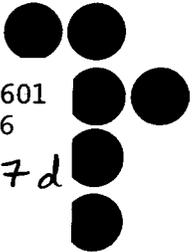


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COMPETITION AND COOPERATION IN TELECOMMUNICATIONS
BETWEEN JAPAN AND THE UNITED STATES

April 2, 1987

Seminar Notes

**MASSACHUSETTS INSTITUTE OF TECHNOLOGY
COMMUNICATIONS FORUM**

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**Yoshiji Nogami
Embassy of Japan (D.C.)**

**Clyde Prestowitz
Woodrow Wilson Center for Scholars
Smithsonian Institution**

COMPETITION AND COOPERATION IN TELECOMMUNICATIONS
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Clyde Prestowitz summarized succinctly what appeared to be the crux of the problem during the question and answer session. The United States, he said in response to one query, asks the Japanese to be 'open' which effectively means "be like us," and the Japanese are puzzled by such a request. In turn the Japanese ask the US to work harder to be competitive, meaning "be like them," which puzzles the Americans. The net result is, he said, a deadlock of frustration. Prestowitz recommends that the US negotiate for specific results rather than request 'open procedures' which are alien to the Japanese way of doing business.

Introducing the topic for the day the moderator, Prof. Richard Samuels, noted that Japan and the US have many traditional economic ties. The countries represent the two largest free market economies, and both are democracies that espouse free trade. Further, Japan and the US both protect and nurture different parts of their markets for different reasons and in different ways. In addition, the two countries are military allies. However, in spite of all of these common features and ties the "trade war," he said, has overwhelmed "star wars" as a focus of national attention. He observed that nothing could be said with enduring certainty about the US-Japan economic and security relationships. Everything about it, he said, is exceptionally dynamic.

While all this is true, it is not so obvious, he said, that issues haven't changed that much. As far back as 1978 the US had the weakest dollar in post-war history, a record trade deficit with Japan, and concern about the decline in competitiveness. But what has changed are the terms of the debate. He stated that the changes currently taking place would probably be looked upon in later years as the beginnings of the first real change in the US-Japan post-war alliance. The discussions to follow, he said, would explore further these changes.

Clyde Prestowitz - Woodrow Wilson Center for Scholars,
Smithsonian Institution

Prestowitz began by discussing the US's large trade deficit with Japan which he stated was partly the problem and partly the result of the problem. This trade deficit has given rise to trade barriers, questions of open/non-open markets, US attempts to open the Japanese market, and the Japanese claiming that the US exporters "don't try hard enough." In the context of this problem telecommunications, he said, is important for two reasons. Firstly, in the telecommunications industry the US has had strong entrants, a competitive lead, and has been competitive in the international marketplace. Secondly, the worldwide telecommunications market is a big market, and the Japanese share is the second largest. As a result, telecommunications is one of

the primary candidates when it comes to US-Japan trade and the reduction of the US trade deficit.

Prestowitz asserted that the telecommunications debate with Japan focused on NTT (Nippon Telegraph and Telephone) itself, and the liberalization of the telecommunications service business in Japan by the Ministry of Posts and Telecommunications (MPT). The question of NTT first came up towards the end of the multilateral trade talks of 1978/79 relating to the opening of government procurement to foreign bidding. The Japanese offer initially did not include NTT. However, it was eventually seen that NTT had to be included to balance the offer, and agreement was finally reached at the end of 1979 to open bidding for NTT products to foreign bidders. Till then NTT did all its procurement from the 'NTT family' comprising of four companies (NEC, Oki Electric, Fujitsu, Hitachi) and Toshiba which has been lobbying to become part of the 'family.' In spite of these agreements, many Americans still feel, he said, that the spirit of open trade has not been maintained.

NTT set up an elaborate three tier system of bidding as follows :

- (a) Off-the-shelf products.
- (b) Off-the-shelf products that needed some modification.
- (c) New products that needed joint development with NTT.

NTT's relationship with the five key companies goes back a long time. NTT while it had and still has a world class R&D operation similar to Bell Labs it did not have its own manufacturing facilities similar to AT&T's Western Electric. As a result, manufacturing for NTT was traditionally done by the 'family'

companies. In addition, NTT's first chairman came from NTT, also several key NTT executives came from the 'family' companies. All these ties make it very difficult, he said, for foreign companies to break in and compete against the 'family' companies in the three tier bidding system, particularly category (c). Apart from these strong manufacturing and personnel ties that NTT has with the 'family' companies, they view the non-family companies, particularly the American companies as "enemies." As a result, now, even the thought of doing business with these US companies requires a complete change of basic attitudes.

At this point Prestowitz reminded the audience that most problems of this nature have two views. The Americans complain that despite NTT's claim that its procurement system is 'open,' there is a notable lack of results to show for it - of an annual procurement budget of \$3-\$4 billion the highest ever value of NTT's foreign purchase has been \$130 million. Meanwhile, the Japanese complain that building relationships take time and that the US exporters anyhow don't try hard enough, the products are of poor quality and high price, and the US companies don't have Japanese speaking representatives.

As an example of the problems faced by the US manufacturers, he cited the case of Corning's effort to sell optical fiber to NTT. Patents were issued in the US and the rest of the world in the early 1970s though not in Japan. NTT refused sales offers made by Corning in 1970s. It developed its own fiber with three Japanese companies. Corning argues that NTT

infringed on its patents. Courts in both Canada and the US upheld Corning's claim but it did not happen in Japan as there was no patent in Japan. In 1980 when NTT signed the agreement (open trade) Corning went back to NTT in an attempt to sell the optical fiber cable. NTT wanted a design that was different from Corning's (Corning's design is used everywhere else in the world except in Japan and is cheaper too.) After a year NTT gave its specifications to Corning. Though most procurement is for Single-Mode, NTT wanted Multi-Mode. It took another year of US government pressure for NTT to give over the specifications for Single-Mode. Corning, to produce the cable according to NTT's design, would have had to put in a whole new plant and equipment, thus negating the cost advantage it had. Further, it still couldn't be sure of getting the order. Therefore Corning was unwilling to go ahead.

Meanwhile, Japan was considering de-regulating its telecommunications market. A bill was developed in 1983 to de-regulate the telecommunications transmission service business and also turn NTT from a government monopoly into a private company. The US became aware of the bill in the Summer/Fall of 1983 and was particularly concerned about a clause that restricted foreign participation in any Japanese telecommunications company to 20%. Because the US telecommunications industry was considered competitive and more advanced than the Japanese industry in several areas, this action by Japan was seen as another instance of the 'infant industry' phenomenon. The US government made an effort to persuade the Japanese government to remove the

offending clause. The US wanted to see deregulation accompanied by the opening of the Japanese market to foreign competition. This was particularly important considering that Japanese telecommunications exports to the US rose from \$100 million (1980) to \$2 billion (1985) following the AT&T break-up. A team including Prestowitz went over to Japan to lobby for this change. He said he was surprised at the "blatantly obvious protectionist sentiment" expressed by several interested sectors (including Kaydonoran, and the Japanese Socialist Party,) and what really shocked him was that they didn't think it was protectionist. They couldn't understand why he couldn't understand that for them not to open the market at this stage was perfectly natural. He concluded from this experience that the Japanese view of free trade was that free trade should take place between countries that had industries that were more or less of equal strength. Also, until there was equal strength free trade shouldn't take place and was neither fair nor right. However, as a result of the teams effort and the threat of US counter measures the offending clause was removed allowing 33% foreign ownership of Type I (telecommunications transmission) and 100% of Type II business (value added service provider.)

Then looking at the second stage - licensing/ permission of MPT, the US felt that this brought the whole protection issue back full circle negating all that was gained in the earlier negotiation. Therefore, the US disagreed with the idea of having licensing. The Japanese then wanted to replace it

with a notification system (i.e. notification to the Ministry.) Eventually it was agreed, with US pressure, to have a notification system less rigorous (on paper) than originally proposed by the MPT, incorporating in it elements of 'due process' and 'transparency.' This was also accompanied by a move from the US side to reduce some restrictive Japanese technical standards procedures. Some standards are legitimate, while others are unnecessarily bureaucratic, and many serve to prevent foreign entry. The US negotiators recommended a system similar to that used in the US - i.e. if the equipment didn't adversely affect the network it was allowed.

During this debate, he said, another difference of perspectives surfaced. The Japanese bureaucracy is more paternalistic toward the public. In turn, the public has come to expect bureaucrats to choose the best products and standards. For example, the decision regarding optimal telephone voice quality is left to the bureaucracy rather than the market. Finally, the Japanese government acceded to these US recommendations and an agreement was signed.

However, though on the US side everyone was satisfied with success in "opening the market," in practice the stories were quite different. Motorola, he said, complained that the market still wasn't open. The Japanese government explained that Motorola was correct in that the Telecommunication Business Law (TBL) was liberalized but the products in question came under the Radio Wave Law (RWL.) The RWL is the same as the TBL except that it applies to radio waves and the agreement didn't cover radio

wave products. The Japanese, said Prestowitz, are uncomfortable with the concept of generic negotiation. They prefer operating on a case-by-case basis. Therefore, the next step was the negotiation of the RWL, and this was concluded similar to the TBL. But the problem arose again. Motorola in a joint venture with Daini Den Den wanted to introduce a paging system. But when they went to hand in the application, the Ministry requested them to not submit the application before discussion. It was then the US negotiators discovered that according to the Japanese system both parties have a long informal discussion till the deal is set and the formal application is submitted after. Meanwhile, the Ministry was intent on creating a bigger company with Motorola, Sony, and others, thus reducing foreign participation.

Prestowitz concluded by saying that it is less useful to negotiate procedural matters under these circumstances, and attention should focus on final outcomes. He further pointed out that conflicts between MPT and MITI concerning administrative jurisdiction will continue to complicate the process. Many decisions have more to do with Japanese domestic politics than international trade policy.

Yoshiji Nogami - Embassy of Japan, Washington D.C.

Nogami referring to the day's topic for discussion asserted that it was very complex and formidable. Also, the idea of cooperation and competition between Japan and the US was, he

said, applicable not only to telecommunications but many other areas of economic importance as well. He noted that the friction being referred to in the media was just in one area of this overall relationship, and it was one area where a solution had yet to be found. Because of the size of the economies of the two countries there was bound to be competition. He further suggested that this competition was likely to increase in the future rather than decrease. However, on the other hand, because of the close relationship between the two countries there would definitely be cooperation he predicted. He stressed that in spite of Prestowitz's colorful anecdotes, telecommunications is an area where the two countries could come up with the "right answer." Nogami added that in the context of the relationship between Japan and the US the concepts of cooperation and competition should not be mutually exclusive or contradictory but rather mutually reinforcing. This is the theme followed by the two countries over the years though in many cases the "right answer" had not been found.

As a case study he considered the issue of NTT procurement. He did not repeat the facts of the case related by Prestowitz, but commented on the difficulties of the case. The NTT procurement issue was agreed to by the two governments following the GATT negotiation. The GATT negotiation covered government procurement attempting to create a quasi market competitive situation where normally a competitive situation didn't exist. To create this quasi competitive situation the procurement code provides for a number of procedural provisions,

primarily the 'open' and 'transparency' aspects. However, he pointed out, the procurement code alone couldn't conclude the negotiation between Japan and the US. The Japanese people are very process oriented while the US doesn't put value on the process/procedure but rather the end result. Therefore, the Japanese side went about improving the procedure whereas the US measured results by looking at the bottom line. The Japanese government, he said, only creates a system and it is then left to the participants to maximize opportunities.

With reference to the agreement concluded between the two countries in December 1979, Nogami conceded that even the Japanese government was disappointed with the results. Because the early stage of procurement, soon after the agreement, still did not function well (overseas purchase Y4 - Y5 billion), the tendering process was then revised and NTT now purchases in the region of Y37 billion from overseas. Japan, he noted, while having the capacity to export high technology equipment continues to purchase large volumes from overseas.

Nogami addressed the accusation of collusion in NTT's procurement - that is collusion with the 'family' companies. He stated that now that NTT has been privatized and only allowed to operate in the equipment servicing sector of the telecommunications industry, it has a lot of competition from new companies in this sector of the telecommunications market. As a result, NTT is now forced to purchase equipment on a competitive basis in order for it to remain competitive and this purchasing

will certainly include foreign vendors. In this regard he quoted the chairman of NTT as saying that NTT will look for the most competitive price regardless of the vendors nationality. Nogami also added that though NTT was privatized in 1985 its commitment to abide by the government's procurement code has been extended for a further three years. He envisaged NTT's procurement becoming more international and market oriented as a result of these actions.

Nogami then discussed the criticism that NTT does not purchase high technology products from abroad but only basic unsophisticated equipment. He pointed out that a reviewal of NTT's purchase records revealed a 60% level of foreign purchases being state-of-the-art high technology and low technology purchases from the US being only 0.2%. Further, NTT is, he said, moving more in the direction of increasing its foreign high technology procurement. He added that since NTT is not allowed to produce equipment, while it has a high level of R&D, it is moving more and more toward joint development (Track III) and away from off-the-shelf purchases. NTT is also currently involved, he said, in joint ventures in many areas and particularly in services. The company has a joint agreement with IBM and also a basic agreement with AT&T.

Even from the point of view of the Japanese government, he said, the early stages of the procurement record is an eyesore. But now after more than six years of joint effort by the US and Japan the situation has improved and is a good example of competition and cooperation working together. In this context,

he suggested that we look to the future rather than dwell on the past. In closing, Nogami pointed out two pertinent factors to be borne in mind when considering competition and cooperation, particularly with regard to the telecommunication service sector.

- Dichotomy of international and domestic markets with a regulated domestic market poses difficulties. Competition and cooperation is only possible with a liberalized domestic sector. This has been taking place only recently.

- A single sector cannot be examined in isolation. The perspective must be much wider - user industries like financial services, and distribution services should also be de-regulated for telecommunications services to develop, and for competition and cooperation to work well.

SPEAKERS' COMMENTS AND ANSWERS TO QUESTIONS

Prof. Neuman asked about the Japanese public's attitude toward non-Japanese products, and their traditional pride in "buying Japanese," particularly with relation to Customer Premise Equipment (CPE.) Nogami affirmed that the government over the past few years has been teaching the people that "you get for what you pay." the public is being weaned away from the mentality of expecting the government to protect them from poor quality products to consumers exercising their individual choice. CPE is not particularly hightech and a number of East Asian

suppliers are much more competitive than Japanese manufacturers. From an institutional point of view, he stated that no barriers exist, neither quota nor tariff, for CPE imports.

Responding to a question on "informal guidance versus the liberalization of the market" and the merging of the two concepts, Nogami said that "guidance" is becoming less effective, and as a result the government has to resort to legislative means. However, Prestowitz asserted that giving "guidance" was still a strong characteristic of the Japanese bureaucratic mentality. He said there was "no sense in being a Japanese bureaucrat if you can't give guidance." The tension between MITI and MPT is extremely important ?

Asked for a course of action, Nogami suggested that the current conflicts are deep rooted in broader economic policy. The trade deficit/surplus, he said, cannot be solved without appropriate fiscal and monetary policies. The Japanese government has to now start spending after having five years of tight budgets. However, Prestowitz's opinion was that macro economic policies alone will not solve the problem. The US, he said, will have to explore a combination of devaluation and trade restrictions.
