



Background

No. 59

April 3, 1987

JAPAN'S BOOMING CONSTRUCTION PROJECTS: YANKEES NEED NOT APPLY

INTRODUCTION

A strong consensus is building in the United States that trade policy should be a top government priority. Frustrations stemming from last year's record \$170 billion trade deficit are riveting congressional attention to this issue, giving rise to a glut of proposed legislation. Some plans seek to improve the competitiveness of U.S. industries, others would apply rules of reciprocity to U.S. trading partners, while still other proposals are blatantly protectionist, designed to shield faltering U.S. industries from foreign competition.

The target of the most heated debate will continue to be Japan. It is the country with which the U.S. runs its largest trade deficit. Friction between the U.S. and Japan is reaching a flash point because of last year's \$58.6 billion bilateral trade imbalance in Japan's favor, up sharply from the 1984 level of \$19 billion.

Irritation with Japan. Americans are becoming particularly irritated with Japan because of the infuriatingly slow pace of the negotiations with Tokyo for broader U.S. access to Japanese markets. Says Treasury Secretary James Baker: "It is the Administration's view that we've got to be tough with Japan. If they don't live up to their agreements then we're going to have to take some further action."¹

One flash point of the U.S.-Japanese trade dispute is Japan's booming construction market. Although the U.S. is acknowledged to be a world leader in this field and is by far the world's largest exporter of construction services, American firms have not been

1. The Washington Post, February 15, 1986, p. H1.

awarded a major Japanese construction contract since 1965. There is only one reason for this: the Japanese deliberately have slammed shut the door to U.S. construction firms.

Of particular interest to American construction firms are planned Japanese public works projects valued at about \$50 billion. Dozens of U.S. companies, for instance, have tried to compete for contracts in the Kansai International Airport construction project near Osaka, now priced at upwards of \$8 billion. So far, U.S. firms have been blackballed. The story seems to be the same for other lucrative Japanese public works contracts.²

Tokyo Balking at Reform. The U.S. has accused Japanese construction companies of conspiring to rotate winning contract bids among themselves to the exclusion of American and other interested foreign firms. More serious is the almost certainly valid accusation that the Japanese government, which appropriates up to two-thirds of the funding for public works projects and supervises the bidding process, not only has tolerated this collusion but also itself has restricted foreign companies from competing fairly.

As a result of strong U.S. protests over the Kansai project, Japanese Prime Minister Yasuhiro Nakasone pledged last July that American firms would have fair access to Japanese public works projects. The Reagan Administration's response was that only swift execution of this commitment would forestall American trade retaliation. Recent Administration as well as congressional investigations have concluded that Tokyo has done nothing substantial toward reform.

The Kansai Airport issue, together with other planned Japanese public works construction projects, rightly have become a pivotal test of the Japanese government's commitment to open market principles. Tokyo must act immediately to reform its anticompetitive bidding procedures. If it fails to do so, pressure will surge in the U.S. for reciprocal actions to prohibit Japanese participation in American public works projects comparable to those in Japan.

THE U.S. CONSTRUCTION INDUSTRY

The U.S. architectural, engineering, and construction (AEC) industry is huge. In current dollars, the AEC sector represented about 8.6 percent of America's 1985 gross national product (GNP).³ The 25,000 U.S. firms involved in planning, design, and construction in 1984 employed some 261,000 Americans, generated \$6.3 billion in U.S. wages, and produced over \$1 billion in U.S. federal, state, and local tax revenues. About 400 such firms are directly engaged in overseas construction projects.⁴

Unsuccessful U.S. attempts to break into the Japanese construction market are not caused by faltering American international competitiveness. In fact, the U.S. private

2. See Burton Yale Pines, "The Kansai Airport Project: Tokyo Slams a \$6 Billion Door in America's Face," Heritage Foundation Executive Memorandum No. 127, August 1, 1986, and Daryl M. Plunk, "In Japan's Construction Industry, the Strategy Is: Don't Do Business with the Yanks," Heritage Foundation Background Update No. 31, December 4, 1986

3. David B. Perini, "Foreign Competition," a speech delivered at the Business Roundtable, Tampa, Florida, November 18, 1986, p. 10.

4. "The Contribution of Architectural, Engineering Construction Exports to the U.S. Economy," a Price Waterhouse study, Washington, D.C., April 1985, p. 2.

sector is highly competitive in construction, with total contracts and sales abroad amounting to \$225 billion in the 1980-1985 period. During this time, Japanese construction exports totaled about \$50 billion.⁵

Shrinking Pie. International construction markets have been shrinking at a fast pace. The value of annual U.S. AEC industry business abroad fell sharply from \$48.3 billion in 1980 to around \$29 billion in 1985. American construction activity in 1985 in the Middle East alone dropped almost 30 percent below the previous year's level. Other nations' construction industries have been faced with comparable shrinkage of their markets abroad. The result, in the words of one U.S. AEC industry executive, is that, while "we have the largest construction pie in the world, [it is] getting smaller. We have more and more folks who want a share of that pie because theirs is getting smaller....At the same time our doors remain wide open to foreign competition."⁶

The U.S. remains the world's largest market for construction activity. In 1985, worldwide construction business was valued at over \$1.3 trillion, and the U.S. accounted for one-quarter of that total. In the past few years, foreign firms' share of the U.S. construction market has been small but growing. In 1985, foreign companies participated in U.S. construction contracts that totaled \$7.3 billion, or a sizable 2.2 percent of the U.S. market. This is a 27 percent increase over the previous year and double the 1983 level.⁷

Free Access to U.S. Until recently, West German, British, and French firms accounted for most foreign construction in the U.S. As late as 1981, Japanese construction activity in American markets was almost nonexistent. Japanese AEC business in the U.S. that year was valued at less than \$50 million. By 1985, that figure had soared to \$1.8 billion or about 25 percent of all construction in the U.S. by foreign companies. Fueling this increase of Japanese activity in U.S. construction projects undoubtedly was the abrupt constriction of Middle East markets. During the 1983-1985 period, Japan lost three-quarters of its construction business in that region.⁸ Last year Japan's construction exports to the U.S. are estimated to have been at least \$3 billion and possibly \$4 billion. The meteoric growth of Japan's construction business in the U.S. demonstrates the free access to the American market that foreign firms enjoy.

JAPAN'S CONSTRUCTION MARKET

Though Japan's domestic construction market is nearly three-quarters the size of America's, thereby ranking as the world's second largest, U.S. construction activity in Japanese markets contrasts starkly to Japan's booming activities in the U.S. American AEC firms have not been awarded a major Japanese construction project in two decades. According to U.S. Embassy officials in Tokyo, "past foreign participation in major [Japanese] projects...was written off as a 'waste of time' because of the difficulty in penetrating the closed Japanese market." Increasingly, however, "American firms are looking more at the possibility of doing business in Japan."

5. Charles T. Pinyon, "Foreign Penetration of the U.S. Construction Market," a speech delivered at the Business Roundtable, Tampa, Florida, November 18, 1986, appendix 1.

6. Perini, op. cit., p. 6.

7. Pinyon, op. cit., p. 2.

8. Ibid.

In particular, renewed U.S. interest in Japan's construction market has been sparked by a number of planned Japanese public works projects scheduled for completion between now and the turn of the century. These will be funded primarily by the Japanese government. Eight of the largest scheduled projects will account for some \$50 billion in AEC contracts (see appendix). Currently, about 40 U.S. AEC firms have registered for the opportunity to participate in the Kansai Airport construction project. Many more American firms want to compete for pending public works projects.

The trouble is that substantial obstacles confront U.S. companies when they bid for these lucrative contracts. A source of increasing frustration is the "designated bidding system," which is used to award Japanese public works contracts. Explains the president of the "special company" organized by the Japanese government to administer the Kansai project:

As for contracts and construction of public works, the "designated bidding system" is the standard practice. Under this system, the client [the Japanese government] designates reliable firms and invites them to bid; the competitive bid system or the "open-bid system," as it is called in the U.S., in which an unlimited number of companies compete, is almost non-existent in Japan.

By examining a list of registered firms in terms of their business conduct, technological capabilities, reliability, etc....governmental and public bodies can exclude companies of inferior construction abilities and insincere conduct, thereby preventing low quality results.⁹

Nasty "Dango System." Large Japanese businesses, which may include AEC firms, manufacturing companies, and banks under one umbrella group, are often organized into associations known as Keiretsu. During the designated bidding process for public works projects, competing and affiliated companies seek to avoid excessive competition through consultation and consensus. This is the "Dango" system. If this system is encouraged by the Japanese government, and if U.S. companies are excluded, then the U.S. has cause for action. The Office of the U.S. Trade Representative (USTR) cites this as a significant obstacle to the U.S. service industry's access to Japanese markets.¹⁰

The Japanese government insists that the "special companies" established to administer public works projects should be considered private sector institutions. In the case of the Kansai Airport, however, two-thirds of the project's funding is supplied by the government in Tokyo, while local governments and private sector sources each generate only one-sixth of the funds. Furthermore, the President of the Kansai special company is a Ministry of Transport official, and 144 of his 151 staff members are on leave from various government ministries.¹¹

9. Yoshio Takeuchi, "An Overview of the Kansai Airport Project," Kansai International Airport Co., Ltd., 1986, p. 7.

10. Testimony of Assistant U.S. Trade Representative Bruce Wilson before the Senate Subcommittee on East Asian and Pacific Affairs, June 5, 1986.

11. Nihon Keizai Shimbun, May 3, 1986, p. 1.

Thus the administration of the restrictive bidding system used to award public works project contracts is directly supervised by the Japanese government.

THE KANSAI COLLUSION

The Kansai International Airport is being built on reclaimed land in Osaka Harbor 300 miles south of Tokyo. Its \$8 billion price tag is the largest ever for an airport construction project. The \$3.6 billion initial phase is already underway. While Japanese firms already have been awarded Kansai contracts exceeding \$1 billion, U.S. firms have been successful in securing contracts worth only \$1.4 million--despite America's high level of competitiveness in the field of airport construction.

Many U.S. experts suspect that Japanese construction executives have simply grown comfortable with their insular procurement process and are loath to compete with American firms known to be particularly competitive in the fields of airport design and construction. The Japanese press has speculated that "Japan is technologically behind in these areas"¹² and that "bold opposition [to foreign participation] reflects the feeling of alarm by [Japanese] industry."¹³ In the case of public works such as the Kansai project, this industry opposition to foreign competition is implicitly backed by the Japanese government.

Handicapping U.S. Firms. According to an August 1986 study by the Office of the U.S. Trade Representative (USTR), requested by Senator Frank Murkowski, the Alaska Republican, "non-transparent, discriminatory procurement procedures" were followed in the Kansai bidding process. USTR found that the Kansai International Airport Company did not release sufficient information about construction plans and schedules to allow foreign firms to prepare their bids in a timely and effective manner.

In contrast, the Ministry of Transport "presented initial outlines on Kansai to a consortium of Japanese firms almost 10 years ago." Foreign firms were not included in this early notification, according to the USTR report. USTR concluded that the "closing out of U.S. firms from participation in the project during these early years may have severely handicapped U.S. firms in competing for later Kansai opportunities." As evidence, the study quoted a 1986 Japanese government statement, which stressed that, since U.S. AEC companies were not involved in "preparatory stages," it is "impossible [for foreign] companies...to fully familiarize themselves with the project...since scheduling is tight."

Tokyo's Catch 22. The Japanese government's failure to inform foreign companies about upcoming construction projects, on the one hand, and its subsequent reluctance to consider "uninformed" foreign firms for contracts, on the other, is a glaring--possibly deliberate--"Catch-22." It is a formidable obstacle to overseas AEC participation in Japanese public works projects.

By contrast, the USTR report stressed that all U.S. public works projects administered by the U.S. government are bound by laws requiring "a great deal of transparency and

12. Asahi News Service, January 14, 1986.

13. Nihon Keizai Shimbun, March 15, 1986, p. 9.

impartiality" which gives "all potential bidders equal time and opportunity to prepare a responsive bid" and assures that awards are "based on the competitive merits of the bid."

OTHER VIOLATIONS

The anticompetitive tendencies inherent in Japan's Keiretsu construction groups and their Dango system of unfair bidding may have serious implications for the U.S. market. In a December 1986 letter to U.S. Attorney General Edwin Meese, Senator Murkowski argues that, "If the 'dango system' is, in essence, an anti-competitive cartel, it would follow that U.S. firms would not be welcome because U.S. firms are restrained by American law from collusion...." There are also allegations that Japanese businesses are violating Japanese antitrust law by excluding U.S. firms from the Dango system. In such cases, U.S. firms should be urged to take up these violations in Japanese courts. Further, if Japanese firms doing business in the U.S. are violating U.S. laws, there are legal remedies under American laws that the U.S. government should pursue.

A Classic Cartel. Last December, Murkowski asked the Justice Department and the Senate Judiciary Committee to begin investigating possible Japanese violations of U.S. law. And the U.S. Commerce Department reports "episodic evidence" of Japanese collusion in bidding for Interior Department public works contracts. The Republican Senate Task Force on Trade, meanwhile, charges that "through the private tendering system in Japan, the existing Japanese AEC companies earn the kinds of excess profit associated with a classic cartel...[and] can afford to enter the U.S. market, taking unattractive offers or money losing projects."¹⁴

U.S. CONGRESSIONAL ACTION

Congressional activity aimed at securing fair U.S. access to the Kansai bidding process and other upcoming Japanese public works projects has been spearheaded by Murkowski, who chairs the Republican Conference Task Force on International Trade Policy and sits on the Senate Foreign Relations Committee. Since that committee held hearings on the Kansai controversy last June, several U.S. policy options have come to the forefront of congressional attention:

Section 301 Action

Under Section 301 of the U.S. Trade Act of 1974, a nation found to be preventing fair U.S. access to its markets can be put on notice by the U.S. government. If the unfair practices are not redressed within one year, the President can order appropriate economic retaliation.

Last June, Murkowski requested that U.S. Trade Representative Clayton Yeutter determine whether the Kansai Airport dispute met the requirements for a Section 301 action. In August, Yeutter reported that, unless the Japanese moved quickly to reform the Kansai bidding system, "Section 301 remains very much a live option for the future." On February 18, 1987, Murkowski told a Heritage Foundation audience that "a detailed draft 301 petition has been produced."¹⁵

14. Republican Senate Task Force on Trade, "Major Projects in Japan," June 24, 1986, p. 17.

15. Remarks at a Heritage Foundation Conference, "U.S.-Japanese Trade Relations: Time for an Agonizing Reappraisal," February 18, 1987.

Reciprocity Legislation

Another U.S. policy option involves the estimated \$25 billion to be spent by the U.S. government in the next decade for airport construction. Legislation appropriating federal funds for construction of these airport projects must be authorized during the current 100th Congress. Murkowski is considering a proposal to amend either the Federal Aviation Act or the Airport and Airways Improvement Act to establish reciprocity requirements. The amendment would seek to exclude from participation in federally funded U.S. airport construction projects firms from nations that prevent fair American access to comparable projects in their markets.

REAGAN ADMINISTRATION EFFORTS

The Reagan Administration first raised substantive questions about Kansai in 1984 through the U.S. Consul General in Osaka. Since then, USTR and the Commerce Department have negotiated at length and in detail with their Japanese counterparts over equitable treatment of U.S. AEC firms in the designated bidding process. In an apparent breakthrough, Commerce Secretary Malcolm Baldrige met with Prime Minister Nakasone last July and received assurances that the Japanese government would take steps to assure fair and equitable treatment of U.S. companies in the bidding process. Baldrige expressed his hope that reforms would apply to all Japanese public works contracting. He stressed that "only full and immediate implementation of this policy will forestall formal trade action by my government."

An "Intolerable" Situation. After follow-up visits to Japan late last year, however, Assistant Commerce Secretary H.P. Goldfield concluded that the Japanese government was not living up to commitments. This situation, declared Goldfield, is "intolerable."¹⁶ In October, Goldfield and a Presidential Trade Delegation, including senior U.S. construction industry executives, visited Japan to meet with their industry counterparts. Again there was no progress. The delegation reported that it was "unable to point to any discernible changes in the traditional designated bidding system" and called on the U.S. government to "be prepared to impose immediate restrictions on Japanese participation in the U.S. market if recognizable progress is not achieved in the very near future."¹⁷

CONCLUSION

In recent years, the U.S. has pressed for expanded American access to a variety of Japan's goods and services markets ranging from the beef industry to the law profession. The U.S. charges that unfair trade practices are among the most important reasons why the U.S. has trouble selling some products in Japan. The Japanese adamantly deny this and ritually point to "mitigating" factors. International economic conditions, or the strong U.S. dollar, or American unfamiliarity with Japanese cultural attributes and consumer

16. Business America, U.S. Commerce Department, Washington, D.C., November 24, 1986, p. 3.

17. Report of Industrial Participants of the U.S. Presidential Trade Delegation to Japan, October 1986.

preferences, or lagging American competitiveness, or all of these, the Japanese have claimed, limit U.S. ability to succeed in some Japanese markets. While these claims have some merit, they are irrelevant in the dispute over Japan's public works projects. Judging by the strength of American AEC firms in the U.S. and abroad, the U.S. construction industry is arguably the world's most competitive and technologically advanced. However, despite a strong desire to compete in the world's second largest construction market, U.S. companies strangely have not won a major construction contract in Japan for more than two decades. Japanese construction companies, on the other hand, compete freely in American markets and, indeed, are doing a booming business.

Litmus Test. This situation has been so unfair for so long that now the Kansai Airport and the other upcoming Japanese public works projects have become an important litmus test. They will reveal the strength of Japan's commitment to playing fair.

The Japanese government must act immediately to prove this commitment. As a first step, Prime Minister Nakasone should fulfill his pledge and direct the Kansai International Airport Company to offer foreign firms free and equal access to the Kansai bidding process.

The Japanese government also must push broader reforms to allow free competition in all future public works projects. Japanese firms vying for Kansai contracts had enormous advantages since they were supplied preliminary information on the project by the Japanese government years before such information was available to most foreign firms. Initial release of information by the Japanese government on upcoming projects should be shared with domestic and foreign companies alike.

Demand Swift Change. If the government of Japan is acting to exclude U.S. firms from the Dango system, the U.S. government is correct to demand an end to such practices. If U.S. antitrust laws prohibit American companies from participating in this system, forcing them to forgo lucrative business opportunities, the U.S. should modify these laws to allow U.S. companies to compete more effectively.

The U.S. should continue to demand swift progress in these areas and closely monitor the Japanese government's efforts to fulfill its promises. Washington should warn Tokyo unequivocally: Unless Tokyo takes necessary action, pressure will mount in the U.S. for reciprocal measures.

In relation to the Kansai issue, for example, such reciprocal action might be a ban on Japanese participation in federally funded U.S. airport construction projects. Future U.S. action might be considered case by case, leading to a quid pro quo that prohibits Japanese involvement in U.S. public works projects comparable to those Japanese projects that are not open to American firms.

In the case of Japan's multibillion dollar public works construction sector, the Japanese government clearly has the authority to enforce equitable awarding of contracts through an open, competitive bidding process. It is time for Tokyo to prove its commitment to the principles of truly free international trade.

Daryl M. Plunk
Senior Policy Analyst

APPENDIX

SELECTED LIST OF MAJOR JAPANESE PUBLIC WORKS PROJECTS

Kansai International Airport

Cost: \$5-8 billion (800-1200 billion yen)

Date of commencement: Fall 1986 Date of completion: Spring 1993

Tokyo Narita Airport Expansion

Cost: \$3.8 billion (600 billion yen)

Date of commencement: 1987 or 1988

Date of completion: Spring 1991

Tokyo Haneda Airport Expansion

Cost: \$5.5 billion (880 billion yen)

Date of commencement: 1984

Date of completion: Spring 1993

Trans-Tokyo Bay Highway

Cost: \$6.3 billion (1 trillion yen)

Date of commencement: Spring 1987 Date of completion: 1998

Akashi Straits Bridge

Cost: \$6.3 billion (1 trillion yen)

Date of commencement: 1988

Date of completion: 1998

Yokohama Port Expansion

Cost: \$12.5 billion (2 trillion yen)

Dates of commencement: Phase I 1983 Phase II 1988

Date of completion: 2000-2005

New Hiroshima Airport

Cost: \$330 million (50 billion yen)

Date of commencement: Spring 1987

Date of completion: 1993

Nagoya Airport Expansion

Cost \$4-6 billion (600-950 billion yen)

Date of commencement: 1990-1995

Date of completion: 2000-2010

Source: "Industry Sector Analysis," U.S. Consul General, Osaka, Japan, June 1986.