

## Special Report

# ***Implications of Competition Policy for International Trade How Different is Japan from Germany and Does it Matter?***

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Competition policy is emerging as one of the most important and intractable issues in the U.S.-Japan trade relationship. The U.S. government believes that weak competition policy in Japan unfairly allows private firms to block imports and has asked Japan to strengthen its Anti-monopoly Law and enforce it more rigorously. Many observers in the U.S. have expected that Japanese competition policy would eventually become more like American policy because consumers would demand stronger policies to force prices down. Few in Japan, however, consider American competition policy morally superior or historically inevitable. Most, for instance, have considered U.S. requests that Japan weaken its *keiretsu* system tantamount to asking it to dismantle one of the key bases of its national economic strength.

### **Comparison With Germany**

One way to think about the differences between U.S. and Japanese competition policy is to compare them with that of Germany. Some say that the U.S. is the outlier in its fanatical pursuit of antitrust policy while Japan is much like Europe in its reliance on close government-business relations and toleration for cozy cartel arrangements. For instance, Jirô Ushio, chairman of the Japan Association of Corporate Executives (*Keizai Doyukai*), writes,

*Compared to [the] Anglo-Saxon model, the traditional market rules in Japan and Europe are closed by nature....Three Japanese practices go against [the liberal] Asia-Pacific model: market rigging within an industry, excessive government control, and a tendency not to throw bad eggs out of the market. Old-fashioned Japanese businesses tend to avoid competing in open markets. Some industries condone restrictive business practices and they gang up to shut out new entries. True, rigging the market is a highly efficient way to do business, no one gets hurt through government mediation, and everyone can keep the cost of sales low. The upshot is higher prices, and it is the consumer who ends up holding the bill.<sup>1</sup>*

Ferdinand Protzman has written about Germany, "Although less pervasive than in Japan, protectionism in Germany is often just as deep-rooted and effective. The telecommunications, banking, insurance, electrical utility, and chemical industries, for

example, operate as virtual cartels. It is almost impossible for a foreign company to enter those markets without a German partner. Other barriers include restrictive laws, massive government subsidies, and the rigid protocols of a clannish, old-boy network that dominates the economy."<sup>2</sup>

Others argue that, despite some procedural differences, Europe is basically similar to the U.S. in the competitiveness of its markets and its openness to foreign goods. The lesson the European Commission draws from last year's U.S.-European negotiations over the Boeing-McDonnell Douglas merger is the success with which the U.S. and the EC were able to handle complex antitrust issues despite procedural differences. Karel van Miert, Commissioner of the European Commission in charge of antitrust policy, has commented that cooperation with the U.S. is much more intense than within the OECD generally and that this successful cooperation with the U.S. depends on a strong legal structure<sup>3</sup>. On exactly this point antitrust scholar Masayuki Funada has distinguished Japan from Europe. "The large number of extralegal regulations under the surface makes Japanese administrative practices completely different from that of the U.S...And, the fact that in Europe the rule of law is well rooted means that, although there may be some administrative guidance, it is not as powerful as in Japan."<sup>4</sup> Hiroshi Iyori, Commissioner of the JFTC from 1986 to 1991, and Akinori Uesugi, who has held a number of posts in the JFTC, also see a fundamental cleft between the more stringently enforced laws of Europe and the U.S. on the one hand, and the poorly enforced antitrust laws of Japan. "The Antimonopoly Act itself is very much in harmony with its counterpart laws in the U.S. and Europe, the only problem is in its enforcement. By recovering the essential function of the Antimonopoly Act in Japan, this trilateral trading area could enjoy very common conditions for competition."<sup>5</sup>

Although one can compare overall European Union policy to Japanese policy, each European nation still has its own national policies and practices. Germany is perhaps the most important case for comparison, both because it is Europe's largest economy, and because Germany created the idea that cartels could promote industrialization. Bismarckian Germany adopted this strategy to catch up with British industry and Japan imitated it, both before and after World War II. Yet although Germany had stronger cartel policies than Japan before World War II, it appears to have turned away from them more resolutely than Japan, in part because of changes in domestic ideology, and in part because Germany has become enmeshed in a system of international free trade agreements in the European Union, which has high standards of transparency and intense contact and scrutiny among nations.

## **Competition and Trade**

Competition policy can be viewed both in the narrow sense of laws enforced by competition policy authorities, as well as in the broader sense of policies that shape a national economy (industrial policy, financial policy, regulatory policy, standards setting).

In thinking about whether international agreements on competition policy can solve international trade disputes, it is important to consider if market access issues stem from merely competition policy, or from broader differences between systems of capitalism.

At the level of formal policy, Germany and Japan seem roughly similar, if different from the United States. Prohibitions against horizontal and vertical restraints and against abuse of dominant market position have roughly similar coverage. The Japanese Antimonopoly Law grants somewhat stronger powers to the Japan Fair Trade Commission to block mergers than does the German Law Against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*) gives the Cartel Office. The U.S. goes beyond either Germany or Japan in granting a considerable role to the courts in executing antitrust policy. First, American law provides important rights to private parties to bring suits through the courts, where they may receive treble damages. And the courts serve as an important Justice Department tool for breaking up large monopolies. Germany differs from both the U.S. and Japan in being subject to European Community law as well as national law, and the European Commission has played a major role in strengthening competition policy in Europe over the last 15 years.<sup>6</sup>

Prices of tradable goods represent a certain measure of differences in levels of competition and openness to international trade. Japan has had high prices for tradable manufactured goods, as well as for agricultural goods and for services, in comparison with the U.S. since the rise in the value of the yen from an average value of 239 yen to the dollar in 1985 to 145 yen to the dollar in 1987. German prices for manufactured goods have also historically been lower than those for Japanese goods, though higher than those for American goods. The category that has been an exception to this pattern is durable goods, for which German prices have been even higher than Japanese prices. A 1994 MITI survey of business costs found Japanese prices for raw materials, intermediate goods, and capital goods to be 30 percent higher than in the U.S., 19 percent higher than in Germany, and 46 percent higher than in South Korea.<sup>7</sup> Prices for services were 51 percent higher than in the U.S., 96 percent higher than in Germany, and 475 percent higher than in South Korea. A November 1996 survey by Japan's Economic Planning Agency estimated that prices for durable goods in Tokyo were 23 percent above New York prices, though 16 percent below Berlin prices. Tokyo clothing and shoes were 68 percent higher than in New York and 8 percent higher than in Berlin, while other manufactured goods were 31 percent and 11 percent higher respectively.<sup>8</sup> Sazanami, Urata, and Kawai concluded from their comparison of Japanese domestic and import prices that nontariff barriers add 174 percent to the prices of tradable goods in Japan. For machinery the "implied nontariff barrier rate" was 140 percent, for chemicals 127 percent, and for metal products 60 percent.<sup>9</sup> According to Japan's Economic Planning Agency, the current lower yen brings prices for manufactured goods closer in line with those in the U.S., although it is yet to be seen whether this will be a long-term phenomenon or not.

One might argue that the high prices for manufactured goods in Japan are an artifact of volatile exchange rates rather than an indication of weak domestic competition, and there is something to that argument. Nevertheless, a large price gap between Japanese and American prices for tradable goods has lasted for over a decade suggesting that whatever level of competition there may have been among domestic producers within Japan, Japanese producers were not subject to much competition from imports. Not only have Japanese prices long been high compared to American prices, but Richard Marston has shown that they are less affected by exchange rate changes than American prices.<sup>10</sup> Also, even at current exchange rates, prices for Japanese intermediate goods are still high and appear to be cross-subsidized to some extent by continued high prices for services such as transportation and construction.

## **Auto Industry**

It is important to think about specific industry cases in considering the effect of competition policy on domestic competition and international trade. One interesting case is autos. Germany has high auto prices and Japan has high auto parts prices that in both cases appear to provide an indirect subsidy to the domestic auto industry. In contrast to the U.S., both Germany and Japan have exclusive ties between auto makers and their distributors, which U.S. courts have banned. Japan also has restrictive auto repair regulations that support high auto parts prices. Thus, it appears that in the auto industry both competition policy and transportation safety policy play a role in suppressing competition.

In the German case, the European Commission has recently stepped in to weaken German carmakers' control of domestic prices. In January 1998, the European Commission fined Volkswagen some US\$112 million for pressuring its distributor in Italy not to sell cars to Germans and Austrians, who were seeking to avoid paying the 30 to 40 percent higher prices for cars in their own countries. The Commission is also investigating similar practices by Mercedes and Opel.<sup>11</sup> It is important that Europe has an international body that steps in and pursues international restraints on competition. Germany, however, has long been able to keep its auto prices much higher than those of its neighbors without suffering an onslaught of reverse imports that would correct this price discrepancy. In June 1997, when I spoke to the German Cartel Office official in charge of autos, he told me that although he knew of the discrepancy between German prices and those of neighboring countries, he saw no competition policy problem in the auto industry.<sup>12</sup>

The U.S. government has complained that the principal barrier to auto imports into Japan is the existence of exclusive dealerships. Of a total of 16,200 sales outlets, only 753 handle Big Three motor vehicles.<sup>13</sup> Yet Germany has similar ties between dealers and distributors and a huge volume of imports. The European auto industry is in some senses a unique industry because it has been granted special permission by the European Commission to have exclusive dealerships (though following Protzman's analysis above, one might argue that numerous other industries also have other kinds of protection from competition).

In fact, Germany imports far more cars than Japan. Although imports took 5.4 percent of the Japanese market in January-June 1997, imports took about 40 percent of the German market in 1994 (15.6 percent were from Japan). This difference in level of imports is reflected more broadly between the German and Japanese economies. While Germany imported manufactured goods equivalent in value to 54 percent of domestic production, similar to the U.S. figure, this figure for Japan was only 14 percent (See Table 1). I do not wish here to engage in the debate over whether the low Japanese level of imports of manufactured goods is due to high trade barriers, but simply to suggest that the sheer volume of imports into Germany may internationalize competition more than in Japan.

A major difference in closure to international competition lies not in contemporary competition policy per se, but in the legacy of earlier industrial policies. Japan pushed U.S. automakers out of the industry, while Germany has preserved an important place in the industry for Ford and GM. Over a third of the cars made in Germany are made by American-owned firms, Ford and Opel (GM). This may not in and of itself make the market more open to imports, but it means that the major domestic producers have a less national orientation.

The scarcity of foreign investment characterizes not just the auto industry, but the Japanese economy as a whole. Japan has 14 times as much direct investment overseas as foreign firms have in Japan (See Table 1). In contrast, the ratio between inward and outward investment is roughly equal in the U.S., France and the U.K. In Germany the outward/inward ratio is also skewed, though at 3.57, the disproportion is not as great as in Japan. Measured relative to the size of GDP, direct investment also appears to play a smaller role in internationalizing the economy in Japan than in other countries.<sup>14</sup> It amounts to only 0.38% of GDP in Japan, as opposed to almost 7 percent in the US and nearly 21 percent in the UK. Germany again is low, at 2.25 percent. This still puts it at over five times the Japanese level, if less than one-third the American level.

Japanese car prices do not appear to be out of kilter with world prices as are German car prices. Nevertheless, a 1991 U.S.-MITI survey found that prices for auto parts were 109 percent above U.S. prices.<sup>15</sup> Regulations by the Ministry of Transportation tend to insure that Japanese garages use Japanese-made parts and shun imports.<sup>16</sup>

## **Cosmetics Industry**

For the sake of comparison with the German auto market, the Japanese cosmetics market is perhaps an interesting case of heavy-handed actions by manufacturers to prevent retailers from undercutting their prices. Antitrust legal expert Harry First argues that the thrust of the Japanese Fair Trade Commission's stepped-up enforcement efforts since 1991 has been investigating retail price maintenance schemes. The JFTC issued new guidelines on resale price maintenance in 1991 and has pursued cases in drugs, cosmetics, and pre-recorded audio products.<sup>17</sup> In 1997 the JFTC completely banned resale price maintenance for

cosmetics.<sup>18</sup>

Though clearly the JFTC has made greater enforcement efforts in this area, its impact even on resale price maintenance has been feeble. The JFTC's actions in the cosmetics industry have attracted the most attention because of the extremely high prices in this market.

Sazanami, Urata and Kawai estimate the rate of implied non-tariff protection in cosmetics at 660 percent.<sup>19</sup> In October 1995, the JFTC ruled that Shiseido had illegally used threats to cut off deliveries to Jusco, Daiei, and the Consumers Co-ops in retaliation for discounting. However, at the same time, it continued to allow Shiseido to use face-to-face counseling requirements as an excuse for cutting off sales to smaller discounters. In 1990 Shiseido cut off deliveries to discounter Fujiki Shôten, saying it had broken its contract to only sell cosmetics through direct sales in order to provide face-to-face counseling. Fujiki Shôten argued that although it sold cosmetics over the telephone, it provided face-to-face counseling for any customers who requested it. In this regard, its sales were parallel to Shiseido's own subsidiary, Za Ginza, and to the major department stores, which also sell by telephone. What Fujiki does differently is deeply discount prices.<sup>20</sup>

The JFTC investigated the case, but said there was insufficient evidence to decide against Shiseido. A lower court decided in favor of Fujiki, but this decision was overturned by a higher court and is now under consideration by the Supreme Court. The upshot is that Fujiki is still unable to get deliveries from Shiseido, as is Kawachiya, another discounter. In August 1997 Fujiki also asked the JFTC to issue a cease and desist order against Kanebo, another major cosmetics producer, and against Kanebo's distribution company for cutting off supplies to it in retaliation for discounted sales.<sup>21</sup> Other discount stores find that Shiseido will supply them with some products, but reserve other products for stores that do not discount. Shiseido's Vice-President (*fukukaicho*) Akira Genma says that "the retailer decides the price," but admits that "we contract with keiretsu stores that emphasize value (*kachi*) for our new brands."<sup>22</sup> According to the *Nihon Keizai Shimbun*, the managing director of the *Zenkoku keshôhin kouri kumiai rengokai* (National Association of Cosmetic Retailer's Unions), which represents 17,000 *keiretsu stores*, "does not hide his warning when he says, 'the discount stores get hit because they make sales on the side' [that is they sell to blacklisted stores like Fujiki]."<sup>23</sup>

Fumio Sensui notes that while the European Union also allows suppliers of certain types of products to restrict supplies to certain dealers, there must be objective criteria for excluding sellers and these must be applied without discrimination. He notes critically that the JFTC has brought neither consideration to bear in reviewing cosmetics cases.<sup>24</sup> The *Shûkan Tôyô Keizai* (Weekly Oriental Economist) cites an "observer knowledgeable about the FTC" as saying, "Within the FTC there are many voices that are critical of giving too much support to discount stores."<sup>25</sup> The larger discount stores have been cautious about discounting cosmetics. Even Daiei, frequently cited as a champion price-cutter, is only timidly discounting the high-end cosmetics that require counseling by a maximum of 10 percent in the form of stamps good for purchases only at Daiei. According to the *Nihon*

*Keizai Shimbun*, "It is thought that Daiei is trying to maintain the price the manufacturer wants and thus avoid provoking a reaction."<sup>26</sup> Supermarkets have been discounting cosmetics that don't require counseling since 1995, but have not discounted cosmetics that do require it because of resistance from manufacturers.<sup>27</sup> In short, even in its showcase area of enforcement, the JFTC appears ineffective and compromised.

## Steel Industry

Another interesting case of comparison between Germany and Japan is the steel industry, in which the U.S. has low prices compared to both Japan and Germany. Japanese industry insiders say that the level of enforcement of antitrust policy is so different that Japanese producers collude to set prices on a routine basis in ways that American steel companies (in which Japanese steel firms hold large capital stakes) are afraid to do. System-wide issues, such as cross-shareholding patterns, however, probably also play a role in supporting Japanese prices, by reducing pressure on buyers to cut costs and find cheap supplies. Regulatory practices in the Ministry of Construction that favor insiders to the steel cartel also play an important role in keeping prices high and imports out.<sup>28</sup> In the German case, state subsidies have long been an important support for the industry, as have officially sanctioned cartels. (In fact, Germany currently has seven times as many officially sanctioned cartels as Japan.)<sup>29</sup> However, Germany has far higher levels of steel imports than Japan.

## Reflections

It is striking in comparing mutual complaints between the European Union and Japan about barriers to international trade, that the Japanese focus on the ways in which formal barriers to trade, such as subsidies, quotas, and tariffs are overused, while European complaints about Japan look much like American complaints about Japan and address the much broader issues of lax antitrust policy, patterns of cross-shareholding that present barriers to foreign investment, and a wide range of product standards that discriminate against foreign goods.<sup>30</sup> It is also significant that the EU has sided with the U.S. on the film case. EC Antitrust Commissioner Karel van Miert has argued that the film case would likely have been won in the WTO had it been argued on competition rules.<sup>31</sup>

On balance it appears that a combination of factors--greater internationalization through foreign investment, participation in a multinational Europe that makes thinking about the economy somewhat less nationalist, more rigorously enforced antitrust policy both within Germany and increasingly within the European Union--combine to make the German market more open to imports than the Japanese market. Yet this is not a simple comparison and there appear to be aspects of the Japanese economy that provide for more domestic competition, even if this competition for other reasons does not in practice help much with opening windows for imports.

## Table 1: Internationalization of Economies Through

# Trade and Investment



**Sources:** Japan 1997, *An International Comparison*, Keizai Koho Center, p. 17, 63. *Statistical Abstract of the United States*, 1997, p. 807. *CIA 1997 World Factbook* ([www.odci.gov/cia/publications/factbook/index.html](http://www.odci.gov/cia/publications/factbook/index.html)). Manufactured goods figure for Germany is based on 1995 total imports multiplied by the percentage

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### **Selected Antitrust Internet Sites**

#### **U.S. Federal Trade Commission**

[www.ftc.gov](http://www.ftc.gov)

#### **UK Office of Fair Trading**

[www.offt.gov.uk](http://www.offt.gov.uk)

#### **Japan Fair Trade Commission**

[www.jftc.go.jp](http://www.jftc.go.jp)

#### **Fair Trade Commission, Taiwan**

[www.ftc.gov.tw](http://www.ftc.gov.tw)

#### **Fair Trade Commission, Korea**

[www.ftc.go.kr](http://www.ftc.go.kr)

#### **Australian Competition Law Pages**

[sandpit.law.uts.edu.au/~sleung/](http://sandpit.law.uts.edu.au/~sleung/)

#### **Bundeskartellamt (Antitrust Authority, Germany)**

[www.bundeskartellamt.de](http://www.bundeskartellamt.de)

#### **APEC Competition Policy Database**

[www.apeccp.org.tw](http://www.apeccp.org.tw)

#### **OECD Competition Law & Policy**

[www.oecd.org/daf/ccp/](http://www.oecd.org/daf/ccp/)

#### **European Commission Competition DG IV**

[europa.eu.int/en/comm/dg04home.htm](http://europa.eu.int/en/comm/dg04home.htm)

## Delegation of the EC to the US

[www.eurunion.org](http://www.eurunion.org)

## Antitrust Policy Resources by Vanderbilt University

[www.antitrust.org](http://www.antitrust.org)

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