aggressive style of "administrative guidance."

> The latest game where the Japanese seem to be running rings around the West's open market system is M&A. Their special edge: secret "guidance" by government officials. Observers in Tokyo believe the bureaucrats routinely pre-screen the action to ensure that Japanese companies don't bid against each other. That's a breach of anti-trust law in the US and elsewhere C for it means that the seller probably has to settle for less than he could hope for in a free auction.[137]

X. POSSIBLE U.S. RESPONSES

A wide range of measures have been proposed to assist the United States in confronting the problem of private restrictive business practices that distort trade.

Foreign Markets

Improve statutory remedies. Section 301 is, at present, the trade law weapon most directly aimed at foreign anticompetitive business practices that distort trade. In 1988, the list of practices that are "unreasonable" within the meaning of Section 301 was expanded to include "toleration by a foreign government of systematic anticompetitive activities by private firms or among private firms in the foreign country that have the effect of restricting . . . access of United States goods to purchasing by such firms."[138] The discretionary nature of the Section 301 mechanism has, however, limited its success in securing the elimination of private anticompetitive activities.

To improve access to Section 301 remedies in this area, legislation could be enacted mandating that the Administration research foreign anticompetitive practices and assess their effects on U.S. industries (including service industries). The law could require the Administration to identify priority private practices in restraint of trade and negotiate their elimination on a bilateral basis. Legislation could be comparable to the Section 301 provisions specific to public procurement, intellectual property, and telecommunications, and could contain stringent time limits and standards requiring administrative action in appropriate cases. Such legislation would strengthen the Administration's hand in negotiating the elimination of any or all of the types of anticompetitive behavior discussed in this paper, including particularly cartels and distribution barriers.

Increase U.S. Government antitrust enforcement action against the overseas activities of foreign companies which adversely affect U.S. commercial interests. When private foreign companies acting abroad collude in a manner that limits the importation of goods and services from the United States, the U.S. Justice Department (DOJ) should treat that behavior as a violation of U.S. Antitrust law and should bring enforcement actions to the full extent permitted by U.S. and international law. The DOJ has the resources and the statutory authority to make enforcement actions a significant tool in counteracting private trade restrictions abroad, but has established a restrictive policy under which injury to the export opportunities of U.S. firms is not sufficient to trigger enforcement actions to cases where consumers in the United States are injured. This policy is now under review, however, and COT supports the movement to reconsider the policy.

The DOJ should utilize as fully and aggressively as possible its authority to counteract foreign private trade restrictions that limit U.S. exports. In order to encourage such an aggressive DOJ approach, Congress should act to clarify any confusion that may exsist over Congressional intent in this regard. Additional legislation, aimed at removing any other impediments to use of U.S. antitrust laws against foreign anticompetitive activities, should be considered as necessary. Finally, steps should be taken to insure that the Justice Department has adequate resources to implement an aggressive enforcement policy.

Pursue bilateral negotiations. The Structural Impediments Initiative is an effort to address some of the most serious barriers to the Japanese market, including problems posed by *keiretsu* and other anticompetitive activities. SII has some potential to begin to address many of the private practices that limit Japan's imports from the United States and other countries C in particular, through dealing with difficult structural problems such as the shareholding and *keiretsu* systems.

As Administration officials themselves have recognized, however, SII to date has not been very successful. In light of Japan's broad SII commitments to increase the effectiveness and the use of its Antimonopoly Law, for example, the recently issued enforcement guidelines were disappointing.139 In official comments on those guidelines, the U.S. Government criticized their substance and concluded by noting that

> they will have little effect in preventing anticompetitive practices unless they are accompanied by vigorous enforcement by the JFTC and public prosecutors, and by the imposition of severe penalties on persons and firms found to have engaged in unlawful collusive practices.[140]

The U.S. delegation to the SII, in its First Annual Report, voiced similar criticisms of Japanese antimonopoly efforts.

> The Government of Japan has not yet strengthened sufficiently its antimonopoly enforcement regime so that it will effectively deter collusive anticompetitive practices that exclude foreign competition in the Japanese market and result in higher costs to consumers, as undertaken in the Joint Report. In particular, new mechanisms put in place for criminal enforcement have not yet been utilized, penalties are not high enough, and private remedies have not been made effective.[141]

An upgraded, enhanced effort is needed in the bilateral negotiations with Japan. Japan's antimonopoly regime must be improved. Continued labor/industry monitoring is necessary to encourage the U.S. Government to move ahead with the SII agenda and, where results fall short, to acknowledge the need for further steps. Congress should play a greater role, reviewing progress and providing the negotiators with a set of objectives and criteria for measuring success. In addition, the agenda could be expanded to cover the activities of Japanese companies in the U.S. market, rather than focusing exclusively on conduct taking place in Japan. A legislative mandate for bilateral negotiations regarding anticompetitive practices should be considered.

Pursue multilateral competition agreements. There appears to be growing support, both in the GATT and in the OECD, for a multilateral agreement harmonizing (and securing cooperative administration of) competition policy. In the GATT, such an agreement could take the form of a Competition Code C which could provide a long-term solution to the problem of anticompetitive practices. To the extent that there is a risk that the United States in GATT talks will agree to curbs on its ability to respond to unfair trade practices, it is even more important that anticompetitive practices be subject to multilateral discipline. Professor John Jackson has cited the lack of a Competition Code as "one of the largest gaps in the world trading system."[142]

Particularly if confronted by vigorous U.S. action, other countries might be convinced to accept certain basic competition rules. To be sure, complete reliance cannot be placed on international agreements. Even if competition agreements prove difficult to enforce, however, they might give the United States greater confidence in taking unilateral measures under Section 301 or the U.S. antitrust laws. Multilateral disciplines could be particularly useful in curbing the activities of cartels that operate across national boundaries.

Cooperative antitrust enforcement can also extend the effective reach of the U.S. antitrust laws in cases where useful information has been collected by foreign governments. A recent agreement between the United States and the EC could prove helpful in this regard.[143]

U.S. Market

Create improved private remedies. In an important 1986 antitrust decision, the Supreme Court held that a private suit alleging conspiracy and predatory pricing, with the goal of driving all competitors out of the market, can be dismissed if it appears implausible that the predators could recoup their lost profits within a reasonable period of time.[144] This decision overlooks the long-term perspective taken by Japanese companies and ignores linkages between sectors. (For example, dominating semiconductors confers advantages in downstream electronics.) One commentator concluded that, even if the court's decision was factually accurate, the decision robs U.S. antitrust law of social and political content, replacing it with the economics of the Antitrust Division.[145] Legislation should be considered to clarify the law in this area. The courts should pay greater heed to collusive behavior which results in serious injury to U.S. industries through depressed prices. Remedial legislation should improve the chances of U.S. antitrust plaintiffs injured by the activities and pricing strategies of foreign cartels.

Modify administrative reviews of foreign investment. Although the Department of Justice participates in the work of the Committee on Foreign Investment in the United States (CFIUS), antitrust considerations have not been a factor in CFIUS determinations under Exon-Florio. Legislation could be enacted to ensure that competition and technology policies are given due consideration in the CFIUS review process (perhaps including transfer of authority from the Treasury Department to the Commerce Department).[146] Such a change would constitute a sensible and effective step toward counteracting anticompetitive foreign investment in the United States.

Improve rules governing joint production ventures. Congress is considering proposals to extend the National Cooperative Research Act to cover production joint ventures.[147] Under these proposals, where the participants of a production joint venture give advance notice to the U.S. Government of their planned operations, any antitrust suits against the joint venture would be decided under the rule of reason and could seek single damages only. If enacted, this limited and export-oriented exception to the antitrust laws would bolster the competitiveness of U.S. firms and allow them to operate on a scale more nearly comparable to that of their major foreign competitors.

XI. CONCLUSION

No comprehensive trade policy today can ignore the tremendous distortions of world trade caused by private restrictions. As traditional barriers fall away, these private restrictions assume an increasing importance. The U.S. Government - both the Administration and the Congress - should carefully review its trade agenda to ensure that this issue receives the careful attention it deserves.

The measures suggested above are not an end in themselves, but merely the means to an end. The ultimate goal is to achieve an actual change in trade patterns and volumes reflective of relative competitive strengths. Such a change would likely include an increase in U.S. exports commensurate with the competitiveness and efficiency of U.S. firms. The success of U.S. Government bilateral and multilateral efforts must be measured in terms of *objective* criteria, such as prices and import penetration. For purposes of judging success from the viewpoint of U.S. policy, as long as prices for U.S. goods sold overseas remain higher (to a degree not justified by transportation costs) than the prices of the same goods in the United States, those goods will never capture the market share which competitive, price-driven purchasing would otherwise accord them. The U.S. Government should identify specific goals for putting into place international rules regarding private barriers to trade, and, by vigorously combatting foreign restrictive business practices, should strive to realize those goals in the shortest time possible.

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142. International Trade Reporter, 8 (May 29, 1991): 834.

143. "U.S., E.C. Commission Sign Antitrust Cooperation Accord," Daily Report For Executives, 185 (September 24, 1991): A-15. This agreement creates the first formal mechanism by which U.S. authorities can "ask authorities to proceed under foreign law against a potential restraint of trade in the other nation that could hurt U.S. interests C for example, by denying U.S. companies the chance to compete abroad."

144. Matsushita Elec. Indus. Co. v. Zenith Radio, 475 US 574 (1986).

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146. The "Technology Preservation Act of 1991," introduced by Rep. Cardiss Collins (D-Ill) on June 12, 1991 and "strongly opposed" by the Administration, would address these concerns. See "Bill Offered to Strengthen Law Governing Foreign Acquisitions," Daily Report for Executives 114 (June 13, 1991): A-13. Any such legislation would, of course, need to be consistent with U.S. national treatment obligations under the GATT.

147. Senator Leahy, with the support of Judiciary Committee Chairman Biden (S-479), has offered a bill this session, as have Representatives Jack Brooks (HR-27) and Hamilton Fish (HR-1604). An Administration proposal very

similar to these bills, the draft "Cooperative Production Act of 1991," has been forwarded by Secretary Mosbacher and former Attorney General Thornburgh.

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