Dennis J. Encarnation. Rivals Beyond Trade: America vs Japan in Global Competition. (Ithaca: Cornell University Press, 1992), Chpts. 1, 2

purpose: explain the pervasive trade and investment imbalances between Japan and the United States

summary: capital restrictions have made it nearly impossible for American multi-national corporations to invest in majority subsidiaries in Japan, thereby limiting their ability to engage in intracompany trade, offshore production and overseas distribution, and foreign sales there

A. Importance of Foreign Direct Investment (FDI), rather than international trade, in modern economic competition

- the new international political economy: 2 fundamental changes (5)
    1. FDI drives global competition beyond international trade; foreign production is responsible for more overseas sales than cross-border transactions
    2. FDI has moved national competition beyond bilateral trade to encompass multilateral contests among the far-flung subsidiaries of MNCs
- empirics:
    - America's economic domination derives from the value of US direct investments in overseas subsidiaries, which generate more sales than do foreign exporters and overseas investors in the US
    - Japan as the exception: Japanese sell more in the US than vice versa, and Japanese assets in the US more than double the value of US assets in Japan (FDI disparities)

B. The origins of the trade imbalance, or why American MNCs succeed everywhere but in Japan (pp.6-8)

- Japan restricts US FDI and market access because US-owned subsidiaries pose a real competitive challenge through offshore production and overseas distribution, while US has remained liberal about market access to the Japanese
- while Japan began to gradually liberalize, NTBs continued to structurally protect the *keiretsu*; these oligopolists continued to control the timing and extent of liberalization by mediating between foreign demands and government responses; Japanese oligopolists replaced government regulations with private restrictions on business relationships among shareholders, buyers, suppliers, etc..
- without foreign competition at home, Japanese oligopolies grew and expanded into the US, where they traded and invested freely, while American companies have been slowly driven out of producing at home; currency devaluations have been largely ineffective, because most of the trade between the two countries have been intracompany shipments

C. US vs Japanese MNCs (author equates MNCs with FDI), p.9

- majority subsidiaries vs minority affiliates (p.10)
    - majority subsidiaries: managerial control over far-flung operations and reduction in high costs plaguing cross-national transactions enhance technological, marketing, and organizational assets available to the parent MNC and the majority affiliate
    - both the Americans and the Japanese have preferred to invest in majority subsidiaries, which account for 75% and 85% of their global sales, respectively, but in Japan, majority US subsidiaries generate less than 40% of the sales
- foreign sales vs international trade (p.15)
    - foreign sales from overseas subsidiaries come from 3 sources: host-country market of the overseas subsidiary, home-country market of the subsidiary's parent, and third-country markets that are geographically close to the host country
    - for both the US and Japan, foreign sales have always dominated international trade, especially host-country (local) sales
    - differences exist in bilateral trade: the Japanese in America export back to Japan more than do Americans in Japan; Japanese-owned subsidiaries are the largest US-based exporters to Japan, guaranteeing Japanese MNCs control over bilateral trade
- offshore production vs overseas distribution (pp.21)

- offshore production: majority subsidiaries produce in host-countries many of the goods and services that their parents otherwise would export to the same overseas markets
- overseas distribution: majority subsidiaries used to facilitate foreign sales of MNCs by creating sales and service networks for shipments from their parents; becomes especially important in advanced markets with tightly controlled distribution systems and other marketing barriers to entry
- Japan has highly restricted market access, forcing US MNCs to use their subsidiaries for distribution more than for production; at the same time, Japan also invested more aggressively in their overseas subsidiaries to procure supplies to ship back to their parents (upstream movement) than did American wholesaling subsidiaries, thereby allowing Japan greater control over imports from the US

- intracompany shipments vs arm's length trade (pp.26)
  - intracompany trade (between MNC parent and overseas subsidiaries) 1) insures greater control over upstream supplies and downstream markets than do arm's-length transactions among unaffiliated buyers and suppliers; 2) lowers transaction costs normally imposed on marketing and organizational assets across borders; 3) less vulnerable to short-term swings in foreign-exchange rates, thereby minimizing impact of national policies aiming to alter currency movements
  - intracompany trade important for both countries, especially for manufactured goods, but this requires majority ownership of subsidiaries, which Japan enjoys more than does the US
  - this denies US MNCs the same access for US exports than they enjoy in other industrialized states, thereby contributing to lesser importance of US MNCs in this bilateral trade alliance

D. Strategic trade / investment policy (32)

- strategic trade policy: national policies restricting imports and promote exports that create imperfect competition and allows local producers to capture above-normal profits, thereby increasing national income;
  - market imperfections can naturally cause this, but gov't intervention can determine which oligopolies / sectors thrive
  - being shut out of Japanese markets, US rivals are being driven out of producing in their own market and abroad, resulting in a persistent bias in the distribution of gains
  - large economies of scale (high fixed costs) and steep learning curves (high initial marginal costs), both of which create strong incentives for firms and gov'ts to protect domestic markets or promote exports, are necessary for strategic trade policies to be useful; Japanese oligopolists and government policymakers pursued both
- strategic investment policy: two important market imperfections- 1) high transaction costs, 2) large economies of scope
  - majority subsidiaries can overcome these imperfections, but unilateral gov't control on capital inflows in Japan, coupled with private restrictions on foreign investments, shut out American companies from the Japanese market