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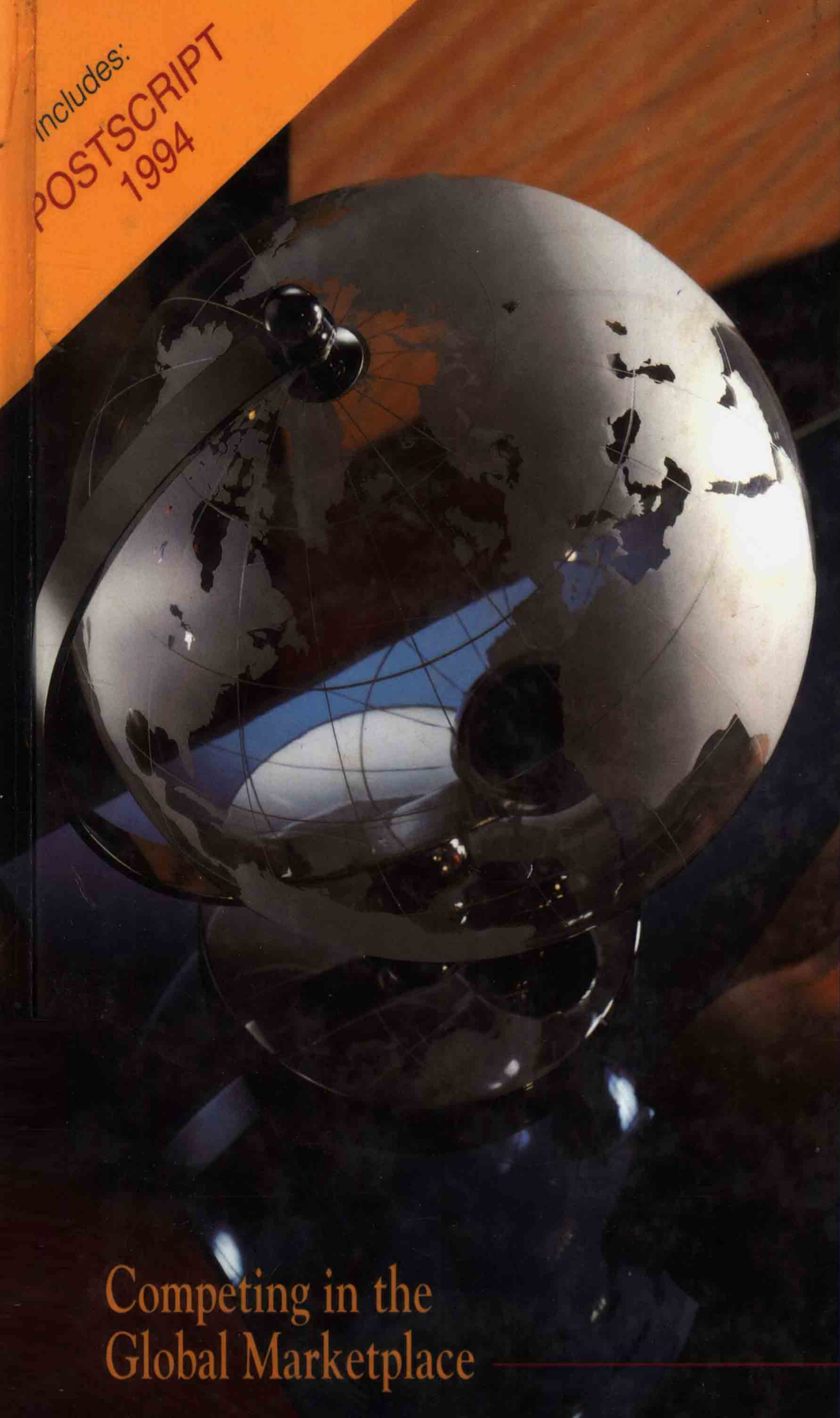

Competing in the
Global Marketplace

Charles W. L. Hill

INTERNATIONAL BUSINESS
Competing in the Global Marketplace

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About the Author

Charles W. L. Hill is professor of management and organization at the University of Washington's graduate school of business. He received a Ph.D. in economics from the University of Manchester Institute of Science and Technology (UMIST) in Great Britain and has taught there and at Texas A&M University, Michigan State University, and the University of Washington. His research interests center on strategic management and international business. The author of more than 30 research papers in academic journals, including the *Academy of Management Journal*, the *Academy of Management Review*, *Organization Science*, and the *Strategic Management Journal*, Professor Hill has served on the editorial boards of six journals, including those of the *Academy of Management Journal*, *Organization Science*, and the *Strategic Management Journal*. Currently he is a consulting editor for the *Academy of Management Review*.

Preface

International Business: Competing in the Global Marketplace is intended for the first international business course at either the undergraduate or the M.B.A. level. My goal in writing this book has been to set a new standard for international business textbooks: I have attempted to write a book that (1) is comprehensive and up-to-date, (2) goes beyond an uncritical presentation and shallow explanation of the body of knowledge, (3) maintains a tight, integrated flow between chapters, (4) focuses managerial implications, and (5) makes important theories accessible and interesting to students.

COMPREHENSIVE AND UP-TO-DATE

To be comprehensive, an international business textbook must:

- Explain how and why the world's countries differ.
- Present a thorough review of the economics and politics of international trade and investment.
- Explain the functions and form of the global monetary system.
- Examine the strategies and structures of international businesses.
- Assess the special roles of an international business's various functions.

This textbook does all of these things. Too many other textbooks pay scant attention to the strategies and structures of international businesses and to the implications of international business for firms' various functions. This omission is a serious deficiency, because the students in these international business courses will soon be international managers, and they will be expected to understand the implications of international business for their organization's strategy, structure, and functions. This book pays close attention to these issues.

Comprehensiveness and relevance also require coverage of the major theories. Although many international business textbooks do a reasonable job of reviewing long-established theories (e.g., the theory of comparative advantage and Vernon's product life-cycle theory) they tend to ignore such important newer work as:

- The new trade theory and strategic trade policy.
- Michael Porter's theory of the competitive advantage of nations.
- Robert Reich's recent work on national competitive advantage.
- The market-imperfections approach to foreign direct investment that has grown out of Ronald Coase and Oliver Williamson's work on transaction-cost economics.
- Bartlett and Ghoshal's research on the transnational corporation.
- The writings of C. K. Prahalad and Gary Hamel on core competencies, global competition, and global strategic alliances.

The failure of many books to discuss such work is a serious deficiency considering how influential these theories have become. A major proponent of strategic trade policy, Laura Tyson, is chairperson of President Clinton's Council of Economic Advisors. Robert Reich is Secretary of Labor in the Clinton administration. Porter's book has influenced the debate on trade and competitiveness. Ronald Coase won the 1992 Nobel Prize in economics, giving the market-imperfections approach new respectability. The work of Bartlett, Ghoshal, Hamel, and Prahalad is having an important impact on business practice.

I have incorporated all relevant state-of-the-art work at the appropriate points in this book. For example, in Chapter 4, "International Trade Theory," in addition to such standard theories as the theory of comparative advantage and the Heckscher–Ohlin theory, there is a detailed discussion of the new trade theory and Porter's theory of national competitive advantage. In Chapter 5, "The Political Economy of International Trade," the pros and cons of strategic trade policy are discussed. In Chapter 6, "Foreign Direct Investment," the market-imperfections approach is reviewed. Chapters 12 and 13, which deal with the strategy and structure of international businesses, draw on Bartlett and Ghoshal's work, and Prahalad and Hamel's research on strategic alliances is examined in Chapter 14.

Finally, in light of the fast-changing nature of the international business environment, every effort is being made to ensure that this book is as up-to-date as possible as it goes to press. Thus, for example, the student will find a detailed outline of the NAFTA, a discussion of the prospects for the EC after the partial breakdown of the European exchange rate mechanism late in 1992, a review of the concurrent problems with the Maastricht Treaty, and an examination of the political and economic turmoil occurring in the newly independent states of the former Soviet Union.

BEYOND UNCRITICAL PRESENTATION AND SHALLOW EXPLANATION

Many issues in international business are complex and thus necessitate considerations of pros and cons. To demonstrate this to students, I have adopted a critical approach that presents the arguments for and against economic theories, government policies, business strategies, organizational structures, and so on.

Related to this, I have attempted to explain the complexities of the many theories and phenomena unique to international business so that the student might fully comprehend the statements of a theory or the reasons a phenomenon is the way it is. These theories and phenomena are typically explained in more depth in this book than they are in competing textbooks, the rationale being that a shallow explanation is little better than no explanation at all. In international business, a little knowledge is indeed a dangerous thing.

INTEGRATED PROGRESSION OF TOPICS

Many textbooks lack a tight, integrated flow of topics from chapter to chapter. In this book students are told in Chapter 1 how the book's topics are related to each other. Integration has been achieved by organizing the material so that each chapter builds on the material of the previous ones in a logical fashion.

Part One Chapter 1 provides an overview of the key issues to be addressed and explains the plan of the book.

Part Two Chapters 2 and 3 focus on national differences in political economy and culture. Most international business textbooks place this material at a later point, but I believe it is absolutely vital to discuss national differences first. After all, many of the central issues in international trade and investment, the global monetary system, international business strategy and structure, and international business operations arise out of national differences in political economy and culture. To fully understand these issues, students must first of all appreciate the differences in countries and cultures.

Part Three Chapters 4 through 8 investigate the political economy of international trade and investment. The purpose of this part is to describe and explain trade and investment environment in which international business occurs.

Part Four Chapters 9 through 11 describe and explain the global monetary system, laying out in detail the monetary framework in which international business transactions are conducted.

Part Five In Chapters 12 through 14 attention shifts from the environment to the firm. Here the book examines the strategies and structures that firms adopt in order to compete effectively in the international business environment.

Part Six In Chapters 15 through 20 the focus narrows further to investigate business operations. These chapters explain how firms can perform their key functions—manufacturing, marketing, R&D, human resource management, accounting, and finance—in order to compete and succeed in the international business environment.

Throughout the book, the relationship of new material to topics discussed in earlier chapters is pointed out to the students to reinforce their understanding of how the material comprises an integrated whole.

FOCUS ON MANAGERIAL IMPLICATIONS

Many international business textbooks fail to discuss the implications of the various topics for the actual practice of international business. This does not serve the needs of business school students who will soon be practicing managers. Accordingly, the usefulness of this book's material in the practice of international business is discussed explicitly. In particular, at the end of each chapter in Parts Two, Three, and Four—where the focus is on the environment of international business, as opposed to particular firms—there is a section entitled *Implications for Business.* In this section, the managerial implications of the material discussed in the chapter are clearly explained. For example, Chapter 4, "International Trade Theory," ends with a detailed discussion of the various trade theories' implications for international business management.

In addition, each chapter begins with a case that illustrates the relevance of the chapter material to the practice of international business. Chapter 11, "The Global Capital Market," for example, opens with a case that describes how a Belgium biotechnology company used the global capital market to raise funds that could not have been raised in Belgium's illiquid capital market.

ACCESSIBLE AND INTERESTING

The international business arena is fascinating and exciting, and I have tried to communicate my enthusiasm for it to the student. Learning is easier and better if the subject matter is communicated in an interesting, informative, and accessible manner. One technique I have used to achieve this is weaving interesting anecdotes into the narrative of the text—stories that illustrate theory. Just how well this objective has been achieved will be revealed by time and student feedback. I am confident, however, that this book is far more accessible to students than its competitors. For those of you who view such a bold claim with skepticism, I urge you to read the sections in Chapter 1 on the globalization of the world economy, the changing nature of international business, and how international business is different.

SUPPORT MATERIAL

Instructor's Manual and Test Bank

The Instructor's Manual, prepared by Duane Helleloid of the University of Washington, contains chapter overviews, teaching suggestions, lecture notes, video notes, and a test bank of multiple-choice, short-answer, and essay questions.

Computest

A computerized version of the test bank is available and allows the instructor to generate random tests and to add his or her own questions.

Teletest

Customized exam preparation is furnished by the publisher.

Transparency Package

A set of full-color transparencies contains key figures and maps from the book as well as additional lecture enhancers.

Videos

Four videotape segments bring the fast-changing world of international business into the classroom for students. Highlighting major sections of the book, these videos focus on such topics as international trade, global manufacturing, and Coca-Cola's entry into Japan.

Global Business Insights

Recent articles from the *Los Angeles Times* provide students with additional, real-life illustrations of the concepts covered in the book. Chosen for their currency and level of interest, they will stimulate and enhance classroom discussions.

The Software Toolworks World Atlas

An atlas, almanac, and world fact book, the *World Atlas* is a powerful computer-based reference tool that combines state-of-the-art maps of every country in the world with a database of international information.

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Charles W. L. Hill

POSTSCRIPT—1994

INTRODUCTION

We live in a world where the only constant is change. This presents a problem for international business books, where we always make an attempt to be as current as possible on multilateral and regional trade agreements, international political and economic developments, the evolution of the international monetary system, and the development of new business strategies and structures for competing in the global marketplace. Because the international economic and political scene evolves so quickly, any international business book is out of date the moment it is published. Since the final draft of this book was completed in mid-1993, there have been a number of developments with important implications for enterprises trying to compete in the global economy. In this postscript we review these developments and discuss their implications. The developments include:

- Completion of the Uruguay Round of GATT negotiations and an agreement to create a new international institution, the World Trade Organization (WTO), to implement the GATT.
- The emergence of serious trade tensions between the United States and Japan over the limited foreign access to Japan's market.
- The ratification of the North American Free Trade Agreement (NAFTA) by the U.S. Congress, which effectively removed the final impediment to the formation of the world's largest free-trade area.
- The ratification of the Maastricht treaty by the 12 members of the European Community (EC). The Maastricht treaty lays out a framework and timetable for a much closer economic and political union between EC member-countries. Symbolically, the EC also changed its name to the European Union (EU) at this time.
- A March 1994 agreement among existing EU members to enlarge the EU to include four new members: Norway, Sweden, Finland, and Austria (subject to approval by the voters of those countries).
- The virtual collapse of the European Monetary System (EMS) following a wave of speculative pressure in the international currency markets.
- Growing economic and political turmoil in many countries formerly part of the Soviet Union and most seriously in Russia, where the risk of political anarchy and economic collapse seems very real.

In this postscript, as of mid-1994, we review these developments and flesh out their implications for material discussed in earlier chapters of this book. We will deal with the issues in the order that they were listed.

GATT: THE DEAL IS DONE

The history and functions of the GATT were discussed in detail in Chapter 5. Established in 1947, the GATT is a multilateral agreement whose objective is liberalizing world trade by eliminating tariffs, subsidies, import quotas, and the like. The process of tariff reduction has been spread over eight rounds. The last round, the Uruguay Round, was launched in 1986, completed on December 15, 1993, and formally signed by member-states at a meeting in Marrakesh, Morocco, on April 15, 1994. The Uruguay agreement now has to be ratified by the governments of the 117 member-countries before being formally put into effect on July 1, 1995.

By all accounts, reaching a final agreement on the Uruguay Round was an extremely difficult process. For some time, it looked as though an agreement might be impossible, which raised fears of trade wars and economic depression. The main impediment to reaching agreement was a long-standing dispute between the United States and the European Community on agricultural subsidies. An agreement had to be reached before December 16, when the "fast-track negotiating authority" granted to the U.S. president, Bill Clinton, by the U.S. Congress would have expired. Had this authority expired, any agreement would have required approval from the U.S. Congress as a whole, rather than only the president—a much more difficult proposition that could effectively have stalled the talks. An eleventh-hour compromise on agricultural subsidies, which reduced the level of subsidies significantly but not as much as the United States had initially wanted, saved the day.

Main Components of the GATT Deal

Some of the most important components of the December 15 agreement are detailed in Table P.1.[1] In brief, if ratified by all member-nations, the Uruguay Round will have the following effects: tariffs on industrial goods will be reduced by more than one-third from their present level; agricultural subsidies will be substantially reduced; for the first time, GATT fair trade and market access rules will be extended to cover a wide range of services; GATT rules will also be extended to enhance protection for patents, copyrights, and trademarks (intellectual property); barriers on trade in textiles will be significantly reduced over 10 years; GATT rules will in general be much clearer and stronger; a World Trade Organization (WTO) will be created to implement the GATT agreement.

Services and Intellectual Property

In the long run, the extension of GATT rules to services and intellectual property may be particularly significant. Up to now, GATT rules have only applied to industrial goods (manufactured goods and commodities). In 1992, world trade in services amounted to $900 billion out of a total of $3,580 billion. Extending GATT rules to this important trading arena could significantly increase both the total share of world trade accounted for by services and the overall volume of world trade. Moreover, the extension of GATT rules to cover intellectual property will make it much easier for high-technology companies to do business in developing nations where intellectual property rules have historically been poorly enforced. In particular, high-technology companies will now have a mechanism to force countries to prohibit the piracy of intellectual property (e.g., the illegal copying of books, computer software, and music recordings, or infringing on patents).

[1] Table P.1 is based on "The GATT Deal," a special report in the *Financial Times*, December 16, 1993, pp. 4–7.

Table P.1: *Main Features of the December 15, 1993, GATT Agreement*

	Up to Now	The 1993 Agreement	Main Impact
Industrial Tariffs	Backbone of previous GATT rounds. Tariffs on industrial goods average 5% in industrialized countries—down from 40% in the late 1940s.	Rich countries will cut tariffs on industrial goods by more than one-third. Tariffs will be scrapped altogether on over 40% of manufactured goods.	Easier access to world markets for exports of industrial goods. Lower prices for consumers.
Agriculture	High farm subsidies and protected markets in United States and EU lead to overproduction and dumping.	Subsidies and other barriers to trade in agricultural products will be cut over six years. Subsidies will be cut by 20%. All import barriers will be converted to tariffs and cut by 36%.	Better market opportunities for efficient food producers. Lower prices for consumers. Restraint of farm subsidies war.
Services	GATT rules do not extend to services. Many countries protect service industries from international competition.	GATT rules on fair trade principles extended to cover many services. Failure to reach agreement on financial services and telecommunications. Special talks will continue.	Increase in trade in services. Further liberalization of trade in services now seems likely.
Intellectual Property	Standards of protection for patents, copyrights, and trademarks vary widely. Ineffective enforcement of national laws a growing source of trade friction.	Extensive agreements on patents, copyrights, and trademarks. International standards of protection and agreements for effective enforcement established.	Increased protection and reduction of intellectual property piracy will benefit producers of intellectual property (e.g. computer software firms, performing artists). Will increase transfer of technology.
Textiles	Rich countries have restricted imports of textiles and clothing through bilateral quotas under Multi-Fiber Arrangement (MFA).	MFA quotas progressively dismantled over 10 years and tariffs reduced. Normal GATT rules will apply at end of 10 years.	Increased trade in textiles should benefit developing countries. Reduced prices for consumers worldwide.
GATT Rules	GATT remains the same as when drafted in 1947 even though many more countries have entered the world trading community and trade patterns have shifted.	Many GATT rules revised and updated. They include codes on customs valuation and import licensing, customs unions and free trade areas, and rules dealing with waivers from GATT regulations.	Greater transparency, security, and predictability in trading policies.
World Trade Organizations (WTO)	GATT originally envisioned as part of an International Trade Organization. ITO never ratified and GATT applied provisionally.	GATT becomes a permanent world trade body covering goods, services, and intellectual property with a common disputes procedure. WTO to implement results of Uruguay Round.	More effective advocacy and policing of the international trading system.

The World Trade Organization (WTO)

The clarification and strengthening of GATT rules and the creation of the World Trade Organization (WTO) hold out the promise of more effective policing and enforcement of GATT rules. By promoting trade, the WTO should have a beneficial effect on overall economic growth and development. The WTO will act as an umbrella organization that will encompass the GATT along with two new sister bodies: one on services and the other on intellectual property. The WTO will take over responsibility for arbitrating trade disputes and monitoring the trade policies of member-countries. While the WTO will operate as GATT now does in dispute settlement—on the basis of consensus—member-countries will no longer be able to block adoption of arbitration reports. Arbitration panel reports on trade disputes between member-countries will be automatically adopted by the WTO unless there is a consensus to reject them. Countries found by the arbitration panel to violate GATT rules may appeal to a permanent appellate body of the WTO, but its verdict will be binding. If offenders fail to comply with the recommendations of the arbitration panel, trading partners will have the right to compensation or, as a last resort, to impose commensurate trade sanctions. Every stage of the procedure will be subject to strict time limits. Thus, the WTO will have something that the GATT never had—teeth.[2]

Implications of the GATT Deal

Some of the general implications of the GATT deal are noted in Table P.1. On balance, the world is significantly better off with a GATT deal than without one. Without the deal there was a very real possibility that the world might have slipped into increasingly dangerous trade wars, which might have triggered a substantial recession. With a GATT deal concluded, the current world trading system looks secure, and there is a good possibility that the world economy will now grow faster than it would have otherwise. Estimates on the overall impact of the GATT agreement, however, are not that dramatic. Three studies undertaken in mid-1993 (before the agreement was finalized)—one by the Organization for Economic Cooperation and Development (OECD), one by the World Bank, and one by the GATT Secretariat—have estimated that the deal will add between $213 billion and $274 billion in 1992 U.S. dollars to aggregate world income by 2002—or about 0.75 percent to 1 percent of gross global income by that time.[3] However, others argue that these figures underestimate the potential gain because they do not factor in the gains from the liberalization of trade in services, stronger trade rules, and greater business confidence. Including such factors, it is claimed that due to the GATT agreement global economic output could be as much as 8 percent higher than it would otherwise have been by 2002.[4] Whatever figure is closer to the truth, recall what a successful GATT agreement helps avoid—the risk of a trade war that might reduce global economic growth and raise consumer prices.

As for individual firms, some clear winners emerge—and also some that have not done so well in the GATT deal. Two big winners in the United States are Caterpillar, Inc., and John Deere & Co., both manufacturers of heavy construction equipment. The GATT deal eliminates import tariffs on the construction equipment and engines these

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[2] Frances Williams, "WTO—New Name Heralds New Powers," *Financial Times*, December 16, 1993, p. 5. Frances Williams, "GATT's Successor to Be Given Real Clout," *Financial Times*, April 4, 1994, p. 6.

[3] The studies are: (i) OECD and the World Bank, *Trade Liberalization: The Global Economic Implications*, Paris and Washington, 1993; (ii) OECD, *Assessing the Effects of the Uruguay Round*, Paris, 1993; (iii) GATT Secretariat, *Background Paper: The Uruguay Round*, GATT, 1993.

[4] Martin Wolf, "Doing Good Despite Themselves," *Financial Times*, December 16, 1993, p. 15.

companies produce. Caterpillar estimates that the deal will add $125 million to its $10 billion annual sales and result in 800 more jobs at Caterpillar with a further 1,600 jobs at Caterpillar's suppliers. Other big winners include many small exporters around the world, who, in addition to falling tariffs, will find that GATT contains simplified import licensing rules and steps for harmonizing customs procedures. These rules promise to simplify exporting procedures—procedures that raise exporting costs and are thought to deter many small firms from getting into the export business.

On the other hand, not everyone is pleased with the deal. While pharmaceutical companies are pleased that drug tariffs will be phased out over the next few years, they expressed disappointment that it will take 10 years to phase in patent protection for their products (weak patent protection in many countries has led to local competitors violating patents and copying the successful drugs of multinational pharmaceutical firms). Among the disappointed were financial services companies—particularly big banks. They had hoped for elimination of many of the barriers that prevent them from selling their financial services across borders, but a failure to reach agreement resulted in financial services being specifically excluded from the extension of GATT rules to services. The Hollywood film and television industry was also disappointed. Hollywood had hoped to use the GATT to break down European quotas that limit the number of U.S. movies broadcast on European TV, but opposition from the French government led to this issue being dropped in a last-minute compromise.[5]

For the Future

Although the Uruguay Round has now been agreed to in principle by all member-states, it still has to be formally ratified by the governments of each member-state. The plan is to complete ratification before the end of 1994 so the new set of regulations can take effect on July 1, 1995. However, in the United States, the world's largest trading nation, congressional passage of the Uruguay Round implementing legislation will not be easy. The Clinton administration faces opposition from a number of influential special interests in Congress who fear that they will lose under the new agreement. This includes the agricultural lobby, which will see significant reductions in subsidies, and many business and labor groups who see the pact as diluting U.S. trade laws. For example, labor groups and some businesses argue that in virtually every area, current U.S. law provides the domestic industry with greater remedies against injurious unfair trade than will exist under the new Uruguay Round regime.[6] Despite such opposition, most observers believe that the Uruguay Round legislation will ultimately pass the U.S. Congress, although it may be a bumpy ride.

Once in effect, the 1994 GATT deal still leaves a lot to be done on the international trade front. Substantial trade barriers still remain in areas such as financial services and broadcast entertainment—although these seem likely to be reduced eventually. More significantly, perhaps, there is still a whole range of issues that GATT, and now the WTO, have yet to discuss—but increasingly will need to. Three of the most important areas for future development are environmentalism, workers' rights, and foreign direct investment.[7]

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[5] Brent Bowers, "For Small Firms, Big Gains Are Seen in the Fine Print," *The Wall Street Journal*, December 16, 1993, p. A12. Staff reporters, "U.S. Business Like Trade Pact as a Whole: But Not Some Parts," *The Wall Street Journal*, December 16, 1993, pp. A3, A13.

[6] Nancy Dunne, "U.S. Farm Interests Fire Warning Shot," *Financial Times*, April 15, 1994, p. 8.

[7] Frances Williams, "Trade Round Like This May Never Be Seen Again," *Financial Times*, December 16, 1993, p. 7.

High on the list of the WTO's future concerns will be the interaction of environmental and trade policies and how to best promote sustainable development and ecological well-being without resorting to protectionism. In particular, the WTO will have to find ways to cope with the increasingly strident claims by environmentalists that expanded international trade encourages companies to locate factories in areas where they are freer to pollute.

Paralleling environmental concerns are concerns that free trade encourages firms to shift production to countries with low labor costs where workers' rights are routinely violated. The United States has repeatedly and unsuccessfully pressed for discussion of common international standards on workers' rights—an idea strongly opposed by poorer nations who fear that it is another excuse for protectionism by the rich.

GATT regulations have never been extended to embrace foreign direct investment. Given the globalization of production that we are now witnessing in the world economy, barriers to foreign direct investment seem antiquated and yet are still widespread (see Chapter 7 for details). Currently many countries place limits on investment by foreign companies in their economies (e.g., local content requirements, local ownership rules, and even outright prohibition). Extending GATT to embrace foreign direct investment might require countries to grant establishment rights to foreign companies.

TWO TRADE DISPUTES

The ink on the December 15th GATT agreement had hardly dried when the burst of euphoria that followed the agreement was dampened by the development of two potentially serious trade disputes, one between the United States and Japan and the other between Britain and Malaysia. Both disputes demonstrate how far the world trading system has to go before reality matches the ideals that GATT has been striving toward for over half a century.

Japan and the United States: Numerical Targets and Cellular Phones

The United States and Japan boast one of the largest bilateral trading relationships in the world. It is also a trading relationship that many see as lopsided, with Japan exporting nearly $60 billion more goods to the United States than it imports from the United States. The trade dispute had its roots in a series of talks between Japan and the United States begun in mid-1993. The subject of these talks was Japan's trade imbalance with the United States and steps that might be taken to open up the Japanese market to more foreign goods and services. In particular, the Clinton administration felt that various nontariff (administrative) trade barriers worked to exclude foreign companies from competing effectively in Japan's automobile, construction, telecommunications, insurance, and medical equipment industries (for details of nontariff trade barriers see Chapter 5).

For months, the U.S. government has been pushing the Japanese government to agree to set numerical targets for foreign imports. The model was a 1991 agreement between Japan and the United States to increase foreign access to Japan's semiconductor market. That agreement contained an *expectation* that due to improved market access, by the end of 1992, foreign companies would be able to gain 20 percent of the Japanese market for semiconductors. The United States chose to view the 20 percent figure as a *target*—as opposed to an expectation—and when the 20 percent figure was reached they jumped to the conclusion that numerical targets work, much to the horror of the

Japanese, who had never seen the 20 percent figure as a target.[8] The Japanese resisted the whole idea of numerical targets for what they saw as a very rational reason: Japan has a free-market economy, and in a free-market economy the government cannot, and should not, tell consumers and companies how much of a foreign product to buy. To complicate matters, the government of Morihiro Hosokawa, then in power, was a fragile coalition and Hosokawa was under strong domestic pressure to stand up to the United States on the issue of numerical targets. The net result was that the Japanese refused to budge and on February 11, 1994, the market access talks collapsed.

The American response was swift—on February 15th the U.S. government announced its intent to introduce formal trade sanctions against Japan for protecting its cellular telephone market. The United States stated that within 30 days it would produce a list of Japanese companies that would be punished with trade sanctions unless Japan opened its cellular telephone market. The cellular telephone market was chosen because it was relatively easy to make a case that administrative trade barriers had made it difficult for the U.S. cellular phone company, Motorola, Inc., to gain market share in Japan. Japan had originally agreed to open up a big part of the cellular telephone market to Motorola in 1989. At that time, the Japanese cellular phone service company, IDO, was building a mobile phone system using a rival technology developed by Nippon Telegraph and Telephone (NTT) to serve the highly populated Tokyo-Nagoya corridor. Under pressure from the Japanese government, IDO agreed to build a separate system using Motorola's technology. However, IDO could not easily afford to build two systems, so it concentrated on the NTT technology. Consequently, as of January 1994 it had 400 base stations for the NTT-compatible system compared with 110 for the Motorola system. This meant that the NTT phones could be used in 94 percent of the area, compared with 61 percent for the Motorola phones. Given this disparity, it is unsurprising that more than 310,000 customers have chosen NTT-compatible phones and only 10,000 use the Motorola phones. According to the U.S. government, the resulting lack of sales violated the comparable market access that Japan promised in 1989.[9]

According to many observers, the real agenda of the U.S. government was to create uncertainty and anxiety in Japan about Washington's next move. The uncertainty would drive up the value of the Japanese yen, thereby making Japan's exports more expensive and further hurting Japan's troubled exporting companies—companies already mired in their deepest recession since World War II. The net effect, it was hoped, would force the Japanese to return to the bargaining table and make concessions on the key issue of numerical targets.[10]

The U.S. government increased the pressure on Japan in early March when it revived a trade law known as "Super 301" that had lapsed in 1990. Super 301 is a provision in U.S. trade law that allows individuals or the government to retaliate against "unjustifiable, unreasonable, or discriminatory traders abroad." While few believe that the U.S. will actually apply Super 301, they see the revival of this law as another step in the game of piling pressure on the Japanese in an attempt to bring them back to the bargaining table with concessions.

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[8] Michiyo Nakamoto, "Japan 'Trapped' by Chip Import Deal," *Financial Times*, March 23, 1994, p. 4.

[9] Andrew Pollack, "The Trade Frustrations of Motorola," *The New York Times*, February 16, 1994, p. C4.

[10] Thomas Friedman, "United States Hoping to Use Fears of Trade War to Pressure Japan," *The New York Times*, February 16, 1994, pp. C1, C4.

While there is still no sign that the Japanese are willing to give ground on numerical targets, there are signs that the Japanese are willing to make some important concessions to avoid getting drawn into a costly trade war; to this extent, the U.S. tactics might be viewed as eliciting the desired response. On March 13, 1994, Japan announced that it had brokered a deal between Motorola and IDO that would increase Motorola's access to the Japanese market. The deal calls for IDO to bring forward its investment in 159 more base stations for the Motorola phone system and to complete that investment by autumn of 1995. IDO also agreed to reallocate some of its radio frequency used by NTT to Motorola. The Japanese government further agreed to monitor IDO's progress in achieving these goals and to provide IDO with low interest rate loans to help it make the accelerated investments.[11]

On March 30, 1994, the Japanese government followed up by unveiling a package of market-opening measures intended to increase imports, reduce its current account surplus, boost the domestic economy, and open up markets to foreign competition through deregulation. The main thrust of the package was streamlining or eliminating many of the bureaucratic procedures used in the past to block foreign competition in certain sectors. However, the package did not include the numerical targets that the United States had been requesting, and U.S. officials expressed only lukewarm approval of the package.[12]

As of early May 1994, this dispute is still ongoing. A final resolution seems some way off, although most analysts doubt that the Unites States and Japan will enter into a tit-for-tat trade war. To complicate matters further, in early April, Japan's prime minister, Morihiro Hosokawa, a champion of deregulation in Japan, was forced to resign following allegations that he was involved in a long-standing corruption scandal that has already forced three prime ministers out of office since 1991. The political uncertainty following Hosokawa's resignation seems likely to push any resolution of the still-simmering trade dispute between the United States and Japan even further off into the future.

Britain and Malaysia

In mid-February of 1994, a British paper, *The Sunday Times*, ran an article alleging that a £1 billion ($750m) sale of defense equipment by British companies to Malaysia was secured only after bribes had been paid to Malaysian government officials, and after the British Overseas Development Administration (ODA) had agreed to approve a £234 million grant to the Malaysian government for a hydroelectric dam of dubious (according to *The Sunday Times*) economic value. The clear implication was that U.K. officials, in their enthusiasm to see British companies win a large defense contract, had yielded to pressures from "corrupt" Malaysian officials for bribes—both personal and in the form of the £234 million development grant.[13]

What happened next took everyone by surprise—the Malaysian government promptly announced a ban on the import of all British goods and services into Malaysia and demanded an apology from the British government. Officially the ban only applied to government orders for British goods and services, with the private sector left free to buy as it chose. However, British companies with experience in the region are nervous that the private sector will follow the government's lead in shunning British products. At stake is as much as £4 billion in British exports and construction activities in Malaysia, and a presence in one of the world's fastest-growing developing economies (Malaysia's econom-

[11] Michiyo Nakamoto, "Cell Phone Pact Lifts U.S. Threat against Tokyo," *Financial Times*, March 14, 1994, p. 1.

[12] Emiko Terazono, "Japan Trade Package Yields to U.S. Demands on Imports," *Financial Times*, April 30, 1994, pp. 1, 4.

[13] Keiran Cooke, "Honeypot of as Much as $4 Billion down the Drain," *Financial Times*, February 26, 1994, p. 4.

ic growth has averaged 8 percent per annum since 1989). In announcing the ban, Malaysia's prime minister, Dr. Mahathir Mohamad, noted that the British media portrays Malaysians as corrupt because "they are not British and not white" and that "we believe the foreign media must learn the fact that developing countries, including a country led by a brown moslem, have the ability to manage their own affairs successfully."[14]

The British government responded by stating that it could not tell the British press what to publish or not to publish, to which Dr. Mahathir replied that there would be "no contracts for British press freedom to tell lies." At the same time, the British government came under attack from members of its Parliament who suspect that the government did act unethically and approve the ODA hydroelectric grant to help British companies win orders in Malaysia. As of May 1994, no quick resolution is in sight. What the dispute demonstrates, however, is that for all of the moves toward global economic integration, trade between nations is still very much subject to the whims of the governments involved.

REGIONAL ECONOMIC INTEGRATION: NAFTA, THE EU, AND APEC

Over the last 12 months the pace of regional economic integration has accelerated worldwide (see Chapter 8 for background). One significant development was in North America, where the North American Free Trade Agreement (NAFTA) was ratified by the U.S. Congress after bitter debate. In Europe, significant developments included the ratification of the Maastricht treaty by the member-nations of the European Community, which subsequently changed its name to the European Union (EU), and a decision to enlarge the EU to 16 nations. In the Asian Pacific region, the Asia Pacific Economic Cooperation group (APEC) emerged as a forum within which intraregional trade issues could be discussed.

NAFTA

The background to NAFTA was discussed in Chapter 8 (see pages 235–38). When Chapter 8 was written NAFTA had been agreed to in principle but not yet ratified by the governments of the three countries involved: Canada, Mexico, and the United States. The United States and Canada entered into a free trade agreement in 1989, and NAFTA involved an extension of that agreement to include Mexico. Both Canada and Mexico had committed themselves to NAFTA by the fall of 1993, leaving only the U.S. government to signal its intention to go forward with the agreement. The Clinton administration had already committed itself to NAFTA, and passage by the U.S. Senate looked likely, but the agreement faced stiff opposition in the U.S. House of Representatives. The vote on NAFTA in the House of Representatives was scheduled for November 17, 1993. Only hours before the vote the outcome was still in doubt, and then a last-minute round of lobbying by President Clinton, which included numerous side deals to sway the support of wavering representatives, led to a final surge of votes for NAFTA and the bill passed the House by a comfortable margin.

The NAFTA agreement became law on January 1, 1994. The contents of the NAFTA agreement include:

- NAFTA abolishes, within 10 years, tariffs on 99 percent of the goods traded between Mexico, Canada, and the United States.

[14] Keiran Cooke, "Arrogance of the West Riles a Maverick," *Financial Times*, February 26, 1994, p. 4. Robert Peston, "Malaysia PM Says Die Is Cast over U.K. Ban," *Financial Times*, March 17, 1994, p. 1.