

Gunther Schnabl and Indira Gurbaxani\*

# Goals, Decision-Making Mechanisms and Instruments in the Japanese-American Trade Conflict

*Trade conflicts flaring up at intervals have become a feature of economic relations between Japan and the USA. The following article examines the history of these conflicts against the background of the two countries' differing political traditions, goals, negotiating mechanisms and policy instruments.*

The crisis in Japan's financial markets – which reached its first peak in late 1997 – has altered the flow of capital and goods worldwide. As confidence in the Japanese financial system faltered and with the resulting recession on Japan's home market, foreign investors withdrew their capital from the Tokyo financial centre. The sale of yen investments led to the currency's devaluation, which in the final two months of the year lost 3.7% against the deutschmark and 7.9% against the dollar. The devaluation of the yen benefited exports, which in November 1997 were up 6.4% against the previous year. As imports fell simultaneously by 4.2%, Japan's foreign trade surplus increased by 59% to ¥1.06 billion.<sup>1</sup>

With the depreciation of the yen, a new trade conflict with the US looks likely. As early as August 1997, a representative of the US auto industry pointed out that a devaluation of the yen was not desirable for American producers given the imbalance already existing in trade between the US and Japan. The strong dollar and the closed Japanese market would, he said, depress sales of American cars in Japan, while exports by Japanese car manufacturers to the US would increase, thus making a further deterioration of trade relations between the two countries inevitable.<sup>2</sup>

The representative's comments are characteristic of trade relations between the two countries. On the one hand, the US government has officially recognised that the US trade deficit is due to the difference between savings and investment in the economy as a

whole<sup>3</sup>, so neither the steadily appreciating trend of the yen since the early 1980s<sup>4</sup> nor the gradual dismantling of Japan's formal trade barriers have led to any significant change in the level of the bilateral trade deficit. Nevertheless, under pressure from some industries, the US continues to demand the opening of the Japanese market to redress the trade imbalance. This has resulted in a shift in trade negotiations to the sectoral level instead of solutions being sought at the macro level.

Do US government representatives lack an understanding of the macroeconomic background or is the

<sup>1</sup> Cf. Neue Zürcher Zeitung: Markanter Anstieg von Japans Handelsüberschuss, 19th Dec. 1997, No. 295, p. 9.

<sup>2</sup> Cf. Nihon Keizai Shimbun: Head of the American Auto Manufacturers' Association: "The disequilibrium in the balance of payments on current account is difficult to accept" – Attack on the Impenetrability of the Japanese Market (original title in Japanese), 18th July 1997 (morning edition), p. 11.

<sup>3</sup> Cf. United States Council of Economic Advisers: Economic Report of the President, Washington, D.C. 1990, p. 91. A detailed description of the macroeconomic relationship between savings, investment and the balance of payments on current account can be found in: P. Krugman, M. Obstfeld: International Economics: Theory and Policy, 4th ed., Reading, Mass. etc. 1997, pp. 301–330. The differential between savings and investment shows up in the current account of the balance of payments. To simplify matters, the following section will discuss the balance of trade only – the most important sub-class within the current account.

<sup>4</sup> The revaluation of a country's currency leads, *ceteris paribus*, to a reduction in the country's exports and an increase in imports if the price elasticity of demand is normal. Therefore a revaluation of the yen ought, *ceteris paribus*, to lead to a reduction in the Japanese trade surplus. For the economy as a whole, however, there is a close correlation between the course of the economic cycle, exports, imports, the exchange rate, and savings and investment behaviour. A revaluation of the domestic currency not only leads to a reduction in exports but also to a cyclical slump which depresses imports. At the same time, savings and investment are linked to the economic cycle, so despite the constant revaluation of the yen since the early 1980s there has been no significant change in Japan's balance-of-payments surplus.

\* University of Tübingen, Germany.

trade imbalance being consciously used as an effective public relations instrument for asserting specific interests? Is Japan really as unwilling to reduce trade barriers as the US maintains? Is the popular categorisation of Japan as protectionist and the US as free-trade-oriented at all justified? The following article will define the trade policy priorities of the two countries. Based on the current general economic framework, the political negotiating mechanisms will be analysed and the two countries' trade policy instruments filtered out. In conclusion, their trade policies will be examined in terms of their conformity with market principles.

### Different Traditions

Japanese and American traditions of industrial and trade policy are very different. Whilst American economic policy has always espoused the principles of free competition and free trade, in Japan the state has traditionally been given a central role in the country's economic affairs.<sup>5</sup> Japan's reputation as a centrally controlled economy stems from the period of economic growth which followed the Second World War. Accompanied by the heavily interventionist industrial, trade and competition policies of the Ministry of International Trade and Industry (MITI), Japan grew to be the world's second largest industrial nation measured in terms of its gross domestic product.

Since the 1980s it has become more difficult to firmly assign the economic policies of the two

countries to the liberal or interventionist camps. The United States is no longer the sole dominant international economic power. Important branches of industry such as automobiles and electronics have lost a substantial amount of market share to foreign competitors. Since the early 1980s the balance of trade has recorded very high deficits (see Fig. 1). As the trade deficit was seen as a sign of the declining competitiveness of the American economy, there were calls from industry, politicians and the academic world for government intervention.<sup>6</sup> Japan's successful export industries, on the other hand, generated a significant trade surplus which caused trading partners to demand the opening of the market and deregulation, with the result that the degree of government intervention in the Japanese economy has been declining continuously since the 1960s.<sup>7</sup>

Despite the changes in the trade policies of the two countries, the trade imbalance in the 1980s and '90s remained constant because the macroeconomic fundamentals did not alter. Whilst the Japanese balance of trade remained in surplus throughout, the balance of trade in the US was its mirror image in negative (see Fig. 1). The changes in the balance of trade figures were determined by cyclical trends. A boom in Japan caused the trade surplus to fall and in the recession it started to rise again. Cyclical developments in the early 1990s thus aggravated the trade conflict as the surplus rose in Japan as a result of the recession and the deficit in the US increased due to the upswing in the American economy.

The development of the balance of trade directly influenced trade policy. The trade deficit, accompanied in the US by a loss of market share for domestic industries, led to pressure from interest groups. The US government was forced to publicly take the initiative, and brought its Japanese counterparts to the negotiating table. Japan reacted to America's negotiating offensive. Thus the negotiating patterns of both countries can be described as complementary.

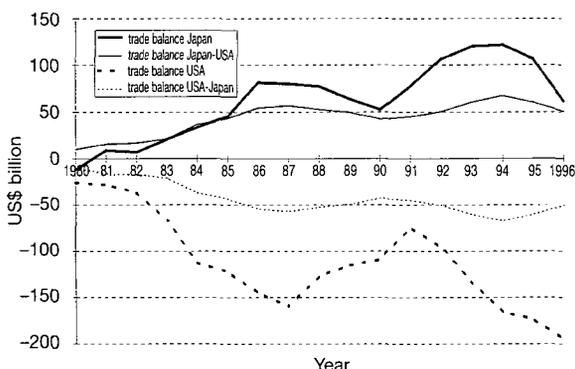
<sup>5</sup> On the role of the government in Japan's post-war economy, from which the term "Japan Inc." is also derived, see D. I. Okimoto: *Between MITI and the Market: Japanese Industrial Policy for High Technology*, Stanford 1989.

<sup>6</sup> Cf. B. Bluestone, B. Harrison: *The Deindustrialization of America*, New York 1982; and B. Babbitt: *The States and Reindustrialization*, in: *Economic Impact*, Vol. 14 (1986), No. 1, pp. 54-59, esp. p. 55. (Since Clinton entered office in January 1993, Babbitt has been the US Interior Secretary).

<sup>7</sup> Cf. G. Schnabel: *Balance of Trade and Government Intervention - Japan as a Role Model?*, in: *INTERECONOMICS*, July/August 1996, pp. 189-196.

**Figure 1**  
**The Trade Balances of the US and Japan**  
**(both overall and bilateral)**

- in US-Dollar -



Sources: United States Council of Economic Advisers (1997), IMF (various years), and own calculations (conversion based on period averages).

### Negotiating Mechanisms

Trade conflicts between Japan and the US have a long tradition and reflect the structural changes in the Japanese economy.<sup>8</sup> Post-war conflicts began in the 1950s with negotiations over textiles, followed by rows in the 1960s and '70s in the electronics and steel industries. Since the 1980s negotiations have focused on automotive and high-tech products. The growth of the US trade deficit in the early 1980s increased the potential for conflict. Komiya notes that the trade problems in certain branches of industry developed into a broad economic conflict during the 1980s. Whilst negotiations in the 1960s and '70s concentrated on tariffs and quotas on specific industrial goods, during the 1980s the emphasis shifted to factors such as Japan's domestic demand, exchange rates, public procurement, anti-trust laws, business practices and distribution structures.<sup>9</sup>

One thing that remained unchanged, however, was the pattern of negotiations between the USA and Japan. On account of its trade deficit and the pressure of individual interest groups, the US invariably takes on the active role in negotiations. It determines the areas for negotiation, whilst Japan reacts to America's initiatives. Since the position of both countries in negotiations is determined by the balance of political interests at home, we will start by outlining the decision-making mechanisms in each country in turn.

### Decision-Making Mechanisms in the US

US trade policy since World War II has been contradictory. On the one hand, the US was the chief initiator of an international trade organisation – the ITO – which was set up to liberalise international trade, yet the ITO was not ratified by Congress. In addition, between 1947 and 1958 the President was granted by law the right to negotiate bilateral tariff reductions on a reciprocal basis.<sup>10</sup> The tendency towards bilateralism has grown since the 1970s. In the 1974 Trade Act the term “fair trade” was used for the first time in addition to the term “free trade”. By using this supplementary term, the US indicated that it viewed protectionist measures as an appropriate response to

the “unfair” trade practices of its trading partners – especially those of Japan.

A particularly significant move was the addition of Section 301 to the 1974 Trade Act, which provided the legal basis for protectionist measures in answer to “unfair” trade practices from abroad. A number of non-tariff trade barriers were implemented on the basis of Section 301, particularly Voluntary Export Restraints (VERs). At the same time, the US was also attempting to bring the tariff reductions tabled at the Tokyo Round of the GATT (1973-79) to a successful multilateral conclusion. This twin-track policy was continued during the 1980s and '90s. Whilst the US demanded the inclusion of additional sectors (services, intellectual property and trade-related investments) into the articles of the GATT during the Uruguay Round of 1986-93, it kept up its bilateral pressure on Japan.

The 1988 Omnibus Trade and Competitiveness Act further tightened US trade legislation. The focus was on the reform of Section 301 which, with the new Super 301 added in, commits the United States Trade Representative (USTR) to listing the “unfair” trade practices of trading partners. If foreign countries maintain an act, policy or practice that is “unjustifiable, unreasonable or discriminatory and burdens or restricts U.S. commerce”, the USTR is required to initiate an investigation, to negotiate on the reduction of trade barriers and to resort to retaliatory measures if these actions should fail. Any protectionist measure which is deemed feasible and appropriate may be taken.<sup>11</sup> In practice, Section 301 was intended to enable the US to take direct action against Japanese trading methods.<sup>12</sup> The first list of unfair trade practices in 1989 explicitly named Japan as an unfair trading partner. Despite constant negotiations between the two countries the list continued to grow.

It is difficult to gain a clear picture of the decision-making mechanisms within US trade policy. The reform of Section 301 has strengthened the position of the USTR. Under President Reagan it was common practice for negotiations on, say, VERs to be handled

<sup>8</sup> For a comprehensive survey of the structural development of the trade dispute see M. Itô: *Introduction to Foreign Trade* (original title in Japanese), Tokyo 1997, pp. 314 f.

<sup>9</sup> Cf. R. Komiya: *The Economics of Trade Surplus and Trade Deficit* (original title in Japanese), Tokyo 1996, pp. 42 f.

<sup>10</sup> Cf. S. A. Lenway: *The Politics of U.S. International Trade. Protection, Expansion and Escape*, Boston 1985, p. 75.

<sup>11</sup> For a survey of the implementation of Section 301 in the 1975–1990 period, see I. M. Destler: *American Trade Politics*, 2nd ed., New York 1992, pp. 404–431. Section 301 has been employed most frequently against the EU and its member states and Japan.

<sup>12</sup> Cf. C. Johnson: *Trade, Revisionism, and the Future of Japanese-American Relations*, in: C. Johnson: *Japan: Who Governs? The Rise of the Developmental State*, New York, London 1995, pp. 69–95, esp. p. 92. For the above reason, the then British prime minister, Margaret Thatcher, called the expansion of Section 301 a “demonstrable act of frustration” (p. 89).

directly by the Secretary of Commerce, but since the late 1980s this has been the job of the USTR.<sup>13</sup> Neither the US government nor Congress may determine trade policy alone. Section 301 allows trade-policy decision mechanisms to be influenced via the USTR. American initiatives have usually been prompted by the demands of certain industries or companies, although the US government has always emphasised the automatic mechanisms of the Trade Act.<sup>14</sup> Koopmann's verdict on this issue: "In tendency, '301' has developed from a flexible instrument of trade diplomacy to a means of aggressively opening foreign markets."<sup>15</sup> Examples of this are the pressure on Japan regarding satellites in 1990, semiconductors in 1991, and films, wood products and cars in 1995. According to Section 337 of the Trade Act, industries may even demand protectionist countermeasures without having to provide proof of having incurred direct damage through the "unfair" behaviour of their trading partners.

### Decision-Making Mechanisms in Japan

The Japanese government has always reacted to US trade initiatives by showing willingness to negotiate and by making concessions. Numerous authors point out that pressure from outside (in Japanese – *gaiatsu*) has traditionally been a significant factor in political change in Japan.<sup>16</sup> Chalmers Johnson has even likened the US to an opposition party which has wrought more change in Japan than the Japanese Opposition itself.<sup>17</sup>

The reasons for Japan's conciliatory stance towards the US are numerous. For one thing, since World War II the US has enjoyed a strong economic and political hegemony over Japan, so in this sense there is a tradition of Japanese subordination. For another, the deregulation of a large number of sectors

of industry was the condition for Japan's membership in international organisations such as the IMF and the OECD and its joining GATT in 1955.<sup>18</sup> Japan's increasing dependence on foreign trade has made its formal integration into the world trading system indispensable. The opening of its import market can therefore be seen as its "entry fee" to vital export markets. The US continues to be Japan's most important export market.

The decision-making process for trade policy in Japan is complex. Trade policy is the responsibility of a number of ministries. MITI is responsible for industry, while the Ministry of Finance and the Ministry of Agriculture, Forestry and Fisheries look after their respective business sectors, and the Ministry of Construction deals with public procurement.<sup>19</sup> Depending on which authority is responsible, the trade talks have varying chances of success. MITI, now that it has gradually reduced its interventions in industrial and trade policy, can largely be seen as a market-oriented department. On the other hand, the Ministry of Agriculture, Forestry and Fisheries and the Ministry of Construction both maintain very protectionist reputations.

The Japanese negotiators stand for a system which is characterised by stability and the continual reconciliation of interests between the political system, bureaucracy and business. Decision-making is consensus-oriented. Chief factors in the outcome of negotiations are political interests, the degree of self-sufficiency found in the industry concerned and the influence exerted by bureaucracy over firms in that industry.

Governmental decision-making is dominated by the bureaucracy. The influence of politicians remains negligible as long as the interests of the electorate are not directly affected.<sup>20</sup> Taniguchi notes that the average member of parliament for the governing party

<sup>13</sup> The appointment of William Daley to Secretary of Commerce in the second Clinton Administration is seen by political insiders in Washington, D.C. as a further erosion of the department. For some time now Republicans have even been demanding that the Department of Commerce be completely dissolved. The key figure in trade policy in the Clinton Administration is considered to be the USTR Charlene Barshefski (cf. *Neue Zürcher Zeitung: Zauberlehrlinge in der U.S.-Handelspolitik*, 31st Jan./1st Feb. 1997, No. 24, p. 13).

<sup>14</sup> Cf. A. Porges: *U.S.-Japan Trade Negotiations: Paradigms Lost*, in: P. Krugman (ed.): *Trade with Japan: Has the Door Opened Wider?*, Chicago, London 1991, pp. 308 f.

<sup>15</sup> G. Koopmann: *Außenwirtschaft und Außenwirtschaftspolitik der USA*, Hamburg 1991, p. 52.

<sup>16</sup> See, for example, K. B. Pyle: *The Japanese Question: Power and Purpose in a New Era*, Washington, D.C. 1992; and K. Hamada: *Behind the US/Japan Trade Conflict*, in: *The World Economy*, Vol. 18 (1995), No. 2, pp. 269–294, esp. p. 283.

<sup>17</sup> Cf. C. Johnson, *op. cit.*, p. 89.

<sup>18</sup> Cf. Y. Mikanagi: *Japan's Trade Policy: Action or Reaction?*, London, New York 1996, pp. 20 f.

<sup>19</sup> Cf. T. Ikuta: *Kanryo, Japans Hidden Government*, 1995, pp. 26f. The strong demarcation between the areas of responsibility explains the American strategy of focusing talks on certain sectors of the economy, to avoid inter-ministerial conflicts by minimising the number of ministries actually involved.

<sup>20</sup> Negotiations on the markets for agricultural products are politically very sensitive as the rural population is politically over-represented due to the disproportional distribution of constituencies. (Cf. Y. Sone: *Structuring Political Bargains: Government, Gyokai, and Markets*, in: G. D. Allison, Y. Sone (eds.): *Political Dynamics in Contemporary Japan*, Ithaca, N.Y., London 1993, pp. 295–306, pp. 301 f.) Negotiations on opening up the rice market were for this reason largely unsuccessful.

LDP actively supports a solution to the trade conflicts. However, members also tend to propose measures which do not directly affect their own voters or the industries located in their constituencies. Thus they favour promoting investment at home, intervention to revalue the yen, or the simplification of import procedures. As the grass-roots interests involved will vary according to a member of parliament's constituency and field of activity, the influence of the political grass roots on trade talks depends on how specific interests are managed by the leaders of the parliamentary groups within the parties.<sup>21</sup>

According to Okimoto, the influence of bureaucracy on the private sector depends on the life cycle of the relevant industries. It is easier to influence up-and-coming "sunrise" industries and outdated "sunset" industries than mature industries. The latter are highly competitive and have sufficient resources at their disposal, strengthening their negotiating position over that of the bureaucrats. A lack of resources or dependence on subsidies or import restrictions leave the way open for state intervention.<sup>22</sup> Ôyama believes influence depends on the extent to which the deregulation of an industry has progressed. His view is that dependence is high if the industry is heavily regulated and low in deregulated industrial sectors.<sup>23</sup> Taniguchi points out that the solution to the trade disputes can be particularly easy in the case of autonomous industries if the industry has an interest in deregulation.<sup>24</sup> One example of this is the lowering of trade barriers in the semiconductor industry – a move which was tolerated by the industry as it was already highly competitive in the international arena and its autonomy was thus increased by deregulation.

Political interests in Japan are reconciled on an informal basis. Japanese bureaucracy is able to influence the private sector in its decision-making

without the need for formal, statutory powers to do so.<sup>25</sup> There are close personal interrelationships between politicians, ministries and big business which facilitate the exchange of information and interplay of interests. As the arrangements made do not have a formal legal basis and the interests of both sides are taken into consideration, the final outcome is usually a compromise. For this reason, as Hamada notes, signs of fundamental reform are rare in consensus-oriented Japanese society.<sup>26</sup>

### Development of the Trade Conflict

The analysis of decision-making mechanisms in the trade policies of the US and Japan has shown that although negotiations between the governments take place at the official level, the interplay of interests between the government and the private sector is informal in character. In the US, interest groups press for trade policy interventions whereas Japan attempts to meet US demands while taking into consideration domestic political and business interests.

US calls for restrictions on Japanese exports or increased Japanese imports derive their political justification from the substantial disequilibrium in the bilateral balance of trade, which the public considers to be an unsatisfactory state of affairs. Although Japan agrees to conduct trade talks, the US demands are only carried out hesitantly due to the difficulty of reconciling political interests. Only when the US threatens concrete punitive measures is the decision-making process accelerated. This results in one-off concessions which are restricted to controversial market segments but which do not really ease the overall trade disequilibrium.

From the Japanese point of view, the aim of the agreement process is not wholesale deregulation, which would reduce the potential for conflict long-term, but the short-term reduction of tension in specific sectors. This way although the interests of the US and those of interest groups at home are complied with short-term, no long-term solution to the conflict is provided. Japan's short-term solution provokes new negotiating initiatives from the US. Tamura calls this cycle of *gaiatsu* and partial concessions by Japan, which has remained unchanged since the 1950s, the "vicious circle" of the Japanese-US trade conflict (see Fig. 2).

Whilst the basic pattern of the trade conflict between the two countries remains unchanged, the market segments involved in the controversy and instruments employed have altered over time. The following

<sup>21</sup> Cf. M. Taniguchi, *op. cit.*, p. 37.

<sup>22</sup> Cf. D. I. Okimoto, *op. cit.*, pp. 48 ff.

<sup>23</sup> Cf. K. Ôyama: *The Political Economy of Administrative Control* (original title in Japanese), Tokyo 1996, pp. 189 f.

<sup>24</sup> Cf. M. Taniguchi, *op. cit.*, p. 31 f.

<sup>25</sup> Cf. S. Nanjô: *Joint efforts to solve the trade dispute*, in: H. Shimada et al.: *End the US/Japan trade dispute* (original title in Japanese), Tokyo 1995, pp. 53–91, esp. p. 71. The informal influence of bureaucracy on Japan's companies is known as *gyôseishidô* (administrative guidance).

<sup>26</sup> Cf. K. Hamada, *op. cit.*, p. 186 f. However, there is a tradition of developing fundamental reform approaches. The most important of these are the Maekawa Report under Prime Minister Nakasone and the Hiraiwa Report under Prime Minister Hosokawa.

section reviews the development of the trade conflict during the 1980s and '90s from these two perspectives.

**Anti-Dumping Proceedings and VERs**

The strong growth of the US trade deficit in the early 1980s led to protectionist measures. The most significant instruments used in the first instance were anti-dumping proceedings which were initiated against foreign industries on the grounds of "unfair trade". The industries affected were usually the ones who initiated proceedings. The actions which were sustained were resolved by the government in one of two ways. Either high penal tariffs were levied on imported goods or the proceedings were settled after negotiating VERs.<sup>27</sup>

Voluntary export restraints are obligations self-imposed by the industries concerned to reduce the volume they export to a certain country. They are brought about by pressure from the importing country. As they are agreements between industrial associations they do not come under the jurisdiction of the GATT and have been employed increasingly as "grey-area measures" as tariffs and quotas have been reduced.<sup>28</sup> VERs restrict only the actual volume of particular products exported out of a country, and there are no rules on the price or quality of those products. Thus VERs for Japanese goods exported to the US only had a limited effect in curbing imports in value terms.

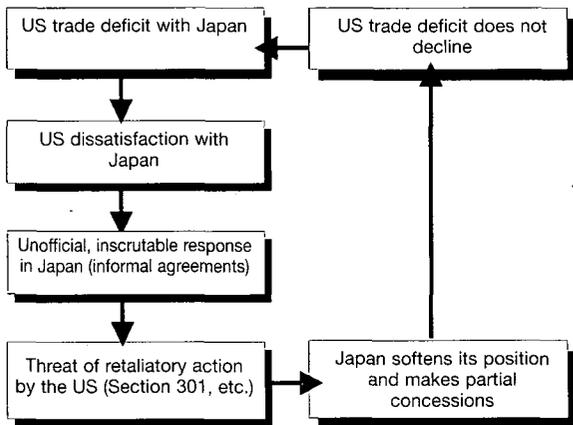
The quotas negotiated in 1981 for Japanese cars imported into the US led to a rise in the prices of the

vehicles involved, and thus also to greater profits for the Japanese competition. As domestic producers reacted to the reduction in foreign competition, the prices of American-built cars in the relevant classes also increased. The prices for passenger cars rose for certain models by between 30% (Nissan Sunny) and 65% (General Motors Century) within three years. Alongside the price increase, there was also a trend towards importing more expensive models with higher value-added, while models of the old quality were obtained from third countries. As marketing costs fell due to the reduced competition, the profit margins on the sale of a car in the US were some 10 times as high as they were in Europe. Over the long term, the exporters tended to circumvent the trade barriers by producing in the market they wished to supply. That in turn led to renewed attempts to manage the level of competition, in the guise of "local content" requirements.<sup>29</sup>

In the final analysis, the value of Japanese imports into the US was not reduced and the trade deficit remained constant. Japanese producers were boosted by the greater profit margins, while domestic consumers suffered by having to pay higher prices for imported and American vehicles alike. A large number of agreements were no longer extended since welfare effects were difficult to assess; for example, the agreement on auto imports was discontinued in 1994. The number of anti-dumping proceedings initiated by the US against Japan fell sharply in the early 1990s. In 1989 there were nine registered cases, in 1990 only three. In the years that followed the figure remained equally low.<sup>30</sup>

**Figure 2**

**The Continuing Cycle of US-Japanese Trade Talks**



Sources: J. Tamura: Containing the conflict by sticking closely to the rules, in: H. Shimada et al.: End the US-Japan trade dispute (original title in Japanese), Tokyo 1995.

**Dismantling Structural Trade Barriers**

As the VERs only achieved the intended effect to a limited extent and the employment of tariffs and quotas was restricted by GATT, the focus of US trade policy in the 1980s shifted from protecting domestic industries to opening the Japanese market, and to

<sup>27</sup> Cf. I. M. Destler, op. cit., pp. 326-402, which cites 65 anti-dumping proceedings by the US against Japan for the period 1979-1990, including proceedings against steel products, mobile telephone components and 64K-RAM components. Examples of penal tariffs are semiconductors (100% in 1987) and steel (109% in 1993) (cf. Neue Zürcher Zeitung: Zauberlehrlinge in der U.S.-Handelspolitik, loc. cit.)

<sup>28</sup> Cf. A. M. El-Agraa: VERs as a Prominent Feature of Japanese Trade Policy: their Rationale, Costs and Benefits, in: The World Economy, Vol. 18 (1995), No. 2, pp. 219-235.

<sup>29</sup> Cf. Asahi Shimbun: Change in Self-imposed Export Restrictions to US (original title in Japanese), 19th Oct. 1983, Evening Edition, p. 3.

<sup>30</sup> Cf. M. Itô, op. cit., p. 314.

what kind of structures were keeping it closed.<sup>31</sup> This shift in the emphasis of the trade talks is the outcome of trade policy between the 1950s and '80s which concentrated on reducing trade barriers in the industrial sector. Whilst since the '50s Japanese state intervention in the export-oriented industrial goods sector had been continuously reduced in response to pressure from abroad, regulation in the home-oriented economic sectors continued, and these became the new focus of negotiations.

The first negotiations on the Japanese import market were held in 1985 and 1986 between President Reagan and Japan's Prime Minister Nakasone under the heading of Market-Oriented Sector-Selective (MOSS) talks. These concentrated on sectors where the US saw its market share in Japan as being too low measured against the international competitiveness of the industries concerned. As the objective of the MOSS talks was not to protect its domestic market but to reduce foreign trade barriers, the US was able to demonstrate that it was following the principles of free trade. The success of the talks in the individual sectors varied. Whilst a positive outcome was reached in the pharmaceuticals industry, no real advances were made in the politically sensitive timber and paper industries.<sup>32</sup>

Under the Bush Administration the MOSS talks were followed up by the Structural Impediments Initiative (SII), which began in July 1989. Negotiations concentrated on structural trade impediments as the exchange rate policy instituted via the Plaza Agreement had proved to be without effect.<sup>33</sup> The negotiations moved off the sectoral level and used macroeconomic factors as a prime point of reference for the first time, together with Japanese market structures.<sup>34</sup> At the same time the reports on foreign trade barriers published since 1989 by the USTR listed the controversial market sectors.

The success of the negotiations was limited. The central factor, overall savings and investment behaviour, remained unaffected in both countries. Nor did they do anything to loosen up the complex interrelationships between companies in Japanese industry (*keiretsu*). On the other hand the negotiations

were successful in those sectors which either were highly competitive in the international arena (auto industry) or in which liberalisation was deemed necessary even in Japan, e.g. in the financial markets. Negotiations in politically sensitive areas such as agriculture and the paper industry were concluded without success.<sup>35</sup>

### Import Promotion

In the early 1990s, the Japanese government developed a new instrument for trade policy – import promotion. The roots of import promotion can be found in export promotion. Both fields are the responsibility of the Japanese External Trade Organisation (JETRO) and the instruments are employed in very similar ways. According to the Japanese government the aim of import promotion is to encourage domestic producers and traders to switch to foreign products. The temporary subsidy on imported products was intended to lower the costs of entry to the Japanese market, to compensate newcomers for language barriers and different styles of doing business. Import promotion was underpinned in 1992 by the "Law for special measures to improve import promotion and direct investment in Japan". The measures are divided into the provision of information, infrastructure measures and loan and tax subsidies.<sup>36</sup>

Insofar as the import promotion measures are limited to the provision of information, these have a neutral effect on the market and are completely innocuous in terms of upholding a fair economic system. The same is true of infrastructure measures which go to create new public goods. If the measures contribute to making markets more transparent and increasing competition, positive welfare effects can be expected. On the other hand, subsidising certain branches of industry through loan subsidies and tax breaks is questionable. The concessions were focused on sectors where there were (or had been)

<sup>31</sup> Cf. T. Kondô: How Japanese-American relations have to change, in: H. Shimada et al.: End the US-Japan trade dispute (original title in Japanese), Tokyo 1995, pp. 93–140, esp. pp. 118 ff.

<sup>32</sup> Cf. Y. Mikanagi, op. cit., pp. 14 ff. Initially, the MOSS talks concentrated on the telecommunications, electronics and pharmaceuticals sectors and on wood and paper products.

<sup>33</sup> Cf. T. Kondô, op. cit., p. 122.

<sup>34</sup> The Americans highlighted six sectors of particular interest in the Japanese market: savings and investment behaviour, land use, systems of distribution, price mechanisms, corporate affiliations (*keiretsu*) and direct foreign investment in Japan (cf. United States Trade Representative, op. cit., p. 107). In return Japan demanded negotiations in the following sectors: savings and investment behaviour, corporate investment and productivity, corporate activity, government market restrictions, export promotion and training (cf. T. Kondô, op. cit., pp. 122 ff.) Whilst the US focused on market access in Japan, Japan pointed to the poor productivity of US companies as being the reason for the imbalance in trade.

<sup>35</sup> Cf. Y. Mikanagi, op. cit., pp. 48 ff.

<sup>36</sup> Cf. N. Yasuda: Japan's balance-of-trade disequilibrium and its import promotion measures, in: *nihon keizai seisaku gakkai* (ed.): The Japanese Economic and Social System (original title in Japanese), Tokyo 1995, pp. 155–159, p. 156.

trade conflicts with the USA.<sup>37</sup> Thus political goals and not the reduction of structural trade barriers were at the forefront. Its import promotion allowed the Japanese government to make a clear show of good will and reduce the potential for conflict. At the same time indirect instruments such as tax breaks and subsidised loans were easy to implement politically. Political considerations thus play an important role in the impacts generated both at home and abroad.

### Quantitative Trade Targets

However, import promotion measures were not sufficient to avoid further trade conflicts. There was no discernible direct effect on the trade balance. The measures to channel trade from the Japanese side were therefore supplemented by US demands for concrete quantitative import agreements. The semiconductor agreement between Japan and the US in 1991 marked a turning point towards "voluntary import expansions" (VIEs). The basis for negotiations were US complaints that the distribution structure of the Japanese semiconductor market was impenetrable due to keiretsu relationships.<sup>38</sup> In its view, sealing off their domestic market allowed Japanese producers to gain production experience which would give them the edge in competition on the American market. The reproach was based on the theoretical concept of learning curves which allow costs to be reduced as experience is gained with increasing levels of output. The negotiations were followed by the announcement that the share of foreign producers in the Japanese semiconductor market was to be increased to 20% by 1994.<sup>39</sup>

The binding nature of this pledge was hotly disputed. Whilst Japan, once negotiations were over, officially interpreted the 20% mark as a tentative

guideline, the US emphasised that a specific commitment had been made.<sup>40</sup> Despite the varying interpretations, purchases of semiconductors from the US by Japanese companies did indeed increase. By as early as the fourth quarter of 1992 the 20% mark had been exceeded.<sup>41</sup> Just how this goal was achieved remains unclear. Shigeru Matsushima at MITI has indicated that in view of the US threat to implement penal tariffs under Section 301, Japanese producers adopted a strategy of damage minimisation. He points out that in cases where the products of Japanese and American suppliers were similar in terms of price and quality, the American supplier could be chosen without a great increase in costs in order to meet the quota. The role played by MITI in negotiations was in his view a minor one – the ministry limited itself to a statistical presentation of market developments, which may have indirectly influenced the outcome in some circumstances.<sup>42</sup> Even if the role of MITI and the question of how the burden of the semiconductor agreement was spread among Japanese companies remain unclear, the informal decision-making and implementation mechanism of the trade agreement is plain. With their strategy of minimising damage, the Japanese semiconductor companies unofficially yielded to US demands. MITI, which exerted little influence due to the relative independence of the booming semiconductor industry, restricted itself to the role of mediator. The conflict with the US could be resolved for the short term.

The semiconductor agreement, however, had knock-on consequences. Other industries in the US tried to negotiate similar outcomes for themselves. In January 1992, President Bush paid a visit to Tokyo accompanied by the big three American car producers, in order to negotiate with representatives of MITI and the Japanese auto industry on increased purchases of American auto parts. The recession in the States increased the pressure exerted by interest groups on the president. After mediation by MITI, Japanese car manufacturers announced that they would increase the volume of car parts purchased. American producers were the only ones to profit from this increase.<sup>43</sup>

The Clinton Administration continued with the policy of quantitative import targets for Japan when bilateral trade relations with Japan were reformulated in 1993. The "Framework for a New Economic Partnership" created a new foundation for trade policy.<sup>44</sup> The central point of the framework agreement became the determination of "objective criteria" for import promotion. The US sought to have the strategy

<sup>37</sup> Cf. GATT: Trade Policy Review: Japan 1994, Vol. 1, Geneva 1995, pp. 73ff.

<sup>38</sup> Cf. F. C. Bergsten, M. Noland: *Reconcilable Differences? United States-Japan Economic Conflict*, Washington, D.C. 1993, pp. 127ff.

<sup>39</sup> Cf. M. Itô, *op. cit.*, pp. 335f. The success of the strategic alliances organised by MITI is controversial (cf. S. Callon: *Divided Sun. MITI and the Breakdown of Japanese High-Tech Industrial Policy, 1975-1993*, Stanford 1995).

<sup>40</sup> Cf. S. Nanjō, *op. cit.*, p. 56.

<sup>41</sup> Cf. F. C. Bergsten, M. Noland, *op. cit.*, p. 132.

<sup>42</sup> Personal interview with Mr S. Matsushima, Ministerial Secretary at MITI, on 14th Oct. 1997.

<sup>43</sup> For a detailed description of negotiations and their results, see J. Levinson: *Carwars: Trying to Make Sense of U.S.-Japan Trade Frictions in the Automobile and Automobile Parts Markets*, in: R. C. Fenestra (ed.): *The Effects of U.S. Trade Protection and Promotion Policies*, Chicago, London 1997, pp. 11-32.

of target volumes which had been so successful in the semiconductor market built into the agreement. Alongside fixed targets for several industries, the US demanded that the Japanese trade surplus be reduced to 1%–2% of GDP.<sup>45</sup>

The quantitative targets for Japanese imports led to intense discussions on the implications for welfare. Whilst one side emphasised the necessity of reducing trade barriers, the other side spoke of “managed trade”. In an investigation by Congress the Clinton Administration rejected the accusation of managed trade and spoke of “results-oriented negotiations” as a reaction to the “process-oriented negotiations” of the last two decades which had not led to an improvement in the balance on current account. In its view the process-oriented negotiations with the aim of reducing trade barriers had not affected the import-impeding business and trade practices of Japanese firms. According to the Administration, the logical consequence of this was to focus more on the desired results by, for example, increasing the level of exports or achieving a higher market share in Japan.<sup>46</sup>

The Japanese sharply criticised the target volumes.<sup>47</sup> The attempt to lay down quantitative targets in some branches of industry was in their view tantamount to a “planned-economy” trading system and contrary to the basic principles of trade and welfare theory.<sup>48</sup> Leading US economists and representatives of the WTO expressed similar views.<sup>49</sup> Ishiguro highlights the problem with VIEs, namely, they are determined politically. The danger that politically negotiated import increases will be politically allocated to certain companies or branches of industry is high. Yet both political allocation of benefits and politically fixing import volumes are economically inefficient. There is also a danger of retaliatory measures. Ishiguro also points out that the American government is in a dilemma since on the one hand it regulates trade with VIEs even while calling for the

deregulation of the Japanese market on the other. He also reminds us that VIEs are at variance with the GATT’s most-favoured-nation principle (Art. 1).<sup>50</sup>

The clear discrepancy between quantitative targets and the basic principles of the GATT and trade theory plus the resulting political irritation meant that Japan did not make any new volume-related promises. When the then Minister for International Trade and Industry and current Prime Minister Ryūtarō Hashimoto adopted a determined stance, Japan publicly resisted US demands for the first time, and target volumes in the automobile industry were buried.

### Return to the Principles of GATT and Free Trade

The negotiations on opening up the automobile market mark the most recent turn in Japanese/US trade relations. Unlike in the case of the semiconductor market, US calls to fix target volumes were not met. Despite an investigation on the basis of Section 301 in October 1994 and the threat of penal tariffs to the tune of 100% on Japanese luxury motor vehicles in May 1995 the negotiations were unsuccessful. Conciliation procedures before GATT led to the settlement of the disputes without volume concessions being made by the Japanese.<sup>51</sup>

Nanjō notes that the unsubtle US trade policy, strongly influenced by particularised interests, has provoked resistance from Japan.<sup>52</sup> He explains how the negative consequences of the informal influence of the ministries over firms has weakened the position of Japan’s bureaucrats – bureaucratic mistakes such as target volumes in the semiconductor industry or the “bubble economy” in the financial sector have made calls for deregulation and curtailing the responsibilities of the ministries even more frequent. For this reason, he believes bureaucrats are reluctant to make any concessions implying target volumes.<sup>53</sup>

In 1996 the target volumes negotiated in the semiconductor market gave way to a new approach. On the insistence of Japan an inclusion was made to the framework agreement on Japanese/US trade that trade talks should be limited to areas that are the

<sup>44</sup> For Japan, this included the obligation to remove structural trade barriers in certain sectors such as automobiles, auto parts, insurance and public procurement, and macroeconomic measures to stimulate domestic demand. The US has committed itself in the medium term to reducing its budget deficit, promoting domestic savings and increasing international competitiveness (cf. MITI: Japanese-American Automobile Negotiations (original title in Japanese), Tokyo 1997, pp. 319 ff.)

<sup>45</sup> Cf. S. Nanjō, *op. cit.*, p. 55.

<sup>46</sup> Cf. W. M. Morrison, W. H. Cooper, D. K. Nanto: A “Managed Trade” Policy Toward Japan?, Part 1, Tokyo 1994, p. 1.

<sup>47</sup> Cf. M. Itō, *op. cit.*, pp. 336 f.; K. Ishiguro: Japan’s Course in the Trade Disputes: a Vision for the 21st Century (original title in Japanese), Tokyo 1996, pp. 61 ff.

<sup>48</sup> Cf. S. Nanjō, *op. cit.*, p. 55.

<sup>49</sup> Cf. JETRO: Trade between Japan and the World: JETRO White Paper (original title in Japanese), Tokyo 1994, p. 119. For the exact wording of a protest note from leading American economists and Nobel prize winners, see K. Ishiguro, *op. cit.*, pp. 60 ff.

<sup>50</sup> Cf. K. Ishiguro, *op. cit.*, pp. 65 f.

<sup>51</sup> Cf. M. Itō, *op. cit.*, p. 312.

<sup>52</sup> Cf. S. Nanjō, *op. cit.*, p. 55.

<sup>53</sup> Cf. W. M. Morrison, W. H. Cooper, D. K. Nanto, *op. cit.*, p. CRS-20.

responsibility and lie within the sphere of influence of the countries' governments.<sup>54</sup> Itô concludes that in future US calls for an opening of the market will no longer be solved on a bilateral but on a multilateral level via the dispute-settlement mechanisms of the WTO. The vicious circle of *gaiatsu* and partial Japanese concessions (see Fig. 2) appears – in Itô's view – to be at an end.<sup>55</sup>

Instead of a solution in the form of informal agreements between ministries and industries, MITI has recently referred parties to national and international institutional mechanisms for resolving conflicts. In the dispute over the Japanese film market MITI simply pointed out that the Japanese Fair Trade Commission was the institution responsible. Aside from this it has limited itself to providing information aimed at disproving the American claims.<sup>56</sup> The inflexibility of both sides led to a hearing before a GATT dispute-settlement panel which was not able to confirm that Fuji had sealed off the Japanese market.<sup>57</sup> In MITI's view, conflict solution at multilateral level is a desirable state of affairs compared to the previous bilateral negotiations which mostly ended in concessions from Japan.<sup>58</sup>

### Concluding Remarks

The development of the Japanese/US trade conflict since the 1980s shows that the political situation in both countries does not allow a fundamental solution to the problem. Approaches based on the long-term increase of Japan's average propensities to invest and to consume or the reduction of private and government consumption in the US have been politically unfeasible. The crisis on Japan's financial markets has shown once again that the development of the balance of trade is controlled by macroeconomic factors which are difficult to influence at government level. As it was not possible to make any significant change in these macroeconomic factors, the conflict shifted to the micro level whereby the continuation of negotiations on both sides was influenced by interest groups. Partial concessions from Japan brought the US visible successes in some branches of industry. Industries such as semiconductors, automobiles and telecommunications directly profited from the outcome of negotiations. As the overall trade balance remained unchanged, however, the trade structure had simply altered in favour of certain industries.<sup>59</sup>

In both countries, trade policy is dictated by political aims. Although the US economy is traditionally less regulated, the threshold for trade-policy interventions is very low. The opposite is true of

Japan. Although in most sectors of the economy there is still strong government regulation, pressure from abroad makes it difficult to create new barriers to trade. For this reason a further reduction in trade barriers is more likely in future.

MITI is currently adopting a market-economy stance and putting its faith in national and international dispute-settlement institutions. This is made possible by the fact that the industrial sector under MITI is largely liberalised. Meanwhile, other sectors of the economy such as financial services, transport, construction, telecommunications or agriculture are still highly regulated. Deregulation is the responsibility of ministries that are subject to pressure from interest groups and unwilling to give up areas of jurisdiction. Here one can expect a continuation of the cycle of foreign pressure and partial concessions. This is apparent in the most recent conflict between Japan and the US over the use of sea ports in which the Ministry of Transport was responsible for negotiations on the Japanese side. The bone of contention was the high degree of regulation in Japan's ports, where shipping companies face costs 25%–100% higher than those in other countries. Although the US has imposed high penal tariffs on Japanese shipping lines, the Ministry of Transport did not call on the dispute-settlement mechanisms of GATT. Instead Japan agreed to liberalise its port services after the US threatened to bar Japanese ships from entering its ports. Whether Japan will be able to assert these concessions in the political arena is, however, doubtful.<sup>60</sup>

<sup>54</sup> Cf. S. Nanjô, *op. cit.*, p. 56.

<sup>55</sup> Cf. M. Itô, *op. cit.*, p. 313.

<sup>56</sup> Cf. MITI: Statement by Minister of International Trade and Industry Shunpei Tsukahara, in: News from MITI, No. 19/1996, 14th June 1996; MITI: Surging Imports and "Mirror Images": The Photographic Film and Paper Market in Japan, in: News from MITI, No. 20/1996, 14th June 1996. The start of the conflict was a petition by Eastman Kodak which prompted an investigation by the USTR under Section 301 on account of exclusive business practices.

<sup>57</sup> Cf. *Neue Zürcher Zeitung*: Keine Marktabschottung Japans durch Fuji, 8th Dec. 1997, p. 7.

<sup>58</sup> Cf. *Nikkei Sangyo Shimbun*: The Japan/US Trade Conflict in the Film Market (original title in Japanese), 26. 6. 1997, p. 24.

<sup>59</sup> It is of increasing interest how the US will react in future to its trade deficit with China. This reached \$41.7 billion in 1997, a similar level to the deficit with Japan (\$46.6bn) (U.S. Census Bureau, Internet page). In the run-up to the US visit of the Chinese Secretary General Jiang Zemin in late October 1997, Trade Secretary Daley emphasised that China would have to open its markets to American cars, agricultural produce, telecommunications and high-tech products (cf. Singapore Press: Record US Gap May Put Trade in Sharp Focus at China Talks, 23rd Oct. 1997, Internet Edition).

<sup>60</sup> Cf. *Neue Zürcher Zeitung*: Entschärfung des Hafestreits USA – Japan, 20th Oct. 1997, No. 243, p. 7; *Frankfurter Allgemeine Zeitung*: Der Hafenkrieg ist beigelegt, 29th Oct. 1997, No. 25, p. 17.