CAPTURING JAPAN’S ATTENTION AND CANADA’S EVOLVING ECONOMIC RELATIONSHIP

by

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ABSTRACT

Capturing Japan’s Attention and Canada’s Evolving Economic Relationship with the Asia Pacific Region

For historical and geographic reasons, Canada’s relationship with large economic powers like the US and UK has been extremely close. Canadians have thus not had to work to receive attention or have Canadian interests taken into account. This situation has been reinforced by multiple business and economic interests. US companies have invested over $70 billion in Canada, and Canada is the US’s largest trading partner with $212 billion in two-way trade. But, despite Japan’s size as the world’s second largest economy and status as Canada’s second largest trading partner, Canada does not share the same kind of economic and historical relationship with Japan. However, Japan does have such a relationship with the US, which places the US not Canada at the hub of the relationship.

Canada’s economic relationship with Japan must also be seen in both historical and dynamic terms. In the 1950s, 60s and early 70s, Japan’s economy was expanding rapidly based on its emergence as the world’s low cost producer of steel, ships and related products. Japan thus had a seemingly insatiable demand for raw materials, food, and energy. This created a natural symbiotic relationship with a country like Canada, rich in raw materials, food and energy resources. Indeed, during this period Japan developed its “ABC” strategy for managing the relationship with Australia, Brazil and Canada, all countries rich in resources the Japanese economy needed.

However, the Nixon shock that revalued the yen in 1971 followed by the two oil shocks in 1973 and 1979 changed Japan’s economy from high growth based on abundant energy and raw material imports to slower growth emphasizing high technology. Instead of steel, shipbuilding and power being the leading business sectors, the mantle passed to autos, consumer electronics, semiconductors, computers and telecommunications. Continued yen revaluations in the 1980s and 1990s have only amplified this trend, forcing Japanese producers to shift production abroad. Currently Japanese firms are
therefore focused on three primary goals. The first is to expand their presence in Asia through investments that access low cost manufacturing and rapidly growing markets. The second is to retain their markets in North America and Europe. The third is to gain access to new technologies. Increased imports of energy and raw materials are thus not a policy drive.

Yet, despite this dramatic structural change, except for auto manufacture, Canada’s economic interface with Japan still remains largely centered on continuing to supply food, rocks, and energy. In addition, these activities including autos are primarily outcomes of Japanese strategies rather than Canada’s initiatives. The shift has thus left Canada’s economic relationship largely centered in Japan’s economic past rather than its future.

Still, there are sustainable strategies open to Canadian firms. They can work with Japanese companies to develop Asian raw material and energy resources. Also, in software and biotechnology, they have much to offer the Japanese who are falling behind in global competitiveness. There are also more North American plants that could be located in Canada. However, Canadians must pursue these opportunities. They will not come from the Japanese side as in the past or as they do from the US and UK. It may even require tax and legal concessions. That is, changing the relationship’s orientation will require Canada to become more aggressive in promoting its high technology, its resource companies’ FDI, and attractive plant sites to capture and compete for Japan’s attention. This is a new role it has little experience playing and represents a challenge to Canadian policy makers

Introduction

This paper places Canada’s evolving relationship with Japan in the context of large Japanese firms’ strategic development and their changing interest in the Canadian economy. It thus explains why even very early reports on the Canada-Japan economic relationship (Hay 1972) strongly reflected the nature of Canada’s raw material, food and
energy bias while only being able to note the potential opportunities to expand in areas like software. It then goes on to indicate why this situation has not changed and some of the proactive options open to Canada to alter the current relationship if it so desires on a sustainable basis given Japanese corporate goals and strategies and Canada’s strengths and weaknesses.

In 1965, approximately 98% of Canada’s exports to Japan were food, energy or raw materials and about 97% in 1969. While, many Canadian observers and policymakers expected this percentage to drop over time as Canada added more value and shifted to new industries and services, after almost thirty years the rocks, food, material export ratio to Japan had only declined to about 93% (Canada-Japan Trade Council 1994) compared to a US Japan level in these items of 48%. That is, although both the Japanese and Canadian economies had advanced significantly by 1992 and 1993, Canada’s interface with Japan appears stuck in 1960s and 70s since in 1993 these products were only 44% of Canada’s total exports, compared to a US overall number of 30%. So, while US Japanese exports are also somewhat skewed towards food, raw materials and intermediary products, Canadian exports to Japan are overwhelmingly so. This is despite the fact that currently more than 15% of Canada’s exports are high technology products (Smith 1991) up from 10% in 1987 (Statistics Canada 1988).

Nevertheless, in examining this situation from a Japanese perspective, these results are not so surprising. Japanese energy, raw material or food processing firms are not growing. If 1990 is 100, in 1993 steel was 89, non-ferrous metals 98, fabricated metal products 93, non-metallic minerals 91, pulp and paper 99 and food and tobacco 100. Further, there has been no growth or negative growth in these sectors since 1989 (JEI 1994). Given Japanese firms’ primary goal of corporate existence and employment, they will not increase value added in Canada when this would mean unemployment in Japan. In addition, their plants are fully depreciated, while they can maintain competitiveness through over investment. Further, experience indicates that raw material resources over time are subject to depletion and increased cost. They thus want to maintain the flexibility to shift procurement. In sum, absent legal compulsion, there is little likelihood Japanese
firms will increase their value added processing in these sectors despite Canadian exhortations (McMillan 1989 and Canada-Japan Trade Council 1990).

In turn, because these Japanese industries are under continued economic pressure, there is little incentive for them to shift the nature of their relationship from long-term contracts to foreign direct investment (FDI). This is probably one reason why Japanese FDI in Canada has remained quite low compared to their US or European FDI, even though Japanese firms have expanded their activities in the US (Rugman 1990). Indeed, as of March 31, 1994, total Japanese FDI in the US was US$177 billion compared to $7.8 billion in Canada and $2.2 billion in Mexico (JEI 1994). Total FDI in the US was thus about equal to Japan’s total US trade in 1993 of $160 billion while Canada’s two way trade of about US$14 billion was roughly twice its FDI from Japan. Thus, there appears to be some statistical basis for claiming that Canada is not getting its share of Japan’s investment and economic attention (Canada-Japan Trade Council 1990).

However, regardless of the reasons, FDI does represent a greater commitment to a relationship and ultimately economics rather than fairness is what attracts investment. Thus, Canadian policymakers must take seriously the relative disparity in economic attention from Japan indicated by this data, especially as given Japan’s current and evolving economic structure this result could be expected. This is because Japanese trade and FDI are actually extensions of their firms’ competitive behavior and strategic orientation which frequently has little relation to a host country like Canada’s desires.

Rather, presently, large Japanese multinationals’ (MNCs) international business interests are as follows. First, they want to develop low cost manufacturing in Asian countries for lower technology products to improve their global competitiveness and to access these emerging high growth markets. The second type of strategic FDI and related trade is to retain and improve market share in their major North American and European markets, such as their investments in autos, auto parts and consumer electronics (Rapp 1993). The third type is to access new technologies and products that enhance competitiveness or can be introduced as “shinhatsubai” (new products) either in Japan or the global market (Rapp 1993). These interests include software and biotechnology where
Japanese firms are relatively weak.

Understanding these motivations is critical to influencing Canada’s current economic interaction with Japan because without any shared security interests or larger global connection, the relationship is determined primarily by the two countries’ two way trade and Japan’s direct investment. Canadian investment in Japan is small, and Japanese portfolio investment after 1985 was fully hedged to avoid repeating investors’ large exchange losses and then declined sharply after the bursting of the Bubble in 1990 (Wright 1994). Further, portfolio investment is inherently transitory and subject to the vagaries of the market and investors’ preferences. It thus does not represent a long term commitment to Canada and does little to define the longer term relationship. The same reasoning applies to contractual relationships which are likely to be terminated after a period of time.

Rather, the strategic relation revolves around more permanent trade relationships and direct investment. These in turn have been largely driven by the decisions of large Japanese firms subject to three major influences. The first is Japan’s growth stage when Canada’s relation with Japan was most dynamic. The second is Japan’s constantly evolving economic structure and relationships with the US and other nations, especially Asian. The last and perhaps least recognized is Canada’s experience managing relationships with economically powerful nations like the US and UK. To understand the first two perspectives requires some appreciation of Japan’s competitive development and especially the emerging global strategies of its multinational corporations (MNCs) which are responsible for most trade and investment and with which Canadian companies and policymakers chiefly interact.

These MNCs' trade and FDI in turn reflect their administrative heritage and their current competitive context. Unfortunately, unlike nation states, this does not revolve around bilateral relationships. Rather, their global strategic behavior relative to Canada and other countries is a logical consequence of their experience managing the interaction of product cycles, lower cost expectations based on continuous improvement, and their industry’s evolutionary and competitive development. It is true that Japanese MNCs' FDI
has developed quickly over the last fifteen years (Komiya 1987, Okumura 1989, and Komiya and Wakasugi 1991). However, so did their international trade in the years before that, and one is a direct extension of the other. That is, after having introduced a product into the domestic market, they began to export once that market became saturated (Porter 1990). Then having established an international presence, they started investing to service customers better, hedge exchange risks, and extend sales opportunities. Finally, in response to actual or potential import barriers or the need to acquire new skills and technologies, they invested in productive capacity or acquired foreign companies. Nevertheless, throughout this evolutionary process, they were constantly conscious of their administrative heritage and long-term strategic objectives.

For example, SONY's acquisition of CBS Records and Columbia Pictures was driven by their earlier experience with Betamax where the system was ultimately rejected in favor of the VHS format because of insufficient software support. They could not afford a similar experience in 1 3/4" CD or 8mm video. Purchasing major software producers with extensive libraries and cross licensing arrangements avoided this. Then Matsushita responded with their acquisition of MCA and Toshiba with their tie-up with Time-Warner because they could not risk SONY achieving a market advantage they could not match. Only recently as Matsushita has perceived SONY’s strategy as less of a threat. This combined with MCA’s management difficulties has prompted them to divest 80% of MCA. Some reasons for this competitive compulsion are analyzed below but are covered in detail elsewhere (Ohmae 1991, Rapp 1992 and Yoshino 1968).

From these types of situations, one can appreciate that Japanese MNCs' trade and FDI are heavily influenced by Japanese competition as it has evolved from the import substitution stage through FDI even more than for Canadian or US corporations. Further, their motivations often have less to do with extending profit opportunities for new technologies than concern for protecting global market share, maintaining low cost production, and insuring firm survival (Porter 1992 and Rapp 1992). Thus, it is expected that future decisions will represent similar responses as they continue to adapt to pressures and changes in their economic and political environment. In turn, their
relationship with Canada will be determined by how they perceive Canada’s contribution to achieving their strategic objectives within this dynamic context. Therefore, if Canada or Canadian firms wish to participate in and benefit from this evolving situation, they must position themselves to capture Japanese firms’ attention. This is a radically new situation for a Canada that in the past has always been courted, especially as little reliance can be placed on diplomatic ties due to the growing weakness of the Japanese government relative to its corporate giants.

**Japanese MNCs’ Emerging Motivations in a Global Context**

As noted above, for Canada and Canadian firms to competitively position themselves relative to Japan’s evolving economic structure, Canadian policymakers need some understanding of the pressures and considerations expected to affect Japanese managers’ global decisions. These include:

- Corporate existence, which remains the primary organizational drive. This is because senior executives' survival and benefits plus lifelong commitment to the firm, customers, employees, suppliers, banks, etc. requires this, and alternative employment for top managers is limited. In sum, managers are more concerned with insuring the firm's continuous wage stream than maximizing corporate profits (Rapp 1992, Porter 1992, and Fruin 1992).

To insure this goal, managers need to protect the firm against the effects of further yen appreciation and shifts in cost competitiveness towards the NICs in many major products as well as offset persisting US protectionist pressures to reduce the trade deficit. For most companies the task of maintaining corporate competitiveness will be complicated as an aging labor force and low birth rates combine with continued corporate growth to make Japanese labor shortages acute, especially for technical personnel. At the same time, in many raw material processing industries where slow or no growth is limiting productivity improvement, maintaining employment will be difficult.
- Constantly upgrading intra-industry technology, which will continue to be necessary due to competitive pressures from Japanese and foreign competitors combined with customer demands for improvement (Imai 1986 and Abegglen and Stalk 1985). Some upgrading will depend as it has since the War on continued access to new more advanced global technology. This can also be a way to counter the shift in competitiveness towards the NICs while dealing with cost pressures due to labor shortages, slow growth and a stronger yen.

- Competitive compulsion because Japanese producers in a given industry face similar external environments, and managers have similar backgrounds. Thus, the tendency will be for most competitors to follow the leading Japanese firm. For FDI in mature markets like raw material processing, autos or consumer electronics in the US and Europe, this can lead to overcapacity and "excessive competition" (Ohmae 1991). But since government action usually preserves market share, being the most aggressive investor domestically and overseas and the lowest cost producer remains the best strategy (Rapp 1992). So overcapacity and excessive competition in these global markets remains a strong likelihood. This in turn requires that Japanese firms stress productivity increases to remain low cost producers.

- Controlling technology transfers to the NICs and LDCs as a way to achieve these objectives, if possible via one's affiliates. The NICs in turn will try to emulate Japan and develop global competitors who will evolve with the product cycle. This is a logical outcome of Vernon’s original product cycle model (1966) and its extension by Krugman (1979). However, the Vernon-Krugman argument stresses constant product innovation as the driving and dynamic motivation for Western firms and the product cycle with Japan and other followers acquiring competitiveness through technology transfer and lower labor costs. There is no mention of the role of process innovation. Yet, without addressing the role of process innovation, these models cannot explain Japan’s improved terms of trade, yen appreciation, or Japan’s ability to retain competitiveness despite wages that are now higher than many Western competitors.
But it is their ability to control the transfer of process innovation which relies heavily on tacit knowledge and improvements in organizational structure (Nelson and Winter 1982 and Florida and Kenney 1991) that provides the key to both their strategic intent and global competitiveness. This is because unlike product technology which can be copied by a follower country once it is seen, process technology requires the active participation of the developer. Further since process innovation can usually proceed at a more rapid pace than product innovation, a logical extension of the Krugman hypothesis is that successful process innovators will attract both capital and improve their terms of trade which by extension leads to currency appreciation. These theoretical outcomes are all consistent with Japan’s actual development.

- The fact that the Japanese market is fairly well saturated for many established products with global markets. Yet, it is still a large and important market to control in order to introduce various product innovations from abroad due to its demanding customers. In addition, it is by supplying this market that Japanese firms are able to apply and develop the process innovations that give them their competitive advantage before transferring this expertise to their foreign affiliates. However, the Japanese market in such mature industries must always be supplemented by overseas sales to maintain competitive position. Having a global presence is therefore necessary. Maintaining or growing market share domestically and abroad thus remains an important strategic objective, especially as Europe and North America form economic mega-states, giving European and North American firms a natural market advantage. Japanese MNCs must participate in these large advanced markets to be globally competitive, especially if their customers and competitors are moving in this direction. FDI is thus a key element in their corporate strategies as well, including strategic alliances or acquisitions.

- Japanese MNCs’ pursuit of their strategies with little domestic political interference because the Japanese government has no clear economic goals and has been hurt by various political and financial scandals. The government’s ability to exercise
authority over the MNCs outside Japan is weak. Therefore, managing the trade and FDI process is likely to be left to the companies, competitors, and foreign governments.

- The Japanese government's primary development concern of continued interindustry rather than intraindustry development and their major economic problem of growing transfer payments to an aging population. Thus, they will continue to sponsor their successful development routine of interindustry evolution in areas like space, supercomputers, software, telecommunications and bioengineering. The MNCs, though, have little desire to phase out their businesses since this could threaten their corporate existence. They are thus more interested in intraindustry development. In fact, because industrial policy necessitates creating a preferential access to resources for selected industries, present policies would transfer resources from established industries like consumer electronics, automobiles, and steel to fields like aerospace. Therefore, rival claims and objectives exist between the government's and the MNCs' strategies and what is needed to achieve them. This lack of policy congruence is new and will lead to more independent action by the MNCs, including actions that affect trade and FDI. This situation is reinforced by Japanese firms’ competitive advantage in process innovation dependent on their unique product specific organizations and production systems which are not always easily adapted to totally new product areas.

Given these considerations, it is logical for large Japanese MNCs to try to manage the product cycle within which FDI as well as trade will be an increasingly important strategic activity. In this respect, Japanese FDI must be seen as part of a total corporate system for creating and maintaining competitive advantage to insure corporate existence though constant investment and productivity improvements. For instance, by investing in US steel companies and upgrading their process technology and capital stock to supply Japanese auto companies, Japanese steel producers have made the US firms and themselves less vulnerable to competition from the NICs. Further, as higher quality steels are used by Japanese auto companies, such as very thin light weight one sided zinc coated
sheets, this forces US auto producers to improve quality too. However, the product is only available from Japanese affiliated US firms. Therefore the NICs are denied the market share they might otherwise have captured via a classic product cycle evolution as the US industry matured and its firms became less competitive. This in turn has obvious implications for Canadian steel producers too. It also illustrates the impact of process innovation and the ability to control its transfer on the traditional product cycle.

To fully appreciate the reasons for and motivations behind these strategies, one need not review Japan’s entire postwar economic performance. However, one should recognize the role product cycles have played within Japan’s industrial development and appreciate FDI’s position within such cycles. That is, historically, Japanese industries and firms have mostly been followers and imitators. Japan first produced and exported simple manufactures and primary commodities such as copper and raw silk. Then growth and development improved technical production capabilities and generated demand for more advanced products, initially cotton textiles but then machinery, steel, shipbuilding, automobiles, ICs, computers, etc. Since more advanced industries were frequently capital intensive, growth and capital accumulation shifted the factors of production in the right direction as part of Japan’s economic development. Yet, they were lagging similar developments in countries like the US, UK, or Germany. This interindustry product cycle evolution is well-documented (Akamatsu 1962, Vernon 1966, and Rapp 1967).

**FDI’s Place in the Product Cycle**

In this follower pattern of industrial development, products have been first imported from more advanced countries where they were developed. When domestic demand developed further, the government protected the industry. It then grew and began to export as the local market became saturated (Porter 1990) and producers became more efficient. Japan was assisted in this evolution because firms in the more advanced countries simultaneously became less competitive in such follower industries as their economies grew, capital increased and wages rose. At the same time, they were moving into more advanced industries and products for which there was growing demand, for
which they had the production factors, and which justified higher wages. Since their industries were usually more technically sophisticated and capital intensive, their economies were innovating and creating the demand, technology, and capital required to competitively develop these higher value added industries. Such growth and development generated by the creative destruction of old industries and the introduction of new ones (Schumpeter 1947) is entirely consistent with the Vernon-Krugman model.

Once the new technology was known, though, the cost of transfer declined, aiding followers like Japan. Having become globally competitive, Japanese exports first went to LDCs who were not in that industry and where competition from advanced countries was relatively similar, that is, export versus export. In addition, these markets were more price sensitive and aggressive pricing strategies by followers like Japan could overcome quality or service problems. After building their export experience and further lowering costs and increasing quality, the Japanese industry began exporting to the more advanced countries. The industries in those countries by that time were usually mature with many products now commodities produced in high volume. Therefore, price competition was again a good entry strategy given reasonable quality and service. As Japan evolved, its own labor intensive, lower value added industries became subject to similar competitive pressures from followers like Taiwan and Korea who in turn experienced their own shifts in competitive advantage to countries like China and India. Indeed, this classic international product cycle was first observed analyzing Japan’s cotton textile industry and its corresponding decline in countries like the US and UK (Akamatsu 1962).

Given this pattern of industrial and trade development, Japan’s managers saw markets build first via imports from advanced countries. Then came domestic production, exports to the LDCs, exports to more advanced markets, and finally imports from less developed countries. FDI has usually emerged during the later export stage to the advanced countries or as part of imports from the LDCs where those producers are often Japanese owned. This situation appeared in textiles in the 1970s when FDI was used to retain export competitiveness to advanced markets and for imports to Japan (Ozawa 1979).
The import substitution stage has usually been the high growth period. By the initial export stage, domestic growth is often decreasing, motivating firms to export. By the later export stage, Japanese and advanced country demand is usually mature so that gains in global market share are more of a zero sum game. Yet, exports also became a larger part of total production (Abegglen and Rapp 1972 and JEI 1991). This has meant that more Japanese exports have often led to political pressures from the affected countries in turn stimulating Japanese FDI to leap protectionist barriers and to preserve market presence. This is why Japan’s MNCs’ FDI has come at a much later stage in the product cycle than US producers whose motivation is primarily to capture new markets and profits for their innovations. For the Japanese, the markets exist and the products are not new. Yet, as has been true for US producers (Vernon and Wells 1991), once these FDI infrastructures were in place, firms could then introduce or produce products in those locations as well as Japan, collapsing the evolutionary process and changing the nature of global competition.

Depending on the industry and Japan's growth rate, this sequence could take twenty to forty years. But because Japan has been changing its ability to produce and use advanced technologies, at any given time the industry mix has been at different stages. The cotton textile industry might be declining, the synthetic textile industry investing abroad, the steel industry exporting successfully to several countries, the auto industry starting to export, but mostly to LDCs, semiconductors beginning production, and aerospace importing. This profile, for example, would describe fairly well Japan's structure in the late 1960s. This is also the period in which Japan’s interest in Canada as a major raw material supplier to its growing raw material processing industries became apparent.

From a firm and manager's strategic viewpoint, including the role of FDI, World War II had a major impact on this evolutionary process as well as Japan’s emergence as the leading process technology innovator. The War put Japan's economy back about twenty years. Thus, even her existing industries repeated the pattern described above in a short interval during the immediate postwar period. But though Japanese firms in
traditional industries had traced this process beforehand, the recovery exposed a new generation of managers to it, in a concentrated, very rapid manner and across all industries.

Japan's prewar cotton textile industry, for example, was the world's most competitive in all export markets, and her steel industry had exported to LDCs. This same pattern, however, was compressed again during the early postwar years. Therefore, all managers, even in traditional industries like textiles and steel, became conscious of the effect of product cycle forces in their industry. They became aware too of cost reductions generated by high growth, market expansion, and the introduction of new technologies though rapid investment (Abegglen and Stalk 1985). At the same time, because Japanese firms were importing product and process technologies developed by others, and because MITI to encourage competition did not permit exclusive licensing agreements, Japanese firms’ ability to differentiate themselves and to succeed competitively was dependent on their process innovation adaptations to reduce costs and improve quality. The firms that became globally competitive did this extremely well, e.g. Toyota and Matsushita.

By the early 1970s, this development pattern was so clear MITI stated it as its industrial policy. The government should help upgrade industry by sponsoring higher value added, more technically advanced industries, while allowing less advanced industries to migrate. What had been a pragmatic ad hoc policy to resuscitate the economy became a formal development model due to Japan's success. This approach was then adopted by countries like Korea and Taiwan, who also achieved high growth and economic success. This reinforced the evolutionary export led growth model's visibility and acceptance.

However, in managing this process, a divergence emerged between firms' intraindustry goals to maintain their existence and global competitiveness and the government's interindustry development plans. This consideration has applicability to Japan's trade and FDI. For example, based on its vision, MITI moved in the 1960s to phase out the cotton textile industry while promoting semiconductors via projects like VHISC (Very Highly Integrated Semiconductor). This approach has persisted into the
1990s with government protection and support shifting to supercomputers and satellites. But with each shift, Japanese FDI in the neglected sector has increased as firms in those industries resisted the implications of being phased out in Japan. That is managers did not simply accept such competitive shifts as inevitable, especially if they adversely affected firm results.

Given their core competencies, they could not just move production (e.g. capital and labor) from producing textiles, steel, and automobiles to producing computers and airplanes. It was usually not possible to sell or scrap their major assets or to dismiss their labor forces. In addition, their competitive advantage was in their industry specific organizational structures and innovative production processes. So they pursued a mixed strategy combining resistance and pursuit of shifting competitive advantage while generally remaining in their basic businesses. This contrasts somewhat to the US, where through the political process, managers sought and often received protection in response to similar competitive developments. Indeed, over twenty years a series of "Voluntary" Restraint Agreements (VRAs) in textiles, steel, television, machine tools, autos, and semiconductors were negotiated in an evolution that both confirmed interindustry product cycles and Japan's successful entry into constantly more advanced industries. US firms also lobbied for a dollar devaluation with some success in 1971-73 and 1985-87, while investing offshore to lower production costs and maintain their companies’ manufacturing competitiveness.

Japanese synthetic textile manufacturers pursued a similar strategy after the Nixon Shock and the first Oil Crisis (Ozawa 1979). However, by successfully investing in advanced countries such as the US and Europe to preserve market share, Japanese MNCs fundamentally changed the strategic use of FDI. The key to their success in this regard was their ability to successfully transfer their organizational and innovative process advantages without losing control of their competitive advantage as had been true for US innovators when transferring product innovations through licensing or other arrangements (Vernon 1966, Vernon and Wells 1991 and Krugman 1979). A good case in point is Matsushita’s transfer of its global air conditioning operation to Malaysia (Craig 1995).
FDI in the NICs and LDCs for both the Japanese and Western MNCs clearly had the benefit of capturing those countries’ market growth, frustrating the development of native competitors and keeping support, sales, and managerial people employed at home. Nike’s migrating global production strategy is a good example of this. This development showed that FDI extended and managed the international product cycle by increasing imports from the LDCs but produced in plants owned by the importers. Meanwhile at home, the US, European, and Japanese firms expanded into new more advanced areas that were either related to their existing businesses or were completely different, i.e. they upgraded and diversified. Many Japanese companies followed this pattern of protection, offshore sourcing, diversification, acquisition and technical improvement after the 1985 yen revaluation and the automobile and semiconductor VRAs. They also made large gains in manufacturing productivity in Japan due to massive investments, these improvements were then incorporated into their FDI in the US and UK, expanding their competitiveness worldwide. This confirmed their emphasis on process innovation as the primary strategy.

Of course, the potential to upgrade or expand an existing product line through R&D and technical change or intraindustry development has always been an important aspect of the classic product cycle (Rapp 1975). Synthetic textiles emerge after cotton textiles; high grade alloy steels evolve after carbon steel; and color television follows black and white. As Japanese firms have advanced through these intraindustry stages, and acquired the available pool of existing foreign technology, they have ceased to be followers, and have become product innovators as well. Additional intraindustry development then requires more invention along the lines of Krugman’s basic model. Still, such innovators were constantly subject to competitive pressures from the fast imitators with excellent process innovation capabilities. Thus, by the mid-1970s, as argued by Baba (1989), the fast imitators had to become more innovative while the innovators had to become more cost oriented or conscious of process innovation possibilities in their new and established products. Those who could not make this shift fell behind competitively and became vulnerable to foreign or domestic acquisition as in GM-Isuzu, Merck-Banyu, and Nissan-Fuji Heavy.
However, Japanese firms have differed from many Western counterparts by not abandoning production of the simpler technological products for which there was still large global demand (Vernon and Wells 1991). This can be seen in Fuji’s continued domination of the commercial print film market, having driven Kodak out through intense price competition in the early 1970 and in Abegglen and Stalk’s (1985) discussion of Japan’s ballbearing manufacturers relative to SKF and FAG. Rather, as part of their logical strategic behavior to maintain corporate existence and employment, their FDI strategy was to retain but move the older products offshore while producing the newer ones at home. This has been done by Japanese auto, consumer electronics and camera producers among others. Honda for example first produced its Civic in North America, then introduced the Accord, and now recently announced the migration of its low end Acura, the Integra. Similarly, Toyota’s production into China is based on a subsubcompact built by its affiliate Daihatsu, a vehicle size not even manufactured by the US Big Three. This strategy keeps the non production people associated with those products employed while exploiting their advantages in organizational and process innovation.

In this way, intraindustry cycles have affected Japanese FDI by impacting the motivations behind particular offshore investments. While interindustry evolution can stimulate FDI to acquire new technologies for introduction into Japan, intraindustry evolution stimulates FDI to protect global market share. This mean firms have not had to give up sales and earnings, while they have at the same time denied potential competitors from the NICs and LDCs a production platform from which to enter the industry and repeat to the Japanese what they had done to the Americans.

This FDI pattern shows up as investments in offshore assembly operations to leap various barriers as with Japanese auto investments in the US, Canada and Europe or synthetic textile investments in Indonesia. Similarly, investments in manufacturing facilities in the NICs and LDCs are used to source lower cost parts for assembly in Japan (Rapp 1993) and elsewhere or as export platforms to remain competitive in products previously supplied from Japan (Ozawa 1979). In addition, high quality and technology
advanced parts production are retained in Japan and exported in place of assembled products. For example, in the case of automobiles, US auto parts imports from Japan have risen from $7.5 billion in 1987 to $12.7 billion in 1993, while auto imports of $21.3 billion are virtually unchanged at $21.9 billion.

Indeed, such intraindustry unbundling of production and its complementary FDI seem to dominate Japanese corporate behavior patterns and affect trade trends as well. This is to be expected in terms of evolutionary theory (Nelson and Winter 1982) since firms normally innovate close to existing areas of experience. Since initially FDI is an innovation, firms will at the beginning keep to existing areas of expertise to reduce the number of new variables. When they do diversify into new products via FDI, it is usually to access foreign technologies or expertise only available via an ownership interest. Otherwise long-term contracts are sufficient since they involve less capital and commitment.

Indeed, the latter approach was their preferred strategy for obtaining secure raw material and energy resources when they had little mining, oil and gas, or large scale agricultural expertise. It also economized on capital when they needed capital to expand their own processing capacity. In addition, it gave them long term sourcing flexibility when these resources gradually became depleted and thus higher cost. Canadian companies were major beneficiaries of such strategies during the 1960s and 70s. However, those industries are now mature. Further, after two oil crises, increased environmental concerns and three major yen revaluations, such energy intensive Japanese raw material processing industries are not really globally competitive. Therefore, complementary FDI is occurring mostly in terms of strategic alliances or acquisitions related to new high technology industries (Dalton and Genther 1991, 1991A and Rapp 1993) like Nippon Steel and Prime Computer, Kubota and MIPS or SONY and Columbia Pictures.

This scenario thus represents the way major Japanese firms are responding to the changing economic forces constantly working to shift competitive advantage in a given industry or product from one country to another due to economic growth. In the process,
workers and managers in various countries experience constant shifts in employment. Still, while the competitiveness of a country may be adversely affected, the impact on firms is moderated. This differential effect on corporate and national competitiveness, however, is important since it explains the influence of product cycle analysis on Japanese MNCs’ strategic thinking, competitive behavior, and FDI. It also explains such puzzles as why despite excellent diplomatic relations Japanese firms have been reluctant to increase the value added processing of Canadian raw materials, why Canadian exports continue to be mostly raw materials, and why the Canadian share of Japanese FDI appears modest. The reality is that Canada is no longer at the leading edge of Japanese firms’ global strategic thinking and getting there will require a significant policy shift if in fact having a more significant relationship with Japan is really an important Canadian goal.

The Changing Canadian-Japanese Paradigm

As noted above, early reports in the 1960s on the Canada-Japan economic relationship (Hay 1972) clearly describe the raw material, food and energy bias of Canada’s exports to Japan at over 95%. However, these reports also expected that over time this percentage would drop as Canada added more value and developed new industries like software. Yet, though both economies have advanced the rocks, food, material export ratio has only dropped to about 93% (Canada-Japan Trade Council 1994). The interface between the two countries thus seems stuck in 1960s since a similar percentage for the US in 1993 was 48%. In addition, Canada’s absolute exports to Japan declined 6% from 1989 to 1993 while US exports rose 15% (JEI 1994). Nevertheless, because Japanese energy, raw material or food processing firms are not growing, this result is not surprising given that Canada’s exports continue to be raw and semi-processed materials. Since Japanese firms’ primary goal of corporate existence and employment, they will not increase value added in Canada when this would mean unemployment in Japan.

These industries are under continued economic pressure. There is therefore little incentive for them to shift the nature of their relationship from long-term contracts to
FDI. This is one reason why Japanese FDI in Canada has remained low compared to the US or Europe. That is, as of March 31, 1994, total Japanese FDI in the US was US$177 billion compared to $7.8 billion in Canada and $2.2 billion in Mexico (JEI 1994). Total FDI in the US was thus roughly equal to Japan’s US 1993 trade of $160 billion while Canada’s two way trade of about US$14 billion was roughly twice its Japanese FDI.

Nevertheless, while these results are explicable in terms of Canada’s existing Japanese customers, what is less apparent is why it is not doing more in other areas since Canada has been able to sell advanced manufactured products and software to the US. The answer lies, as explained above, in the fact that Japanese trade and FDI remain extensions of their firms’ competitive behavior and strategic orientation that often has little to due with a host country’s desires. Currently, as described above, Japanese MNCs’ interests are to develop low cost manufacturing in Asian countries for lower technology products. These investments use advanced Japanese manufacturing methods to supply high quality parts and finished goods at competitive costs to the local market and to the firms’ global supply chains. Such investments help them maintain global market share despite a rising yen, while impeding the development of new competitors. Canadian firms can participate in this activity through helping Japanese firms supply these countries’ infrastructure needs as well as to develop new sources of energy and raw materials. Such new raw material or energy supplies could come from any location, including Canada, if they were the low cost global producer. Among advanced countries, though, Australia seems to be doing better in this regard. The activities of firms like Ontario and Quebec Hydro in Asia would fall into this category to the extent they worked with Japanese electrical equipment suppliers to increase local power supplies.

The second type of strategic trade and trade related FDI is to retain and improve market share in their major North American and European markets, such as their investments in autos, auto parts and consumer electronics (Rapp 1993). Canada is already participating in this trend and has been helped by NAFTA. This is seen by the fact that besides the trading companies who dominate the food and raw material trade, the largest Japanese investors in Canada are the auto, auto parts and consumer electronics companies
Canada has little control, though, over the timing, location, nature, size and scope of these investments since they are driven by Japanese firms’ strategic perception of market and competitive developments.

The third type of direct involvement is to access new technologies and products that enhance corporate competitiveness or can be introduced as “shinhatsubai” (new products) into either Japan or the global market (Rapp 1993). This area includes software and biotechnology where for the reasons enumerated below Japanese firms are relatively weak, while access to the Japanese market could improve Canadian competitiveness globally, helping to create a sustainable advantage for some Canadian businesses not only in Japan but worldwide. Thus, there is a natural complementarity of interests in this area which has not been fully exploited. As the recently announced Fujitsu-Delrina strategic alliance to produce a new facsimile software product that will substitute for a scanner indicates, this is a sector where there is clearly potential. But there is frustration too, since more of these type of alliances are not occurring. Indeed, several Canadian commentators appear puzzled that more business has not been done (Donnelly and Kirten 1988 or McMillan 1990) in these sectors, especially given the numerous strategic alliances in these fields with US technology firms. Perhaps part of the issue could be better addressed if Canadian firms appreciated more the interaction between the economics of these industries and Japan’s competitive paradigm relative to innovation. This is because this paradigm differs sharply from Japanese firms’ emphasis on low cost and supply reliability in energy, food and raw materials, the model with which Canadians have had the most experience.

**Innovation and Competition in Japanese High Technology Industries**

In Japan as in most other developed countries, the high cost of development and the low cost of reproduction for software and biotechnology products means the user base not the cost of production drives their cost structure. In software, this situation can also combine with increased utility to the user resulting from a larger user base. That is, some software shares aspects of public goods like the telephone where increased usage
enhances utility and value. This in turn results in very strong first mover advantages and a tendency towards oligopoly or even monopoly as larger user bases lead to falling prices by software market segment (e.g. word processing, spread sheet, netware, operating system, or graphics program). In turn, prices tend towards equilibrium where the cost of adding a user (reproducing the program) equals the increased utility to the user. The latter will become relatively constant once a large user base exists. There is also an incentive for mergers and for large developers to have their programs manage and handle the systems of their largest competitors. These economics mean the cost per unit for a successful program drops rapidly, establishing a large competitive barrier from a cost and user experience standpoint, short of actual copying.

After initial development, most software or biomedical improvements are evolutionary rather than revolutionary. This facilitates the “upgrade” marketing approach to the existing user base given low incremental development costs per unit. It also promotes globalization based on localization and adaptation of existing programs or biological formulations since an expanded user base lowers the average initial development cost and the unit cost of improved versions on both a local and global basis.

Patents using PCT filings in major markets are generally a good way to protect biotechnology inventions. However, copyright is an even better method for protecting software long term since protection in global markets is automatic and for fifty years. Since copyright protects only the expression of an idea not the idea (i.e. the style of a spread sheet not the concept of a spread sheet), it is normally considered weaker than a patent. However, for most users it is in fact the expression than ties them to the program as they become learn to use it and become familiar with its capabilities and idiosyncrasies. It is therefore difficult to change the expression of the idea since this alters the external benefits to users and means the infringer cannot access the user base that determines firm economics. Therefore, practically and legally they cannot compete.

Thus if a Canadian firm develops a new biotechnology or software product, intellectual property protection in Japan or other Triad markets if properly done is usually fairly good from a legal and economic standpoint. Equally important however is the
ability to sustain that advantage in the market. This requires a sophisticated market entry strategy and continual innovation according to the Vernon-Krugman model (Vernon and Wells 1991 and Krugman 1979). This is because Japanese competition in new products and services is very intense, especially when the foreign firm initiates the process. In the case of autos, food and raw material development, Canadian business has been an extension of Japanese firms’ product strategy. Therefore, Canadian’s have not had to manage the strategy process. However, when Canadian firms are the innovator, a Japanese strategic alliance is an extension of the Canadian development strategy. This necessitates the Canadian firm understand and manage the competitive process in conjunction with its Japanese partner.

**The Pattern of Competition in Japan**

As discussed above, it is well established that most large, successful Japanese firms developed by importing products and technology from abroad, producing for the local market, improving on the product and the process for manufacturing it on an innovative and proprietary basis, then exporting, first to less developed countries and then to more advanced ones. This competitive development has been supported by rapid rates of investment and aggressive pricing to build volume and global market share over an extended period. There has been little ability to establish product differentiation in a market served by similar producers using similar technologies. Price pressures are severe because each firm has an incentive to capture more market share to keep its plant operating at capacity. This pattern has been repeated in a series of more technically sophisticated and higher value added industries - starting with cotton textiles, extending to steel and ships, then to cars and earth moving equipment, and next to computers and semiconductors (Abegglen and Rapp 1970 and 1972, Abegglen and Stalk 1985, Baba 1989, Rapp 1992, and Rapp 1993). The leading firms emerging from this intense “weeding-out” process are those who are best at continually reducing costs.

Further, a careful analysis of firm behavior indicates that competitive pricing is not used uniformly across all products and market segments. Dumping suits in industries
like TVs, automobiles, steel, semiconductors and textiles indicate the domestic Japanese market has been used to subsidize export sales in other markets. Further, excessive protection in one part of a product-process chain may subsidize a whole series of related products, services, and technologies, including their export to third-country markets. This can be seen in ammonia-based fertilizers' support of ammonia-based chemicals and the caustic soda cartel's subsidization of the chlorine-based chemical chain, including PVC (Rapp 1986). Similarly, Ostrom (1993) found Japan's paper products market is so segmented that each submarket is dominated by one or two producers. He notes, for example, that while Tomoegawa is one-tenth the size of the largest paper producer, Oji, it has 55% of the insulating paper market. As market share and profitability are generally correlated, one can expect Tomoegawa receives much of its profits from this market.

At the same time, Japanese manufacturing firms usually offer a full range of products to their customers. When a competitor comes out with a new product, it is quickly copied. Thus SONY’s “Walkman” was soon followed by models from Sharp, Matsushita, Toshiba, Hitachi, and Sanyo. Similarly, Honda's entry into luxury cars was followed by Toyota and Nissan and then Mitsubishi and Mazda. Firms seem able to keep their expanded product lines' costs under control because most major auto and electrical manufacturers are assemblers, less integrated than their Western counterparts. Many use the same major subcontractors. It is thus at the subcontractor level market concentration tends to occur. Toyota has larger volume and lower costs than Mazda, and more power vis a vis major auto parts producers. But by buying from the same major subcontractors, Mazda can coattail Toyota's scale and efficiency. Toyota in turn benefits from the added volume to its subcontractors (Smitka 1990, 1991 and Fruin 1992). Nevertheless from a Canadian or US management viewpoint, Japanese firms’ willingness to incur any additional cost in such a competitive and price sensitive environment appears contradictory.

The answer lies in the "competitive compulsion" or intense "follow the leader" behavior that has been well described by Ohmae (1991) and Yoshino (1968). In addition, Rapp (1993) notes a strong motivating factor in Japanese FDI has been reluctance to risk
another Japanese competitor gaining an advantage or - just as importantly - gaining access to a major customer abroad which subsequently could be developed into a domestic or global relationship. With this background the competitive paradigm can now be stated:

Japanese firms often offer products or services with the purpose to protect and maintain existing client relationships and market share, and this is more important than making a profit. They consciously use existing business to cross-subsidize this activity. In other words, profits from core activities - oligopolistic or regulated markets where a firm has pricing power or low costs due to organizational and proprietary process advantages - are used to subsidize new or peripheral activities, frequently pricing at or below cost. In peripheral products, competition is particularly severe except for the most efficient producers, and since everyone feels the necessity to offer them to their customers, it is likely they will become relatively undifferentiated products sold almost solely on the basis of price (Rapp 1994).

The competitive pattern is a few businesses where firms generate their profits plus many ancillary products and services that encircle the customer but where the firm breaks even or loses money, e.g. banks’ receive higher returns from group companies than non-group members (Caves and Uekusa 1976). The overall return on equity to the company may be no different than Western counterparts trying to equalize returns across a portfolio of businesses, but the competitive behavior and resource allocation are different. There is a disproportionate allocation to core businesses where the firm is quite competitive. These are usually where it focuses its process and organizational innovation. Peripheral businesses, though, are run as "service" or loss leaders. Market share in core businesses is substantial but is minimal in peripheral activities. Peripherals may even be sourced from low cost neutral suppliers. Customers and market share will be defended fiercely because of the company's total commitment to its core businesses combined with its drive for firm survival. Nevertheless, by such tactics one can keep pressure on competitors' cash flow and easily exit a peripheral business if it turns out to have been a temporary phenomena.

Most Japanese firms seem to exhibit this behavior, though it may be chiefly a function of their evolution rather than any special cultural attitude or particular Japanese
way of doing business. While more research may need to be done to fully answer this question, the foreign competitor needs to deal with the environment that exists. This argues for a well articulated investment and entry strategy to define an advantage based on technology, market position, and cost.

**Foreign Firms and the Paradigm**

Foreign firms (gaisha) are by definition outside Japan’s business system and do not usually represent a threat to which Japanese firms must respond aggressively. At the same time, foreign firms that can establish and sustain a competitive position can be very profitable. This is because market returns to Japanese companies are based on their overall competitive environment, and foreign firms are usually not expected to offer the full range of services, only their specialty products. This situation allows the gaisha to keep most of their core profits without having to give much back in "service" and peripherals.

Still, as Japanese competitors will sell peripheral products and services at or below cost, merely entering and competing in an already established or even a high growth Japanese market without a proprietary product, technology, or service is difficult and rarely produces good results. For a Canadian competitor to create a sustainable advantage in the Japanese market thus requires not only establishing a market for a product or service but continuing to define and influence its competitive evolution. Otherwise imitation and the inevitable price-based competitive compulsion is a risk. This goal is achieved by the continuous introduction of innovations from outside Japan along the lines of the Vernon-Krugman model, provided such innovations remain an important element of the competitive environment. This is especially necessary once market growth slows and greater price pressures develop, especially if Japanese competitors are then able to develop innovative process technology advantages. Examples of such success are Coca Cola, McDonalds, Kentucky Fried Chicken, Motorola, IBM and Marlboro.

In cases where emulation, substitution or process innovation by Japanese firms is relatively easy, and where outside innovations can be imitated or are competitively less
important, foreign firms tend to lose their initial advantage. They then become much less profitable and many are forced to exit the Japanese market and perhaps later the world market at considerable expense, unable to compete with large Japanese companies prepared to give the product or service away. De facto standardization makes this result even more likely since the Japanese are excellent at imitation, volume production, and constant improvement (Imai 1986). Such competition in peripheral business areas is particularly severe except for the most efficient producers, since it is likely such products will be undifferentiated commodities that everyone feels the necessity to offer to their customers.

The net result is that a foreign firm is usually either quite profitable or losing money. This scenario has been repeated again and again for many firms and product areas, often in a hypercompetitive environment in which prices drop and market share shifts very rapidly as several Japanese firms enter and try to capture the growth or to establish a position once the product has been standardized, e.g. photo copiers. Further, since the Japanese will compete on price, it is always important that the foreign firm keep its costs under control relative to any potential Japanese competition, even if it can sustain its advantage for other reasons. Otherwise once this period is over, market positions stabilize but without foreign competitors. One way to achieve this result is through a close working relationship with a large Japanese company where the Japanese partner provides service and market access while the Canadian company focuses on sustaining innovation and the pursuit of global market share. This is where Canadian companies’ superior access to the US market could prove an advantage. This is especially true in software and biotechnology due their economic sensitivity to the size of the user base. In these industries, exploiting simultaneously the world’s two largest markets can be a powerful competitive advantage.

Indeed, because Japan is the world’s second largest market for both software and biotechnology (National Research Council 1992), Canadian companies in these industries with world class technology really must develop this market to remain globally competitive. If they leave it to US, Japanese or other competitors to exploit, user base
economics mean they will fall behind globally and eventually in Canada and the US too. This is well understood by major US and Japanese companies in these industries and explains Merck’s acquisition of Banyu or Microsoft’s major localization program (Rapp 1995). Still, for historical reasons, Japanese firms in these sectors are relatively weak and do not have the global or domestic user bases to overcome a foreign firms’ first mover advantages and lower average costs. In addition, yen revaluation and government policies have worked against them (Baba et al 1993 and Rapp 1995). This is both a clear opportunity and competitive compulsion for many Canadian firms with leading edge technology.

In biotechnology, an aging population and government budget restrictions have limited payment for new drugs and the fiscal resources available to Japanese firms for product development. Also, the drug approval processes in foreign countries are different and complex with which Japanese firms have little experience. In software, previous government policies have led to a fragmented industry (Anchordoguy 1988 and 1989) where it pays Japanese firms to localize and adapt foreign packaged software rather than developing it themselves (Cottrell 1993, Coultas 1994 and Rapp 1995). Indeed, major Japanese computer manufacturers have offices in the US specifically designed to find and adapt innovative software to their systems and customers (AEA 1992). This situation offers Canadian firms a unique chance to use this weakness (Delaney 1994) to gain capital and access to the Japanese market. This will then expand their global user base helping the Canadian firms’ economics and competitive position in all markets.

While this development will probably happen naturally for already large Canadian producers in these sectors, the situation for small and medium size players is much less clear. This is because such firms are usually entrepreneurial and rarely have the time or resources to ferret out opportunities in Japan when it is easier to concentrate on the North American and European markets. Normally, Canadian government assistance in identifying and pursuing strategic opportunities might be possible. However, given the weakness of the Canadian dollar and Canada’s current budget stringency, this seems unlikely. The Pacific 2000 Fund appears to be largely unfunded, while resources for
identifying strategic opportunities for particular Canadian companies and technologies with specific Japanese counterparts is of little interest to those administering what is available.

In addition, despite the potentially positive spin-offs, the current budget philosophy is to cut back on subsidies or special interest support for business. Further, Japan is presently out of favor relative to China and Southeast Asia, which seem like more dynamic markets, even though a large part of that dynamism is due to the flow of resources from Japanese companies, reflecting the trade and FDI strategies explained above. Finally, there seems little understanding of the actual affects of the Bubble on Japanese MNCs and their competitive situation. That is, while the Japanese economy is depressed as a result of the collapse of the “Bubble”, the actual result of the collapse was a massive transfer of financial assets from Japanese financial institutions to the MNCs (Zielinski and Holloway 1991), substantially increasing their power and global independence (Rapp 1993 and 1994).

Also, the associated scandals and policy disasters, have cost the government, both politicians and bureaucrats, considerable power and influence, permitting the MNCs greater strategic flexibility. This is seen in the continuation of their trade and FDI strategies in global markets. Therefore, in considering Japan, Canada must no longer link nation and companies too closely together but must treat them as independent players. It is the latter to whom Canada’s economic interests are linked and whose strategic attention Canadian business and policymakers must capture. In this regard, Canadians might emulate the tactics of some American states who see the Ambassador to Toyota as more important than the Ambassador to Japan.

But the initiative must come from the Canadian side, since the businessmen assigned to Canada are either too junior, but on their way up, or older executives in the resource sections of the trading companies and banks reporting to more senior executives in New York or Tokyo. The former are in training to learn about living and working overseas and to develop their English skills. The latter are here to preserve and manage the status quo of Canada’s biased raw material and energy supply relationship with Japan.
Their success is all too apparent in the statistics. The decision makers in the newer industries are elsewhere and must be sought by Canadians interested in developing these opportunities since except for the well known global players like Delrina and Corel, Canada is not consciously part of large Japanese firms’ competitive strategies in these industries. Rather, Canadian firms represent a subset of foreign firms other than US or European.

**Summary and Conclusions**

Therefore, in newer industries, the Canadian Japan economic relationship is working against the tide of history and an established infrastructure. That is, the Canada-Japan relationship has been primarily influenced by the evolution of Japanese competition, Canadian resources and their historical interaction. Canada’s administrative heritage is that it has had to jealously guard its independence from the incursions of economically and politically powerful friends, the UK and US. Initially, Japan’s search for food, energy and raw materials appeared to reflect the same situation. Thus, the Canadian reaction to Japanese resource development initiatives was favorable but cautious, a “Yes, but ...” response. Then as the Japanese economy shifted gears from a high growth raw material and energy using economy to one emphasizing value added, there was a shift in Japan’s trade and FDI paradigm as described above. However, the Canada-Japan relationship continued down the previous path, especially as those Japanese firms that were defining the relationship were still processing raw materials and energy. They still needed those commodities even if they were no longer the leading edge of Japan’s economic growth.

But because they were no longer high growth, they became very concerned about price, employment and security of supply. Thus they were reluctant to shift value added abroad. Further, there have been the difficulties surrounding various megaprojects like the Northeast BC Coal Project where bad planning by Quintette Mining dramatically escalated the price of coal to major Japanese steel mills, or the Cum-by-Chance oil refinery where the project’s failure to meet its obligations at the time of the first oil crisis
bankrupted Ataka, one of Japan’s major trading companies, or the Mitsubishi rapeseed crushing facility where government regulations and intransigence meant that it remained more economical to export seed than to crush it in Canada. These and similar problems involving the Dome/Beaufort oil project in the Canadian Arctic, the C. Itoh sawmill in B.C., and the Mitsubishi pulp mill, have all become negative touchstones in the minds of Japanese executives that limit future investment interest in Canadian natural resource projects without even considering the relative economic decline in those Japanese industries.

Yet, despite these clear negatives from a Japanese business perspective, it was difficult for Canadians to begin wooing FDI, and many seemed genuinely surprised that Mitsubishi’s copper smelter went to Texas (Canada Japan Trade Council 1990), even though Texans aggressively pursued the investment and the US president came from Texas. There was misperception of Canada’s advantage vis a vis the US as nice people with whom to work. Rather, the operative variable was and is that because Japan’s US relationship is so overwhelmingly important, if they have a chance to reduce US frictions at no disadvantage to themselves, they will do it. In addition, lower US taxes, greater political flexibility, and other incentives mean Canada must compete for Japan’s FDI if they want it, even in the raw material, energy and food sectors. Further, to attract frontier or technology intensive business, they must better understand Japanese firms’ global strategies in these industries and position themselves to take advantage of their strengths and weaknesses as outlined above.

From this perspective, the potential strategic interfaces between Canada and Japan include joint ventures abroad in raw material or energy development, e.g. INCO in Indonesia or Quebec/Ontario Hydro in China, where Canadians can substitute for Americans or Europeans. However, these situations provide only limited Canadian jobs. Rather, technology industries such as software and biotechnology where Canada is world class and each can help the other compete more effectively against the Americans offer better growth opportunities for Canadians. But to accomplish this in large numbers, Canadian firms need to inventory and actively solicit such alliances. Current budget
restrictions and the high cost of doing business in Japan, however, seem to limit this to only the largest and already successful firms, whereas the greatest potential is in developing small and medium size firms with such technologies. Indeed, given the user base economics of these industries, these firms' competitive survival may depend on their access to Japan’s market, even though they must continually innovate to maintain their advantage.

In addition, Canada’s continued dependence on raw material, energy and food sales to Japan is bound to result in more adverse changes in the terms of trade and be reflected in a constantly stronger yen as correctly predicted by the Krugman model (1979). That is, a raw material based export sector is not workable long term against a value added economy like Japan based on constant process innovation and improvement. This is especially true when it is clear Japanese firms are not going to increase their raw material processing in Canada and Canada cannot force the issue. If it wants to move away from this situation, though, Canada will need a more proactive strategy. Still, Canada and Canadians may not feel comfortable being aggressively proactive, even if failure to do so means present trends continue and questioning persists as to why things are not changing except at the margin. In this scenario, the Delrina-Fujitsu JV to develop facsimile scanning software or the Corel-NEC project in multimedia would be exceptions rather than potential emulation models. Aggressively proactive strategies do represent a role change for Canada. Yet, if capturing Japanese companies’ attention is a goal, it is also the critical choice.

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