
Resolving Trade Disputes

In some respects, the second half of the 19th century was a golden era of globalization, driven by technological advances and politically facilitated by the Pax Britannica and its associated institutions. It would take the better part of the 20th century for the world to once again attain the levels of cross-border movements of goods, capital, and people that it had seen at the end of the 19th.

Japan tried to opt out of this process, but was forcibly opened to trade by the “Black Ships” in 1854 and the conclusion of the “unequal treaties” with the United States and other Western powers afterward. Despite this initial reluctance to globalize, the 50 years that followed the Meiji Restoration in 1868 were a remarkable period of modernization, during which Japan adapted a myriad of foreign social and technological innovations to its own ends.¹

This densely populated country with a relatively high level of education and social capacity quickly developed a comparative advantage in labor-intensive manufactures. Ironically, the “unequal treaties,” which until 1911 severely limited the Japanese government’s ability to impose import tariffs, may have actually fostered Japan’s development by forcing the country to specialize along the lines of its comparative advantage. The limitation on tariffs also encouraged the use of other policy tools, such as low-interest loans and government procurement preferences for “strategic” industries, establishing a precedent that would continue for a cen-

1. See Allen (1946), Lockwood (1954), Hunsberger (1964), Morishima (1982), and Noguchi (1995) for informative economic histories.

ture. In the first instance of a recurrent pattern, Japanese exports were met by discriminatory trade restrictions imposed by trade partners fearing “import surges.”²

The second half of the 20th century proved to be a second era of globalization, again driven by technological advance, this time enabled by the leadership of the United States. Reductions in trade barriers and transportation and communication costs has facilitated the globalization of the US economy during the past four decades, when the share of international trade (exports plus imports) in national income has nearly tripled from less than 10 percent in the late 1960s to nearly 30 percent in the late 1990s. As in the earlier period of globalization, Japan’s initial response has been less than enthusiastic.

The expansion of international commerce, although contributing to prosperity, creates winners, losers, and political tensions. It is not surprising that the process of economic integration has been marked by intermittent periods of conflict. Moreover, Japan and the United States are dissimilar in history and political culture, and this dissimilarity itself has been a source of tension. The resolution of these conflicts has been strongly conditioned by the institutions of the international system. Central to this process has been the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization.

Japan applied to join the GATT in 1952. Its application was initially opposed by a number of countries, but the United States strongly supported the application, and Japan was granted provisional membership in 1953 and full membership in 1955.³ Once in the GATT, Japan participated in successive rounds of multilateral negotiations (including the Tokyo Round of the 1970s). In cases in which GATT panels found against Japan (e.g., in the case of some agricultural quotas), Japan had a good track record in complying with GATT panel decisions (though in some cases removal of trade restrictions was accompanied by the introduction of more direct forms of support). Adverse panel rulings were arguably a constructive form of *gaiatsu*, or foreign pressure, from a multilateral organization, which Japan had voluntarily joined and supported.

However, because of the GATT’s ineffective dispute settlement procedure, many trade conflicts continued to be addressed bilaterally and often resolved in a discriminatory fashion. In addition to GATT-consistent forms of protection, such as antidumping measures, Japanese exports were subject to grey-area measures, such as Section 301 actions. The most extensive

2. See Saxonhouse (1996) for a history of charges of unfair trading practices against Japan.

3. At the time of Japan’s admission to full membership in 1955, 14 countries, accounting for 34 percent of world imports, invoked Article 35 (“non-application”) to limit their liberalization commitments. By 1960, Australia was the only industrialized country still invoking Article 35. It discontinued this practice in 1964 (Hunsberger 1964).

were the orderly marketing arrangements (OMAs) invented by Japan and the United States in the 1950s and applied to textile trade, the forerunner of the so-called voluntary restraint agreements (VRAs) or voluntary export restraints, which the United States and European Union applied to Japanese steel and automobile exports in the 1970s and 1980s.⁴ In the 1990s, Japan and the United States would pioneer the use of voluntary import expansion agreements (VIEs) in an effort to expand foreign sales in the Japanese market.

Trade relations between the two countries reached a watershed in the mid-1990s. The formation in 1995 of the WTO and its improved dispute settlement mechanism severely circumscribed the ability of the United States to undertake unilateral policies against Japan. At roughly the same time, as described in chapters 2 and 3, it was becoming clear to policymakers in the United States that the two countries were likely to be entering a more than transitory period in which US macroeconomic performance was likely to be stronger than that of Japan, and that excessive weakness, not excessive strength, was the main risk to US prosperity emanating from Japan. Last, as will be discussed in chapter 6, developments on the security front encouraged a diminution of policy-driven economic conflict. These mutually reinforcing developments fostered a shift from the acrimonious trade relations of the first half of the decade to the era of relative quiescence that has continued through the present.

Bilateral Relations

For most of the postwar era, Japan-United States bilateral trade relations were marked by a gradual reduction of protection, which was achieved largely through the GATT system, with the imposition of GATT-inconsistent protection in particular sectors. In Japan these interventions were confined largely to the agricultural sector, whereas the United States imposed quantitative restrictions on Japanese exports of textiles, steel, color televisions, automobiles, and machine tools. Indeed, from the 1960s through the mid-1980s, bilateral trade relations in large part revolved around successive episodes of United States-imposed special protection against Japanese exports.

The Market-Oriented Sector-Specific Talks

In the United States, the system of Congressional acquiescence and oversight began to fray in the mid-1980s under the dual pressures of mounting

4. For those who think that there is anything new under the sun, see Hunsberger (1964), table 7-10, which lists Japanese goods subject to GATT-inconsistent price and/or quantitative restrictions in a number of markets in 1960. See de Melo and Tarr (1992, 1996) for estimates of the impact of more recent US quantitative restrictions.

US trade deficits and divided government.⁵ The second presidential administration of Ronald Reagan essentially reversed field in trade policy and began a proactive attempt to redirect domestic political pressure from import protection to export expansion. The global manifestation of this policy shift was the launch in 1986 of the Uruguay Round of negotiations in the GATT; the Japan-specific initiative was the Market-Oriented Sector-Specific (MOSS) talks, begun in 1985, that covered telecoms equipment and services, other electronic products, wood products, and medical equipment and pharmaceuticals. Since this time, Japan and the United States have been in nearly constant parallel negotiations globally through the GATT-WTO, regionally through APEC, and bilaterally as well. The bilateral negotiations have been characterized by several constant themes: an intermittently shifting relative emphasis between broad issues of structural change in Japan versus the liberalization of specific priority sectors; the use of targets, benchmarks, or other quantitative indicators in sectoral negotiations; and the issue of potential discrimination against other trade partners.

The MOSS talks were not regarded as a great success by the US side. Although the electronics-sector negotiations were generally regarded as successful, achievement of improved market access in telecommunications, and medical equipment and pharmaceuticals, was hampered by regulatory barriers. The wood products negotiations, which threatened the interests of Japan's politically influential forestry and construction interests, were characterized by all-night negotiating sessions and brinkmanship, and in the end accomplished little.⁶ The MOSS talks did not exhaust the universe of bilateral sectoral negotiations during this period, with the Semiconductor Trade Agreement of 1986 (STA) being the most prominent example of a sector-specific bilateral negotiation outside the MOSS framework.

The STA established a market share target for foreign semiconductor consumption in Japan, and, as such, was the first so-called VIE arrangement with a numerical target.⁷ Unlike previous VERs, which accentuated the power of the government of Japan vis-à-vis its private firms by giving

5. See Kunkel (2001) for an excellent history of bilateral trade relations, focusing on the period from the second US presidential administration of Ronald Reagan through the second administration of Bill Clinton.

6. US negotiators dubbed the exercise the More of the Same Stuff (MOSS) negotiations. See Tyson (1992), Bergsten and Noland (1993), and ACCJ (2000) for evaluations of the MOSS talks.

7. See Bergsten and Noland (1993) and Flamm (1996) for more detailed analysis of the semiconductor trade agreement and quantitative estimates of its impact. Both studies conclude that the STA had the effect of boosting foreign firms' semiconductor sales in Japan. Alan Wolff, an active participant in representing the US semiconductor firms legally, concluded that the agreement was "entirely successful" and that now "there is peace in this product sector with no complaints on either side of the Pacific Ocean" (Wolff 1999, 4).

bureaucrats control over access to the lucrative US market, the Semiconductor Trade Agreement put the government of Japan in a very uncomfortable position. The Americans clearly regarded the market share target of 20 percent as a binding commitment subject to retaliation for noncompliance.⁸ However, the government of Japan had no way of ensuring that the target would be met; and, in a stunning role reversal, was reduced to the position of supplicant to private firms.

In February 1987, Oki Electric salespeople were lured into documenting sales at less than fair market value in Hong Kong, violating the price floor provision of the STA. In an increasingly tense atmosphere, in which both houses of Congress voted to recommend retaliation, and the Defense Department issued an alarming report on the state of the US industry, the Reagan administration announced the imposition of \$300 million in punitive tariffs on Japanese exports to the United States, which were to be removed only when the market share in Japan of foreign firm-produced semiconductors reached 20 percent.

Within Japan, some regarded the hapless Oki Electric salespeople as having been “framed,” and the experience tilted political influence away from the “doves,” who had argued for compromise with the United States, toward the “hawks,” who advocated a firm if not confrontational posture. Although some Japanese negotiators claimed that the market-share figure was only a target and that sanctions would not be imposed while honest efforts were being undertaken, others criticized the agreement for sending Japan down the slippery slope of accepting market-distorting numerical targets.

In effect, the two countries came away from the negotiations having learned diametrically opposing “lessons.” In Japan, the lesson was to forswear any future agreements containing numerical targets subject to penalties. In the United States, the market-share approach was seen as an effective way of opening markets in Japan. The following year, the Japan Task Force of the official Advisory Committee on Trade Negotiations, generalizing from the STA, recommended that the US government consider a policy of “temporary quantitative indicators” or market-share targets in its dealings with Japan. This divergence in views would echo through subsequent negotiations over autos and auto parts.

Within the United States, the MOSS and semiconductor talks coincided with a period of growing Congressional frustration over the trade deficit and a “do-nothing” Reagan administration. In 1986, legislation was introduced in the House and Senate that would have imposed an import surcharge on Japan, but the bills never came to a vote. The following year, Representative Richard Gephardt proposed the infamous “Gephardt

8. This target was included in a secret side letter to the original 1987 agreement. When the pact was renegotiated and revised in 1991, the target was made public and explicit.

Amendment," which would have authorized retaliation if countries with large bilateral surpluses (such as Japan) did not meet specified surplus reduction targets. The legislation passed the House, but never came to a vote in the Senate. In 1988, when Congress did pass trade legislation, it included a "Super 301" provision that authorized retaliation against countries that impeded US exports.⁹

The Structural Impediments Initiative

Faced with the task of implementing the 1988 Trade Law and both dubious and weary of negotiating sector by sector with uncertain effects, the incoming George Bush administration reevaluated US strategies and tactics. The result was the Structural Impediments Initiative (SII), a series of meetings held at the undersecretary level starting in September 1989, which was intended to address the underlying regulatory access barriers in Japan on a systemic basis. SII had the appearance of genuine two-way talks, in that both sides raised issues of concern, in part to assuage Japanese sensitivities after US unilateral retaliation in the semiconductor case.

For the United States, issues of concern included savings and investment behavior in Japan (in particular, the excess of Japanese savings over investment, which was thought to contribute to the bilateral surplus with the United States); land use policies, thought to contribute to high land and housing prices (and, *inter alia*, to high personal savings rates and the large current account surplus) and discourage foreign investment; exclusionary business practices and *keiretsu* relationships; the Japanese distribution system; and protection of intellectual property rights. Issues of Japanese concern included low US savings and investment, in particular public budget deficits; export controls and lack of export promotion; and inadequate research and development, education, and training, including adoption of the metric system. Despite the surface appearance of reciprocity, the United States played the role of the demandeur in these talks. The Japanese "demands" were pro forma, and no one seriously expected the Japanese government to significantly influence either US fiscal policy or the (non)adoption of the metric system.

9. The behavior of Japanese negotiators during this period inflamed matters further. ACCJ (2000) characterizes the attitudes of Japanese negotiators as "zero-sum," and, indeed, one senior Japanese official once characterized the point of trade negotiations as to "find your opponent's weak spot and prick it." Makoto Kuroda, a senior Japanese negotiator, caused an uproar in 1987 during the MOSS talks when he reportedly stated that US supercomputer firms would never be able to sell in Japan and that the United States might have to nationalize its producers to save them from the coming Japanese onslaught. Kuroda denied making this statement, which had been reported both in the press and US diplomatic cables. Manyin (2000) provides a nuanced assessment of more recent Japanese negotiating tactics, contrasting its "reactive" intransigence in agriculture with its proactive stance in antidumping.

Whether anyone seriously believed that the United States was going to change Japanese land use policies is debatable. To his credit, newly appointed US Ambassador to Japan Michael Armacost mobilized a public relations blitz in an attempt to convince the Japanese public that the negotiations were not a zero-sum game, and that, indeed, the US deregulation agenda would improve the living standard of the typical Japanese household.

The era of good feelings proved to be short-lived. In the end, SII proved to be largely an educational experience for high-level US policymakers, many of whom had had no personal experience with Japan. To the extent that progress was made, it tended to be on topics such as the distribution system, where a specific measure (the Large-Scale Retail Store Law) could be linked to a specific outcome (the ability of Toys 'R Us to successfully enter Japan). Japan undertook increases in public investment, strengthened its competition policy capability, and made modest changes in taxation and land use laws. SII appears to have had no impact on policy in the United States, though on at least one occasion the US side claimed that the Bush tax increase was undertaken as part of US SII commitments.¹⁰ The Bush administration continued to negotiate sector-specific deals with Japan that embodied quantitative targets or indicators, most notably the second Semiconductor Trade Agreement (1991) and the auto and auto parts agreement of 1992.

The Framework Agreement

The incoming Bill Clinton administration placed an unprecedented emphasis on the US *economic* relationship with Japan when it took office in January 1993, reflecting the emphasis on economic issues (“It’s the economy, stupid”) in candidate Clinton’s campaign. By this time, US enthusiasm for broad structural talks had burned out, and the new administration convened a series of high-level interagency meetings to formulate a new Japan strategy almost immediately upon taking office. The internal consensus that emerged from those meetings was that those earlier agreements that had most enhanced market access had included quantitative targets, such as the Semiconductor Trade Agreements (1986, 1991) and the auto and auto parts agreements (1987, 1992), all negotiated by the Republican Reagan or Bush administrations.¹¹ The vision that emerged from these deliberations was of a Framework Agreement—a multifaceted, bilateral negotiating framework that would cover macroeconomics, struc-

10. For more detailed assessments of SII, see Bergsten and Noland (1993), Schoppa (1997), Lincoln (1999), and ACCJ (2000).

11. As discussed in the following section, evidence exists that these agreements had been unusually effective.

Box 5.1 The Framework Agreement

The 1993 United States-Japan Framework for a New Economic Partnership called for Japan to make a significant reduction in its global current account surplus and then specified five “baskets” of sectoral and structural issues for negotiation. The first basket concerned “Government Procurement,” including Japanese government procurement of telecoms and medical equipment. The second basket involved “Regulatory Reform and Competitiveness,” including reforms in the financial and insurance sectors. The third basket was labeled “Other Major Sectors,” although only one sector, autos and auto parts, was identified. The fourth basket, “Economic Harmonization,” included subbaskets on FDI, buyer-supplier relationships (i.e., *keiretsu*), and intellectual property rights. The final basket was “Implementation of Existing Arrangements and Measures,” which included discussion of the flat glass industry. The agreement then went on to mention areas of mutual cooperation in such fields as international environmental protection and international public health.

tural issues, and sectoral issues, in a series of “baskets” and “subbaskets” (see box 5.1). The new administration approached its Japanese counterparts about renewing negotiations under a new political framework.

When formal negotiations began in June 1993, the Japanese government was badly split. Having been burned by the Semiconductor Trade Agreement, MITI was dead set against any agreement that might contain numerical targets subject to penalties, while others, notably the Ministry of Foreign Affairs (MOFA), felt that it was important to reach some accommodation with the new administration.¹² In the end, lame-duck Prime Minister Kiichi Miyazawa instructed the Japanese negotiators to accept the possible use of quantitative indicators. The agreement to begin negotiations was signed by President Clinton and Prime Minister Miyazawa the following month.

The substantive issues of the Framework Agreement were not new—by this point, Japan and the United States had been negotiating over the same issues for the better part of a decade. The Clinton administration’s treatment of these issues contained three innovations, however. First, economics was given new primacy. Historically, political and security affairs had received precedence in bilateral relations. Summit communiqués began with discussions of political and security issues, with economics shunted to the end. Bureaucratically, the US State and Defense departments typically weighed in against taking a confrontational line with Japan on trade issues.

In this regard, the Clinton policy marked a departure. The Framework Agreement contained no overarching statement about political or security

12. Following one presummit negotiating session in Tokyo, stunned US negotiators returning to their hotel witnessed a scuffle involving officials from MITI and MOFA in the lobby of the Okura Hotel.

relations, and the State Department-managed global cooperation issues (such as global environmental issues and international public health issues), which had figured prominently in the Bush-Miyazawa communiqué, were tacked on at the end. In subsequent speeches and testimony, Armacost's successor as ambassador to Tokyo, former Vice President Walter Mondale, led with economics. Mondale recruited a special economic advisor, Edward Lincoln of the Brookings Institution, to his embassy staff.

Internally, the bilateral economic relationship received unprecedented high-level political attention. The Clinton administration created a National Economic Council (NEC), analogous to the National Security Council (NSC), to demonstrate the importance of economics issues. The NEC's deputies group held long meetings on an at least a weekly basis, with participants at the undersecretary and assistant-secretary level of the NEC, the US Trade Representative (USTR), the Treasury, the State Department, the Commerce Department, and the Council of Economic Advisers normally in attendance. Representatives of the Department of Justice, the Department of Defense, the National Security Agency, the National Intelligence Council, and other agencies often participated.

Second, the new administration sought to regularize the use of quantitative targets or indicators, which had been used in an ad hoc, haphazard manner by the Reagan and Bush administrations. This was resolutely opposed by the Japanese side, which quite genuinely did not want to generalize the use of quantitative indicators with respect to market access in Japan. Although the imposition of VERs in the 1970s and 1980s had enhanced the power of the bureaucracy over the private sector by giving it direct administrative control over access to the lucrative US market, and effective control over the investment and expansion plans of Japanese firms, agreements to boost imports (VIEs) had the opposite effect—they put the bureaucracy at the mercy of private firms to fulfill its political commitments.¹³ Moreover, most Japanese regarded VIEs as welfare-reducing, and regarded US claims as to their desirability with considerable skepticism.¹⁴

At the same time, in contrast to the skillful courting of Japanese public opinion by the Bush administration during the SII talks, the Clinton administration did a poor job of explaining exactly what it was after, other than to assert that it sought multiple quantitative benchmarks or indicators, with no single indicator dispositive of a failure to uphold the

13. For welfare analyses of VIEs, see Dinopoulos and Kreinin (1990), Greaney (1996, 1999), and Nagaoka (1997).

14. The typical argument was that if Japanese sourcing practices were so discriminatory, then why were they not obviously more self-defeating? If Japanese producers were not efficiently sourcing semiconductors or auto parts, then why were Japanese finished products using these goods—electronics and autos—globally competitive?

Box 5.2 Dueling letters

The Clinton administration's Japan policy during its first 2 years in office unleashed what one set of observers described as "a general wringing of hands." An early example of this was a 27 September 1993 open letter to President Clinton signed by 37 US economists, including four Nobel Prize winners, decrying US demands for "managed trade" and recommending that President Clinton "abandon" them. The letter set off a torrent of charges and countercharges made through private correspondence and the op-ed sections of leading newspapers. Japanese economists wrote a similar letter, and both the US and Japanese letters received extensive coverage in the Japanese press.

These missives were followed on 1 March 1994 by a letter to President Clinton and Prime Minister Hosokawa signed by 16 foreign policy luminaries, including a former US secretary of defense, which stated that the United States should "set aside demands for quantitative indicators." The administration had its defenders, however: on 14 February 1994, 78 US corporate chief executives, economists, and commentators, including a former secretary of labor, wrote the president expressing the view that a lasting, meaningful solution to the trade problem could only come through "innovative mechanisms geared toward results that can be measured in a number of ways."

Despite its reputation for degrading the multilateral trade system, the Clinton administration clearly understood that the Uruguay Round agreement under negotiation would effectively end the unilateral use of Section 301—and hence its ability to retaliate—a subtlety that its critics appear to have overlooked.

agreement, thereby absolving it of the charge that it was proposing VIEs.¹⁵ In part, this reticence to publicly explain its goals was deliberate—the maintenance of ambiguity would frustrate the Japanese tactic of trying to drive wedges between different bureaucratic actors, as had successfully been done in the past, while enabling the lead US negotiator (at this time W. Bowman Cutter of the National Economic Council) the leeway to cut a deal in the end.

However, nature abhors no vacuum more than a political one, and in the absence of a convincing public articulation of its position, the Clinton administration's policy was effectively defined by its critics, who pilloried the United States for advocating "managed trade" (see box 5.2).¹⁶ Although there is no real evidence that the Japanese negotiators shared the ideological predilections of some of the administration's critics, the Japanese side eagerly exploited the public relations problems of the Clin-

15. One could easily devise multiple indicators or indices of private- or public-sector efforts to improve market access short of market share targets, and devise responses short of trade retaliation. The Clinton administrations never did this, however.

16. Ironically, during the next presidential election, the Bob Dole campaign would lambaste the Clinton administration for being insufficiently resolute in its pursuit of numerical targets in trade with Japan.

ton administration. In contrast to the SII experience, the Japanese press was filled with editorials denouncing the Clinton line.¹⁷

The third innovation of the Clinton administration was the use of semi-annual meetings of the heads of government as action-forcing events. The notion, derived from past negotiating history, was that the two bureaucracies would negotiate, and then the Japanese Liberal Democratic Party (LDP) power brokers would be brought into the endgame to cut the deals and force the recalcitrant Japanese bureaucracy to accede to market-opening agreements.

This structured use of regular high-level political contact to reach agreement was probably not a bad approach to the Japan that had existed for the previous 40 years. Unfortunately for the Clinton administration, it came into office after the Japanese bubble had burst and just as Japan entered a period of political instability unprecedented in the postwar era, as the public disaffection with the LDP—which had been rising since a series of political scandals in the late 1980s—peaked. In February 1994, in the first heads of government meeting under the Framework Agreement, President Clinton did not meet with an LDP heavyweight capable of cutting a deal, but rather Prime Minister Morihiro Hosokawa, head of a weak, vaguely reformist, coalition government, and the first non-LDP prime minister since 1952.¹⁸ Instead of being an action-forcing event, the Clinton-Hosokawa summit rebounded on the United States, forcing it to scale back its demands for fear of undercutting a nascent reformer and toppling the incumbent Japanese government. For the first time ever, Japan and the United States were unable to reach an economic agreement before a summit. Hosokawa's rejection of the US proposal on autos and parts was hailed by Japanese who regarded the semiconductor deal as a mistake, and lauded by some outside Japan as well.

The result, from the standpoint of the Clinton administration, was a disaster, though it gamely maintained the line that no agreement was better than a bad agreement and pledged to continue negotiations under the Framework Agreement umbrella. It had allocated a colossal amount of high-level political and bureaucratic resources to the bilateral economic relationship and had nothing to show for it. It had been unable to secure Japanese agreement on the use of quantitative indicators. The "managed-trade" charge, whatever its validity, was sticking, and the United States was losing the transpacific public relations campaign. The policy had alarmed third parties, such as Australia and the European Union, which feared being adversely affected by discriminatory deals.¹⁹

17. See Schoppa (1997).

18. As an indication of the unsettled state of Japanese politics, Clinton would go on to meet with seven more Japanese prime ministers during his two terms in office.

19. In contrast to the 1987 and 1992 auto agreements negotiated by the Reagan and Bush administrations, respectively, the Clinton administration was scrupulous about framing its demands in nondiscriminatory multilateral terms. Greaney (2000), in fact, finds evidence

In the aftermath of the Clinton-Hosokawa summit, the USTR reasserted its historic primacy in trade negotiations, and the focus of US attention shifted to more narrow, mercantilist sectoral concerns. This reached its apotheosis (or nadir, depending on one's perspective) in the 1995 confrontation over the hardy perennial, autos and auto parts.

Autos and auto parts featured prominently for a number of reasons. These were largely unionized industries with strong connections to Washington. Because of previous negotiations, a bureaucratic infrastructure had developed to handle auto issues and act as a point of contact for the US industry. Finally, when Clinton took office in January 1993, an overhaul of the US health care system led by First Lady Hillary Clinton was the highest political priority of the incoming administration. President Clinton concluded that he would need the support of Representative John Dingell, an auto industry ally and chair of the powerful House Commerce Committee, if he were to get health care reform legislation through Congress. For these reasons, the auto sector received a highly sympathetic hearing from the Clinton administration on trade matters, and alone was awarded its own "basket" in the Framework Agreement.

Yet despite the collapse of the Clinton healthcare initiative in March 1994, the USTR and the Commerce Department continued to press Japan on autos, demanding that it undertake measures that would make it easier for Japanese automobile dealers to handle foreign cars, increase the use of foreign auto parts in Japanese auto assembly (including by Japanese "transplant" factories in the United States), and ease the use of foreign parts in the aftersales market.²⁰ After failing to reach an agreement with Japan before a self-imposed 1 October 1994 deadline, the administration took the unusual step of self-initiating a Section 301 case against Japan. The subsequent negotiations made little progress, and in May 1995, President Clinton announced two actions: the filing of a WTO case, and the imposition of 100 percent punitive sanctions against Japanese luxury cars, effective immediately, but with actual duties not to be collected until a deadline at the end of June. This time, however, events did not follow the old script.

The dispute-resolution system of the GATT was dysfunctional: there were no time-bound procedures, and "defendants" could block negative

of possible trade diversion stemming from the earlier 1987 auto agreement, providing some justification for third-party concerns.

20. The first two issues directly involved competition policy issues and the third a regulatory matter. In principle, auto dealers in Japan are independent businesses and can handle cars produced by different manufacturers. It was alleged that, in reality, the dealers faced retribution from their dominant suppliers if they sold competitors' models, and the JFTC had never made an antitrust issue of this. As a consequence, only a minuscule share of dealers handled competing brands or foreign products. The second issue involved the vertical relationships between Japanese assemblers and their suppliers. The third issue involved regulations involving safety inspections and certification procedures that allegedly had the effect of encouraging garages to use original equipment parts in making repairs.

dispute panel reports. As a consequence, dispute settlement amounted to a protracted process of “shaming” an offending signatory into compliance, which was occasionally effective, for example, in the case of some agricultural trade disputes involving Japan. But a determined opponent could block the acceptance of a dispute panel report, and the GATT had never actually authorized retaliation for noncompliance with a panel ruling. Understandably, Japan was passive in its use of the GATT’s admittedly weak dispute-settlement mechanism, seldom bringing complaints to the GATT.

The establishment of a new dispute-settlement mechanism was one of the crowning achievements of the Uruguay Round. It provided for time-bound procedures, and ended the practice of defendants vetoing unfavorable panel reports. Instead, panel reports were to be accepted unless overturned by consensus.

So when the United States unilaterally announced retaliation without the authorization of the WTO, Japan broke with its past passivity and responded by announcing that it would file a countercase against the United States, arguing that the imposition of punitive sanctions without WTO authorization amounted to a violation of the US tariff binding under the Uruguay Round agreement. For most Japanese, the auto dispute was puzzling. Japanese autos had a well-deserved reputation for excellence, and if US autos did not sell in Japan, it must be because their characteristics (size, low fuel efficiency, left-side steering) made them inappropriate for Japanese conditions. Most critically, there was no constituency in Japan in favor of compromise with the US demands for a VIE. Instead of the US appeals to enlightened Japanese self-interest under the SII, these demands were regarded more as a manifestation of the self-interested desires of particular US firms.

A series of tense negotiations ensued. One day before the retroactive collection of duties was to begin, the United States blinked. A toothless, face-saving compromise in which the United States achieved none of its core goals was announced. (On the critical issue of quantitative indicators, the joint announcement issued by Kantor and Hashimoto contained the amazing disavowal that “Minister Hashimoto said the Government of Japan has had no involvement in this calculation because it is beyond the scope and responsibility of the government. He said that USTR’s estimates are solely its own.”)²¹ Both countries dropped their respective WTO cases.²²

21. “Joint Announcement by Ryutaro Hashimoto, Minister of International Trade and Industry of Japan, and Michael Kantor, United States Trade Representative, Regarding the Japanese Auto Companies’ Plans,” 28 June 1995. http://www.mofa.go.jp/region/n-america/us/economy/date/archive/26_7.html.

22. Levinsohn (1997) concludes on the basis of an interesting econometric analysis that European, not US, producers would have been the primary beneficiaries had the sanctions been imposed. In comparison with this self-defeating imposition of protection, the actual

Politically, the Clinton administration was able to get away with this incredible climb-down in part because the appreciation of the yen over the previous two years had led to a surge in US exports to Japan (including in autos and parts) and a narrowing of the bilateral trade gap.

The confrontation over autos amounted to the death knell of US unilateralism. For reasons described in chapters 2 and 3, the failure on autos coincided with a period in which US policymakers more and more viewed the major threat to the US economy emanating from Japan to be one of weakness—not strength. There was concern that trade tensions could actually contribute to negative macroeconomic outcomes in Japan, for example, by contributing to exchange rate misalignment. Last, as will be discussed in chapter 6, the 1994 nuclear confrontation with North Korea and the brutal rape of a Japanese schoolgirl by US servicemen in Okinawa the following year contributed to a reemphasis on security issues in the bilateral relationship and a desire to diminish conflict in the trade realm.²³

The result was a period of relative quiescence that continues to this day.²⁴ The locus of US attention reverted from sectoral issues back to structural issues with the 1997 Enhanced Initiative on Deregulation and Competition Policy, the successor to the Framework Agreement. Ironically, foreign penetration into the Japanese auto and auto parts sectors subsequently increased substantially in the late 1990s, primarily as a result of merger and acquisition activity associated with financial difficulties in Japan, not policy actions.

The Economic Partnership for Growth

The accession to power of the Junichiro Koizumi cabinet in Japan and the George W. Bush administration in the United States led to a reformulation of bilateral talks, which were announced at the Bush-Koizumi summit in June 2001. The two governments announced a United States-Japan Economic Partnership for Growth, which in significant respects was built on the 1997 Enhanced Initiative on Deregulation and Competition Policy

outcome—a weak trade-promotion pact—may not have been a bad outcome, despite its origin in a trade threat.

23. See Schoppa (1997) and Lincoln (1999) on the trade-security linkage during this period. See Noland (2000a, chap. 4) for an account of the North Korea confrontation.

24. It is interesting that the one case that followed the old threat and counterthreat script was a 1997 dispute involving harbor services. Maritime services were not covered under the General Agreement on Trade and Services (GATS), and the main protagonists were each country's respective maritime commissions, not the WTO-socialized USTR or MITI. The dispute was resolved after the US Federal Maritime Commission (FMC) threatened to block US ports to Japanese ships unless its Japanese counterpart reformed its discriminatory practices. It has been argued that the only reason that the US FMC was able to make such a credible threat was that it is an independent agency and outside the direct control of the White House (Creel 1997; Stokes 2000).

Box 5.3 The Economic Partnership for Growth

The 2001 Economic Partnership for Growth established a subcabinet group that would meet at least on an annual basis to oversee a multifaceted engagement process. The main innovation of the partnership was to formally involve private-sector representatives in the talks, through a "Private Sector/Government Commission," a body that would meet before the subcabinet group to provide input and include private-sector representatives selected by their respective governments.

At the working level, the partnership created four "initiatives." A Regulatory Reform and Competition Policy Initiative largely reaffirmed the existing efforts carried out under the Enhanced Initiative. Working groups would address cross-sectoral issues, such as competition policy and commercial code issues, whereas four sector-specific working groups would be devoted to telecommunications, information technologies, energy, and medical devices and pharmaceuticals. (The housing working group of the 1997 Enhanced Initiative was disbanded.) Each of these groups would incorporate private-sector input on an ad hoc basis.

Other initiatives established under the partnership included a Financial Dialogue on macroeconomic and financial-sector issues. An Investment Initiative on issues relating to FDI was created to address the issues of transparency, corporate governance, and factor markets, which have been identified as the main impediments to foreign investment in Japan. The Trade Forum was established to discuss trade issues and serve as an "early warning mechanism" for emerging problems. The desirability of private-sector participation in each of these initiatives was recognized, although the modalities of such involvement were left undefined.

(see box 5.3). It is not surprising that the partnership could be regarded as a continuation of previous bilateral initiatives. Like the Agreed Framework—the product of the Clinton administration's incoming attempt to set the agenda in its economic relationship with Japan—the partnership addresses the mix of macroeconomic, structural, and trade issues that the two governments have discussed bilaterally for years. Indeed, the working group on medical devices goes all the way back to the MOSS talks conducted by the Reagan administration and the Yasuhiro Nakasone cabinet during the mid-1980s.

The partnership does differ in several ways from the earlier Clinton policy. First, economic issues are once again clearly taking a back seat to traditional security concerns. Second, even within the economics sphere, the partnership is much looser than the Agreed Framework. Under the partnership, meetings are to be held on an "at least annual" basis, not more regularly as was the case of the Agreed Framework. Unlike the Agreed Framework, meetings of the heads of governments are not programmed into the package to be action-forcing events. Third, the partnership contains no language with respect to quantitative targets.

The partnership breaks with the past by formally involving the private sectors of each country. In some sense, this merely makes formal what has been informal practice all along. Moreover, this could be constructive, to the extent that private-sector participants may have a better grasp of

more and more important technical issues raised by these discussions than their public-sector counterparts. However, private participation is circumscribed in notable ways under the agreement: each government gets to select its private-sector participants, and the discussion agenda is set *ex ante* by each government. Indeed, the handpicking of the private-sector representatives would appear to limit the usefulness of the exercise. The two governments could be predictably expected to select representatives whose corporate agendas mirror their respective government's negotiating positions. In effect, the private representatives could be expected to largely reproduce the zero-sum nature of the negotiations. It would be more constructive (though potentially more embarrassing for the officials involved) if the US (or Japanese) government were able to select some Japanese (or US) private participants. Each government then would be expected to select some foreign "allies," and thus more realistically reproduce the crosscutting cleavages that exist with respect to these issues.

WTO Dispute Settlement

Since the WTO's establishment, Japan has initiated complaints at a rate of slightly more than one per year (see appendix table A.1 at the back of the book). About half the cases involve the United States, and about half involve the automobile industry in some way. WTO panels have regularly upheld Japanese complaints.

At the same time, Japan's partners have taken it to the WTO at a rate of about two cases per year (appendix table A.2). As is often the case in the WTO, many of these disputes are settled bilaterally without going through the complete adjudication process. In the cases that have resulted in panel rulings, Japan has lost two (the complaint about discriminatory taxation on alcoholic beverages brought by Canada, the European Union, and the United States, and an agricultural quarantine case brought by the United States) and has won one, the (in)famous Kodak-Fuji case on photographic film. Japan has also used its third-party rights in 25 cases, mostly involving the United States and/or the European Union (appendix table A.3).

The United States, perhaps reflecting its relative abundance of lawyers and cultural compatibility with formal legal proceedings, has been the leading participant in the WTO dispute-settlement system, being involved as a complainant, defendant, or third party in more than half of WTO cases (appendix tables A.4-A.6). Likewise, it has prevailed in more than 60 percent of the cases that have been settled, in the sense that the WTO panel has ruled in its favor, or the issue has been settled bilaterally before the panel issued its report. Of the 27 cases in which the United States brought complaints to the WTO, the United States has prevailed in 24. In cases related to Japan, the United States has triumphed in cases involving

discriminatory taxation of liquor, import restrictions on certain varieties of fruit (including apples and cherries), and protection of intellectual property rights with respect to sound recordings. Its sole loss came in the celebrated Kodak-Fuji film case.

The photographic paper and film industry is a classic oligopoly: increasing returns to scale in manufacturing and a heavy emphasis on new product development effectively deter new competitors from entering the market, and four firms—Kodak (United States), Fuji (Japan), Agfa (Germany), and Konica (Japan)—dominate the global marketplace. Kodak and Fuji alone account for nearly three-quarters of the photographic film market globally, with each maintaining a market share of roughly 70 percent in their respective home markets, and each accounting for roughly a third of third-market sales (with the remainder going to the competitive fringe manufacturers).

According to sophisticated econometric research by Goldberg and Knetter (2000), Fuji had been gaining in competitiveness relative to Kodak for 25 years. Some of the proximate causes are not hard to identify. After Polaroid introduced its revolutionary SX-70 instant color film camera in 1972, Kodak spent lavishly to develop its strikingly similar alternative, which it introduced in 1976. Polaroid sued for patent infringement, and in 1985 a federal judge ordered Kodak out of the market and levied a \$925 million fine, the largest judgment ever in a patent infringement case. Kodak would dissipate more of its capital in a 1988 takeover of Sterling Drugs, which the company would sell off 6 years later.

In the meantime, Fuji introduced 400-speed film in 1976, at the time faster than any Kodak manufactured. And when Kodak declined to sponsor the 1984 Los Angeles Olympics, Fuji stepped in and used the opportunity as a springboard to expand its distribution capacity and market share in Kodak's home market. By the early 1990s, Fuji's sales per employee were nearly twice Kodak's.

In August 1993, reeling from the Fuji onslaught, Kodak filed an anti-dumping petition, alleging that Fuji and Konica were dumping color photographic paper components from Japan and Fuji's subsidiary in the Netherlands. In March 1994, a preliminary determination by the US Department of Commerce assessed dumping margins in excess of 300 percent. (The Commerce Department was able to assess a high margin even on the products coming from the Netherlands by using a loophole that was subsequently closed in the Uruguay Round agreement.) In August 1994, Fuji and Konica signed an agreement in which they agreed to raise their export prices in return for the suspension of the antidumping case. Exports of color photographic paper to the United States plunged. At little cost, Kodak had gained some temporary breathing room in its most important market, although in response to the dumping suit, Fuji accelerated its construction of a state-of-the-art facility in Greenwood,

South Carolina. The plant would come online in March 1996, and within a year, Fuji's color paper market share in the United States would exceed its presuit level (Komuro 1998).

George M.C. Fisher, the former chair and chief executive officer (CEO) of Motorola, became the CEO of Kodak in December 1993. Fisher had been a central figure in Motorola's struggle to open the Japanese cellular phone market, and he proceeded to apply the same strategy at Kodak. In May 1995, apparently without consulting the JFTC or the US Justice Department, the relevant competition policy authorities, Kodak filed a Section 301 petition with USTR, alleging that the Japanese government policies (or its inaction) had denied Kodak its rights under bilateral and multilateral agreements to which the United States and Japan were signatories.

The USTR accepted the petition, initiating an investigation in July and requesting bilateral consultations with the Japanese government. With USTR's assent, Kodak had in essence "privatized" trade policy, turning an antitrust case in which it was unlikely to prevail in either jurisdiction into an international trade dispute.²⁵ This time, however, emboldened by their victory in the auto case, the Japanese government refused to engage, repeating its oft-stated position that it would not negotiate under the threat of sanctions, and arguing that Kodak's allegations involved private-party behavior, so it would be improper to engage in government-to-government negotiations before an investigation by the JFTC. (The JFTC would subsequently self-initiate its own investigation and conclude that Fuji had remedied anticompetitive practices for which it had been cited in 1989, and that there was no evidence of ongoing anticompetitive behavior.)²⁶ The USTR proceeded with its investigation, and concluded in June 1996 that Japanese government policies had indeed placed an unreasonable burden on US commerce.

This finding alone would have justified retaliation under US domestic law. However, the USTR faced the same dilemma as it had a year earlier in the auto case: if it proceeded with unilateral retaliation, Japan would surely take it to the WTO for violating its Uruguay Round commitments. Moreover, in mid-1996, the Clinton administration wanted neither a visible confrontation with Japan nor an obvious failure—going to the WTO

25. According to one legal scholar, Merit Janow, Kodak could have taken up the case in the United States under the Sherman Act. However, evidentiary standards are typically more stringent in antitrust cases than in trade cases, and it is unlikely that Kodak would have won in the US courts (Greaney 1997). Kodak did eventually bring a complaint to the JFTC.

26. The JFTC did recommend changes in some Fuji business practices, however. E.g., it indicated that Fuji should revamp its system of security deposits that it required from primary wholesalers because the high interest that it paid on these deposits could act as a disincentive for the wholesalers to handle competitors' merchandise.

would permit the administration to kick the can down the road, past the looming November elections.

So, this time, instead of threatening unilateral retaliation, citing Articles 3 (national treatment), 10 (transparency), and 23 (nullification and impairment), the USTR filed its own WTO case, alleging that Japanese government “countermeasures” had denied the United States its benefits from Japan’s liberalization commitments on photographic paper and film in the Kennedy (1967), Tokyo (1979), and Uruguay (1994) rounds. (In the Uruguay Round, Japan completely removed tariffs on photographic film and paper.) The government of Japan denied all US claims. The European Union exercised its third-party rights and formally endorsed the US complaint.

A dispute-settlement panel was established in September 1996, and in April 1997, the United States submitted to the panel a nearly 200-page brief, together with 20,000 pages of documentation. The panel then heard arguments, and it issued its preliminary ruling in December 1997 and its final report in January 1998. It makes interesting, if voluminous, reading.

On almost every single point of principle, the panel found in favor of the United States. Rejecting Japan’s position, it found that administrative guidance and private actions could be considered “countermeasures.” It rejected Japan’s argument that the alleged nullification and impairment should be limited to Uruguay Round commitments, finding that alleged violations of prior GATT commitments could be a legitimate target of complaint. In most instances, it rejected Japanese claims that the United States should have been aware of the measures that Japan was undertaking at the time that the tariff agreements were negotiated, and hence the United States could not claim that these nullified or impaired expected benefits. This was not a “strict-constructionist” panel. On matters of principle, the panel interpreted its mandate broadly. Ironically, the sovereignty-obsessed United States had done more than any other WTO signatory to widen the scope of the nullification and impairment provision.

The problem, from a US perspective, was that it had a weak case in the particulars. It claimed that a broadly worded 1967 Cabinet decision on economic policy in the wake of Japan’s capital account liberalization amounted to a liberalization countermeasure in the photographic paper and film market. The panel rejected this contention. It alleged that 1970 MITI guidelines on photographic film impaired the competitive strategies of foreign producers in the Japanese market (e.g., by setting uniform transaction terms with wholesalers) and encouraged the establishment of single-brand wholesalers. The panel rejected these claims, observing that the guidelines were “origin-neutral” (i.e., they did not discriminate between Japanese and foreign producers) and that single-brand wholesalers had been the norm in both Japan and the United States before 1970.²⁷

27. By limiting the ability of potential entrants to discount prices and pursue other innovative strategies, this regulation could be thought of as inhibiting entry to the benefit of incumbent

Similarly, the United States claim that a 1971 Basic Plan for systematizing the distribution system amounted to a barrier was rejected on the grounds that this was a general government plan to improve efficiency in the distribution of all products, not just photographic products, and in any event was neutral with respect to the origin of the products. The panel report goes on to similarly reject the US allegations regarding a laundry list of other Japanese government measures, the most recent of which was undertaken in 1975.

Actions speak louder than words. Despite the feigned outrage at the panel report (USTR Charlene Barshefsky would describe the panel report as displaying “an instinct for the capillary”), the United States did not appeal the panel’s report, which was accepted in April 1997. It was the first time in the WTO’s brief history that a losing party had not appealed a panel decision.²⁸ Some reformers in Japan also expressed disappointment, hoping that an adverse ruling would have spurred further deregulation efforts.

To the extent that Kodak and other foreign producers are disadvantaged in the Japanese market, this seems to be more related to capital-market imperfections manifested in the apparent inability to purchase a Japanese wholesaler and thus crack the Fuji-dominated distribution system than market interventions of the Japanese government per se.²⁹ (Presumably, establishing a wholly new distribution system would be another, albeit highly costly, option.) The impression one gets is that Kodak and Fuji behave like two Cournot duopolists, which more or less control their respective domestic markets and compete in third-country markets. From a national standpoint, policy has two goals—assist your firm in exploiting the external market, while at the same time limiting its monopolistic tendencies in the domestic market. The textbook answer in this case is to subsidize production (to precommit to high output levels and force the foreign rival up its cost curve) and use taxes to make the domestic firm behave like a perfectly competitive industry.

Because we cannot subsidize production, barriers to entry in each of the (large) domestic markets could be a second-best precommitment

producers. The issue from the standpoint of the United States was that the incumbents were domestic producers and the potential entrants were foreigners.

28. During the early stages of the Vietnam War, Senator George Aiken advised that the United States should declare victory and withdraw. The US government’s actions after the film case would have made the good senator proud: it announced that it would treat Japanese representations that it did not hamper foreign access in the film market nor tolerate anticompetitive behavior as formal commitments and established an interagency task force to monitor these “commitments.” In its subsequent reports, the task force credited itself with improving market conditions in Japan.

29. The fact that Kodak had earlier severed its tie to its own exclusive distributor further reduced the credibility of its case.

mechanism. It appears that both Kodak and Fuji do a reasonable job of creating such barriers. In this setup, penetrating the rival's home market has a real zero-sum aspect to it and would be resisted accordingly. At the same time, it should be noted that firm and national interests are not identical, and neither country appears to do a good job at disciplining pricing internally. Although it might be in the US (or Japanese) interest to increase Kodak's (or Fuji's) monopoly power vis-à-vis the rest of the world, it is not in the US (or Japanese) interest to increase Kodak's (or Fuji's) monopoly power domestically.

In this light, Kodak's proposed remedy of a Section 301 case made sense: Two likely outcomes were either some increase in access to Japan or retaliation against Fuji in the US market, either of which would suit Kodak's purposes (although Kodak denied that it was interested in protection through retaliation). However, from a national standpoint, joint anti-trust might be a preferable policy, to discourage monopolistic pricing in each domestic market, but the JFTC evinced no interest. Likewise, the use of taxes to discipline Kodak's behavior in the domestic market would seem unlikely. From a public-policy standpoint, the question then arises: would the United States be better off pursuing antitrust action against Kodak here in the United States? The issue would be whether the gains to US consumers through lower prices would offset the damage to Kodak's competitiveness abroad.

From Kodak's standpoint, the question is: Was it worth the gamble? It spent millions on private litigation, and indeed, the potential gains to the firm from a successful prosecution of its case were considerable, yet Fuji's demonstrated ability to successfully compete from US facilities raises the issue of just how large or permanent those private gains would have been.

With the notable exception of the Kodak-Fuji case, the United States has prevailed in the vast majority of cases that it has brought to the WTO. Perhaps it is not surprising that the United States has fared less well when it has been in the dock. WTO panels have ruled against it in 8 out of 17 cases. Most notably, Japan and others have successfully challenged the United States on aspects of its antidumping law.

The Future WTO Agenda

Although the new dispute-settlement system represents a noteworthy advance over the old GATT system, the WTO faces a number of challenges. The most immediate are what to do in the aftermath of the debacle at the Seattle trade ministerial, and how to integrate China into the organization. In the long run, issues of personnel and substantive agenda will reemerge.

The 1999 attempt to launch a new round of multilateral trade negotiations in Seattle was driven by a political compromise left over from the

Uruguay Round, rather than any global groundswell for trade liberalization.³⁰ To secure a conclusion to the last round of negotiations, the United States accepted less than complete reform of agricultural trade practices on the part of the European Union, in return for a commitment to revisit the issue in 1999. Services trade liberalization was left similarly incomplete. This is the origin of the so-called built-in agenda of talks on agriculture and services. A certain sense of urgency was attached to the negotiations over agriculture, inasmuch as the “peace clause,” which prohibits WTO cases against certain practices (principally undertaken by the European Union and United States), is due to expire at the end of 2003.

This built-in agenda shaped participants’ negotiating strategies heading into Seattle. From a Japanese negotiator’s standpoint, the built-in agenda was a loser. In agriculture, Japan typically sides with the European Union against the United States and the Cairns Group of self-identified nonsubsidizing agricultural exporters. It originated the term “multifunctionality” as an excuse to maintain internal supports to agriculture. It prosaically observed that its current tariff levels “reflect particular domestic situations” and expressed an interest in strengthening disciplines on the use of export restrictions, reflecting its concerns about food security. In the area of trade in services, Japan is relatively uncompetitive in much of the services sector, and has not pushed as hard as the European Union or United States for liberalization in this area.

Instead, the European Union, Japan, and many other observers argued that a successful round would have to have three characteristics: it would have to be “comprehensive,” it would have to be a single undertaking, and it would have to strengthen rules and disciplines as well as market access. The notion of a “comprehensive round” was motivated by the recognition that Japan needed to broaden the agenda to hide its inevitable concessions in agriculture, and use gains in other areas to make an agreement emerging from the new negotiations politically palatable at home.³¹ Specifically, Japan made tightening the antidumping provisions a high

30. Just the opposite: The developing countries believed that they had been taken to the cleaners during the Uruguay Round, the previous round of negotiations, and were skeptical about taking on further trade liberalization commitments, and far better prepared to defend their interests in these negotiations. Similarly, Asia was still recovering from its financial crisis, and policymakers there believed they already had enough issues with which to grapple. Japan showed its lack of interest in further trade liberalization by blocking the Early Voluntary Sectoral Liberalization effort in the Asia-Pacific Economic Cooperation forum by opposing forestry and fisheries liberalization. And in the United States, President Clinton was unable to secure “fast-track” trade negotiating authority from the US Congress. See Schott (2000) for further details.

31. Japan could not expect major mercantilist gains from service liberalization (the other component of the built-in agenda) to balance its concessions in agriculture. Put crudely in the mercantilist terms of WTO negotiations, the built-in agenda offered the United States two winning issues and Japan two losing issues.

priority (i.e., strengthening “rules and disciplines”), and in the weeks leading up to the meeting, had stitched together a broad international coalition that clearly had the United States on the defensive.³² On agriculture, Japan found an eager ally in the European Union, which jumped onto the multifunctionality bandwagon to distract attention from its more and more indefensible export subsidies.

In the run-up to the meeting, the Clinton administration—which had been refused the authority to negotiate on the customary “fast-track” basis by Congress and hence could not be confident of the approval of any concessions that it might make during the negotiations, showed little flexibility—largely trying to limit the agenda to agriculture and services, where the United States would not be expected to make major concessions. It simultaneously tried to force onto the agenda relatively new and controversial issues such as the relationship between trade and labor standards, and trade and environmental concerns (see box 5.4).³³ As MITI correctly observed, such an approach jeopardized progress on even the built-in agenda, because it left most participants with no incentive to move forward (MITI 1999a). Once in Seattle, officialdom was caught off-guard by the degree of public mobilization against the talks by a wild melange of protest groups, whose motivations and aspirations appeared at times only tenuously connected to the issue at hand. And despite police intelligence, the authorities in Seattle appeared unwilling or unable to comprehend the violent tendencies of some of these groups.³⁴

Yet in the end, it was the traditional dispute between the European Union and the United States over agriculture—the same dispute that had nearly scuttled the launch of the earlier round of negotiations and nearly torpedoed those negotiations a half-dozen times—rather than the shenanigans of the Raging Grannies or the Ruckus Society that sank the Seattle negotiations. Japan appeared content to hold the European Union’s coat

32. See Manyin (2000).

33. The United States also pushed for a number of “immediate deliverables,” such as a second information technology agreement, government procurement transparency, and an e-commerce tariff moratorium.

34. The Clinton administration’s behavior in Seattle was perplexing. It sought to promote the labor and environmental issues. But President Clinton’s statement in Seattle that he would like to see economic sanctions used against countries not meeting labor standards took his Cabinet members in Seattle by surprise, and destroyed any possibility of making progress on the issue. Indeed, conversations with a number of developing-country negotiators indicated that the president’s remark, together with the behavior of the demonstrators, strengthened their resolve to resist US demands—with some regarding the demonstrators as an officially sanctioned attempt to physically intimidate foreign negotiators. The Japanese delegation, led by its foreign minister, could not attend the opening ceremony or plenary session because the local police could not provide an escort from the hotel where the Japanese delegation was staying to the convention center.

Box 5.4 Trade and the environment

Both Japan and the United States favor the inclusion of environmental issues in the world trade system, and Japan floated a proposal in 1996 to allow WTO signatories to use trade sanctions to enforce multilateral environmental protection agreements, such as the Montreal Protocol on chlorofluorocarbon emissions. The Japanese proposal was unable to gain many adherents among either developing or industrial countries, and the issue of integrating environmental concerns into the world trade system continues to bedevil the WTO. The two countries have also come into conflict over US unwillingness to adhere to the Kyoto Protocol on global warming.

Bilaterally, the two countries have clashed on issues relating to endangered species, most prominently whales. By the mid-1980s, global whale populations were on the brink of collapse, and in 1985 the International Whaling Commission (IWC), of which both Japan and the United States are members, voted a moratorium on commercial whaling. Iceland, Japan, and Norway continued to hunt whales on a limited basis for scientific purposes, as is permitted under IWC rules. Whale populations began to recover, and in 1992, these three countries petitioned the IWC to rescind the moratorium on whaling. Their 1992 petition was rejected, as have been subsequent attempts to weaken the moratorium at each annual meeting of the IWC.

Japanese hunting for “scientific” purposes has been criticized by other IWC members, including the United States, which has restricted Japanese fishing activities in its waters, and at times has threatened to impose sanctions. In light of its failure to weaken the whaling moratorium, Tokyo indicated that it would use its foreign aid budget to encourage some small island nations to join the IWC to support Japan’s position, and by the 2000 and 2001 meetings of the organization, Japan, in a coalition with six Caribbean countries, was able to block an Australia-New Zealand proposal to impose a total ban on whaling in the South Pacific. Indeed, at the 2001 meeting, Japanese official Masayuki Komatsu caused a furor when, in an interview with the Australian Broadcasting Corporation, he admitted that Japan actively sought to buy votes with its aid program. (Calling the minke whale “the cockroach of the ocean” did not help matters.)

In the end, the whale imbroglio may be solved by scientific research—although not of the kind Japan normally invokes. A study presented to the IWC by a Japanese academic found that whale meat sold in Japan contained high levels of dioxin and two other carcinogens. Health concerns may ultimately prove to be the savior of the whales.

on agriculture, and its sin was one of omission—passively allowing an opportunity to slip away—rather than one of commission.

In the aftermath of Seattle, the effort to launch a new round foundered. The European Union, and to a lesser extent Japan, moved to right the organization, restarting the agricultural and services negotiations (although the European Union initially blocked the consensus on selecting the chair of the agriculture talks) and undertook a series of “confidence-building” measures, including the extension of the 31 December 1999 deadline for developing countries to implement WTO agreements on

intellectual property, investment measures, and customs valuation.³⁵ For its part, the United States pursued the quixotic agenda of relaunching the round before the Okinawa summit in June 2000, although some within the US government regarded a Japanese proposal to set up a distinguished-persons group to assess the most propitious path for future progress as a delaying tactic.

Prospects for a new WTO round improved following the inauguration of the George W. Bush administration in 2001. The United States dropped its insistence on a limited agenda and accepted the comprehensive agenda of the European Union and Japan (Lamy and Zoellick 2001). The G-7 leaders also gave the initiation of a new WTO round a push at their July 2001 summit in Genoa. Indeed, with the major trading countries agreeing on the broad outlines of an agenda, the major stumbling block to a successful launch of a new round of WTO negotiations at the ministerial in Doha, Qatar, would appear to be opposition by the developing countries.

In this respect, the Bush administration still has not secured fast-track negotiating authority (renamed trade promotion authority), and a domestic consensus on the problematic “social clause” issues remains unattained. It could well be the case that the difficulty of reaching an agreement with the developing countries and the lack of fast-track authority on the part of the United States will mean that the WTO membership will nominally launch a new round in Doha, but that this will, in effect, simply amount to an agreement to formally continue negotiating the agenda.

Beyond the built-in agenda of agriculture and services, the industrial-products trade agenda is dominated by traditional tariff cutting and the need to better integrate antidumping and competition-policy rules. Intellectually, the tariff-cutting exercise is a well-understood process, amenable to traditional WTO tariff-offer negotiations, and it is simply a matter of reaching international consensus on an acceptable formula. The problem here is political rather than conceptual—in the United States, the textile industry is already angling to get its products excluded from the tariff-cutting process, and in Japan, the government torpedoed the Early Voluntary Sectoral Liberalization (EVSL) in APEC over some minimal primary products tariffs. Yet even these obstacles are amenable to deal making—not a trivial task, but not one fraught with the conceptual problems of the other agenda items.

Reform of antidumping rules and the creation of a more coherent international competition-policy regime present a great challenge. Japan has led the international coalition demanding reform of antidumping proce-

35. The urgency of this effort seemed to be tied to the likelihood of China’s accession to membership after the successful conclusion of the bilateral talks between China and the European Union, with Pascal Lamy, the EU commissioner for trade, publicly admitting that it would be easier to conclude the next round of WTO negotiations if China were not a full participant.

dures, which it regards, with significant justification, simply as process protectionism. Its major opponent has been the United States. Within the United States, there is little intellectual consensus as to what the goals of a desirable international competition policy might be, beyond prohibiting horizontal collusive practices such as cartels; politically, the issue has been captured by import-competing firms, which regard competition policy as prospectively a much less protection-friendly alternative to the existing, and WTO-consistent, antidumping laws. Within the US government, the bureaucracy is split: The Antitrust Division of the Justice Department fears that any multilateral accord would amount to a dumbing down of US law, weakening US antitrust practices; the USTR, stung by its defeat in the WTO in the Kodak-Fuji case, opposes narrowing antidumping laws in the interests of its import-competing clients.

The antidumping-competition policy issue is an inside-the-Beltway matter in comparison with the hot-button issues of the social clause. The US agenda on labor and environmental issues of recent years has found little support in Japan, which has not experienced the degree of public and nongovernmental-organization mobilization on these issues as have the European Union and United States, and has been on the defensive in a number of international disputes involving endangered species (see box 5.4).

In addition to the agenda issues, in the long run, the organization will have to deal with personnel issues as well. The last time around, Japan actively promoted Thailand's Supachai Panitchpakdi, while the United States backed New Zealand's Mike Moore in a protracted dispute over who would succeed Italy's Renato Ruggiero as the WTO director general. An eventual compromise was reached in which Moore and Supachai would split the term. This haggling did nothing to promote the institutional development of the organization. Another such brawl can be expected in 2005, when the Moore-Supachai term ends. The search for Supachai's successor could get entangled with personnel decisions made in other international organizations, as will be discussed in chapter 6.

Taken together, these observations suggest that the WTO may face some difficult times ahead. Although the system has served Japan well, it typically displays a lack of leadership, and on a series of issues on the horizon, its positions conflict with those of the United States, the organization's dominant member. We will return to these issues in chapter 7.

Regional Initiatives

Japan stands alone as the only large industrial country that does not participate in preferential regional trade arrangements. However, dissatisfaction with the WTO could encourage it and other countries in Asia to

go their own way, creating regional preference arrangements similar to those that exist elsewhere.

The sole major existing regional initiative, the Asia Pacific Economic Cooperation forum, includes countries from outside Asia, most notably the United States. Indeed, APEC was originally an Australian initiative; some Asians wanted US involvement to counterbalance Japan, which had a similar proposal, and APEC's first meeting was held in Canberra in November 1989. The next big step was in November 1993 when, at the first APEC "leaders' meeting," the United States hosted history's first pan-Asian summit—held, ironically, outside Asia. APEC's membership accounts for more than 2 billion people, 40 percent of the world's population, and more than half of global output. An officially appointed Eminent Persons Group issued a report calling for free trade and investment in the region by 2010 for rich members and 2020 for poor ones, a goal that the governmental leaders adopted in their Bogor Declaration of 1994 (APEC Eminent Persons Group 1993, 1994).

Because of the great political and economic diversity among the APEC membership, no one anticipates "deep integration" along the lines of the European Union. Rather, much activity has been directed toward "business facilitation"—streamlining procedures and the like. Progress on trade and investment implementation has been uneven. Agriculture is a highly sensitive issue, and Japan attempted to carve out agriculture from the accelerated liberalization commitments at the Bogor (1994) and Osaka (1995) leaders' meetings. Later, in November 1998, Japan torpedoed the EVSL initiative, which would have required it to eliminate, during a 10-year period, its relatively low tariffs on forest and fishery products.³⁶ Japan is not unique in this regard: South Korea and one or two other members have been willing to let Japan take the lead in opposing agricultural trade liberalization within APEC, much the same way that Japan stands behind the European Union in the WTO. For its part, the Clinton administration lacked the statutory authority to implement early tariff cuts in several of the EVSL sectors (though it had residual authority from the Uruguay Round negotiations for others).

The growth of regionalism outside Asia and the failure of the WTO meeting in Seattle have encouraged Asian countries to take a second look at regional economic integration schemes. The old East Asian Economic Caucus idea has been revived as the Association of Southeast Asian Nations Plus Three (ASEAN+3; the "three" being China, Japan, and South Korea) initiative. Official studies are under way on the possibilities of a Northeast Asia Free Trade Area involving China, Japan, and South Korea; a Japan-ASEAN FTA; and a free trade area for all of East Asia,

36. See Green (2001) for a detailed account of Japan's experience with APEC and the collapse of the EVSL initiative.

known to the cognoscenti as the "10 + 3." Negotiations on an FTA between Japan and Singapore are expected to be completed in 2001, and preliminary discussions are at various stages with Mexico, South Korea, and possibly others.³⁷

Article 24 of the GATT and Article 5 of the General Agreement on Trade in Services (GATS) specify the conditions under which preferential trade arrangements are consistent with signatories' WTO obligations. The WTO must be notified of the intent to form an FTA. The FTA must not raise barriers to other parties. Tariffs within the FTA must be reduced to zero within "a reasonable time period," which was codified in the Uruguay Round agreement as 10 years. Trade restrictions must be abolished in "substantially all sectors." Finally, liberalization should target the services sector per the GATS.

For Japan and its potential partners, the problem is the "substantially all sectors" requirement. Because of the political influence of its inefficient agricultural sector, Japan is constrained to look to partners that either do not have an agricultural sector (Singapore) or have similarly inefficient agricultural sectors (South Korea), or run the risk of a WTO challenge if it attempts to exclude agriculture from an agreement (ASEAN or Mexico).³⁸ Indeed, because of the agriculture-sector problem, Japan has proposed an ersatz FTA with Canada that would exclude goods altogether, covering only services and investment. Japan's search for regional alternatives to the multilateral system is hamstrung by its own agricultural lobby.

Of the FTAs that Japan is considering, the one with Singapore, a city-state that pursues virtually free trade today, would be the easiest to complete, and perhaps unsurprisingly, convey the smallest direct trade benefits to Japan.³⁹ However, it is possible that provisions of the agreement relating to cross-national factor mobility (e.g., involving reforms of professional accreditation and financial markets) might serve as a constructive form of *gaiatsu*, whereby the need to conform to an external agreement could be used to leverage badly needed domestic reforms.⁴⁰

Of more direct trade interest is the possibility of an FTA with South Korea. The two governments have commissioned studies of this possibility (Cheong 1999; Yamazawa 2000) and the idea has also been evaluated by Scollay and Gilbert (2001).⁴¹ All three studies use static CGE models

37. Initial discussion of these possibilities preceded the fiasco in Seattle. Japan has maintained that it was approached by all of its potential partners, although in the South Korean case there is some disagreement on this point.

38. See JETRO (2000) for a discussion of a possible Japanese FTA with Mexico.

39. Scollay and Gilbert (2001), using a CGE model, find that the benefits to Japan would be virtually imperceptible.

40. For example, see Joint Study Group (2000).

41. Lee (2000) contains a wide-ranging discussion from the Korean perspective, while Cheong (1999) summarizes the underlying technical model.

to evaluate a prospective Japan-South Korea FTA. These models have significant limitations, notably their inability to capture dynamic economic effects and the absence of any reaction functions on the part of other trading nations.⁴² Nevertheless, they are the obvious starting point for any serious analysis of a prospective FTA.

Yamazawa's conventional model generates the result that when Japan and South Korea enter into an FTA, Japan's bilateral surplus with South Korea increases. The United States is adversely affected by trade diversion.⁴³ As would be expected, the impact on the smaller economy is bigger than the impact on Japan: South Korea's real GDP increases 0.3-0.4 percent, while the effect on Japan is "marginal." The implicit message is that an FTA would have little impact on either economy and could well create problems with the United States.

In search of bigger numbers, Yamazawa then presents another variant, in which he assumes that large, sectorally nonuniform productivity increases accompany the formation of the FTA. In this variant, he obtains qualitatively similar results (e.g., Japan's bilateral surplus increases, and the United States is adversely affected by trade diversion), but both Japan and South Korea experience large real national income increases (on the order of 10 percent). This latter result, however, appears to be driven by the assumed productivity gains rather than anything intrinsic to the FTA.

Cheong's results are, if anything, even less supportive of the desirability of a Japan-South Korea FTA. In his model, not only does Japan's bilateral surplus with South Korea increase, but South Korean welfare actually declines—although, as in the case of Yamazawa's original model, these effects are quite small. Cheong then sets out to reverse the latter result, and comes up with two possibilities: unspecified "preferential rules of origin" and the inclusion of China in the FTA.

Like Cheong, Scollay and Gilbert obtain the result that a Japan-South Korea FTA would reduce welfare in South Korea, and like Yamazawa they find that it would also reduce welfare in the United States. They then model an FTA that excludes agriculture. This reduces, but does not

42. Yamazawa's model is a conventional Walrasian CGE embodying the assumption of constant returns to scale in production, with two alternative macro "closures." It has 11 sectors and 7 regions. The underlying data were taken from the Purdue University Global Trade Analysis Project. This means that quantitative restrictions, such as those existing in the agriculture or textile and apparel sectors, have been converted to tariff equivalents. Cheong provides even fewer details about his model. The Scollay-Gilbert model is similar to Yamazawa's, though far better documented. It contains 21 sectors and 22 regions. See Scollay and Gilbert (2001, appendix A) for further details.

43. Japan and other Asian countries have defended their interests in preferential schemes with reference to their trade-diversion losses resulting from the formation of the European Union and NAFTA. Krueger (1999) in an ex post assessment, finds little evidence of diversion. Noland (1995a), in an ex ante analysis, estimated that the long-run trade-diversion effects of NAFTA on South Korea could be substantial, as Mexico upgraded its export profile.

eliminate, the negative impact of the FTA on South Korea (and also presumably on the United States).⁴⁴

Ultimately, these models may badly misspecify the workings of a Japan-South Korea FTA—for instance, not capturing the effects of enhanced investment flows. They do, however, point to something that could be problematic politically. Levels of protection are generally higher in South Korea than in Japan. Moreover, South Korea pursued a policy of actively discouraging imports from Japan through its “import diversification program,” until this policy was terminated in June 1999 as part of the IMF’s conditionality for its December 1997 standby package. When the policy ended, imports from Japan surged in a number of sectors, causing public protest in South Korea. Relations improved dramatically with South Korean President Kim Dae-jung’s state visit in November 1998. But they subsequently took a turn for the worse in 2001, with controversies erupting over new Japanese school textbooks, which were regarded by the government of South Korea as whitewashing Japanese actions during the colonial period, and the visit by Prime Minister Koizumi to the Yasukuni Shrine, a Shinto shrine that includes among its honored dead a number of Japanese imperialists and war criminals. Any FTA with Japan will be a hard sell politically in South Korea.

From a US perspective, its major interest is in seeing that any preferential integration schemes in Asia are WTO-consistent. The requirements that an FTA cover “substantially all products” and include services creates a substantial hurdle for Japan to surmount. Any agreement that actually met these requirements would probably be beneficial to the United States, or involve only minimal trade-diversion losses.

The real risk, from a US perspective, would be WTO-inconsistent free trade areas involving the major economies of Northeast Asia. If China, Japan, and/or South Korea were able to carve out sectors (most likely agriculture) from such agreements, the risk of the United States suffering significant losses would increase. We will return to this issue in chapter 7, when we will specify some rules to ensure that preferential agreements would be “building blocks” to greater international trade liberalization and prosperity, rather than “stumbling blocs.”

Assessment

Japan and the United States have engaged in an intense process of negotiation since the mid-1980s over access to the Japanese market. Given the

44. The FTA that excludes agriculture mitigates some of the negative impact on South Korea because it reduces the amount of inefficient trade-diverting agricultural exports from South Korea to Japan. That is, under an FTA, South Korea is encouraged to use resources that could be better deployed elsewhere in the economy to produce agricultural exports that are sent to the preferentially opened Japanese market. This hurts more efficient agricultural exporters, e.g., the United States.

time, resources, and political capital devoted to this endeavor, from a public-policy standpoint, the ultimate question is whether it has been worth it.

A statistical analysis by Noland (1997a) found evidence that US policy-makers have devoted more attention to bilateral trade and investment issues than Japan's economic characteristics would appear to warrant. Moreover, this study was unable to detect any evidence that this activity had had an impact on aggregate trade and investment flows.

It could be that the econometric models used in that study were simply too crude to detect changes in discrete sectors. Greaney (2000) examined industry trade flows sector by sector, and with two exceptions she found little evidence that bilateral trade agreements had statistically significant effects on trade flows. The two exceptions were the semiconductor agreement and the 1987 auto agreement, although in the latter case, she also discovers evidence of trade diversion away from EU producers.⁴⁵ This suggests that Clinton administration policymakers may not have been deluded into believing that quantitative indicators might be a useful tool in increasing foreign market access, and that third parties might have had reasons for concern about such agreements.

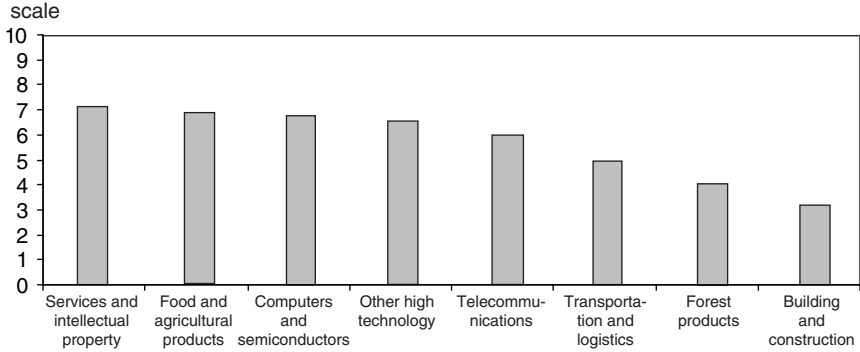
Both of these studies used econometric models to evaluate the agreements, and both use exports from the United States as the basis for evaluating the effects of these agreements.⁴⁶ An alternative methodology has been pursued by the American Chamber of Commerce (ACCJ 2000), which surveyed knowledgeable observers about the impact of 63 major agreements concluded since 1980. Of these, 58 were subjected to evaluation, and 51 received subjective numerical scores for content, implementation, and results.⁴⁷ In comparison with earlier surveys, the ACCJ reports

45. "In most cases, the data suggest limited impacts on Japan's imports of targeted manufactured products, particularly from the US. In fact, in many sectors, growth in Japan's imports of targeted products from the US slowed after an agreement was signed. However, in two high profile cases involving autos and semiconductors, I do find some evidence that suggests positive impacts of the agreements on bilateral trade flows. In the auto case, I find evidence consistent with trade diversion, favoring imports from the US over those from the EU, rather than pure trade creation" (Greaney 2000, 127-28). Greaney's results for semiconductors would be consistent with the analyses of Bergsten and Noland (1993) and Flamm (1996), who concluded that the 1991 agreement had a significant positive impact on foreign sales in Japan. Stokes describes the agreement as "probably the single most successful American trade agreement with Japan" (Stokes 2000, 68).

46. One possibility is that the agreements generate increased sales by US multinational firms, but that these products are sourced from locations outside the United States. This is the famous "who is us?" conundrum; such agreements may benefit US capital, but may do little for US labor.

47. Some observations were dropped from the sample because they were considered subject to ongoing negotiation or were too recent to evaluate, whereas others, such as an agreement on science and technological cooperation, were regarded as too amorphous to be evaluated.

Figure 5.1 Trade agreement evaluation scores by sector



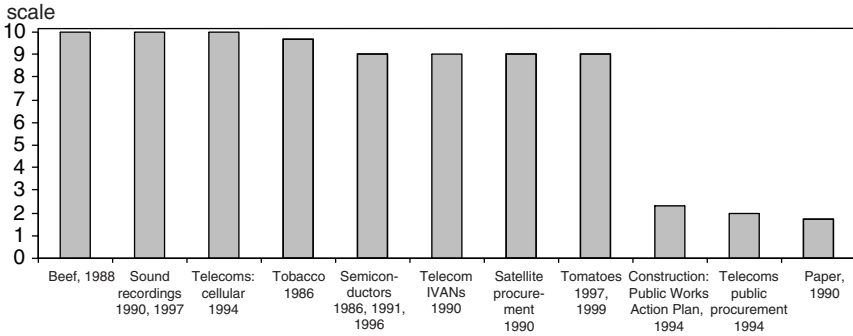
Source: ACCJ (2000).

that “in general, service industries reported significant improvements, while most manufacturing industries found little or no change” (ACCJ 2000, 17).

However, the sectoral averages reported in figure 5.1 suggest that a more nuanced interpretation is warranted. Although it is true that “services and intellectual property” received the highest average score (7.1 on a 10-point scale), the building and construction sector (also a service) received the lowest average score (3.2). Food and agricultural products received the second highest score (7.0), but another primary-products sector (forest products) received the second lowest score (4.1). A careful examination of the individual underlying cases suggests that the results are more idiosyncratic than consistent within sectors (the extreme cases of agreements that received ratings of above 8.5 or below 2.5 are shown in figure 5.2). Instead of broad sectoral characteristics, success appears to be more highly correlated with the existence of visible barriers and GATT-WTO norms and the absence of entrenched opposition by Japanese special-interest groups.⁴⁸ There is no statistical evidence in the scores of increasing

48. The relatively successful beef, sound recording, and tomato cases all reflect the existence of well-established GATT-WTO norms. The relatively unsuccessful cases of construction and paper reflect the power of entrenched special-interest groups and their allied ministries. The contrast between the cases of cellular telephones and government procurement of telecoms equipment is instructive in this regard. The cellular phone agreement essentially created the cellular phone market in Japan. Although there were significant disputes about the terms under which Japanese and foreign firms would compete, in contrast to government procurement, where NTT had a stable of traditional suppliers, the density of connections between the Ministry of Telecommunications and local service providers was lower.

Figure 5.2 Highly successful and unsuccessful trade agreements, scores by sector



Source: ACCJ (2000).

or decreasing US negotiating effectiveness over time or across five presidential administrations.⁴⁹

This suggests a conundrum created by two conclusions, one positive and one normative. The positive conclusion is that there is some evidence that past agreements embodying market-share targets have been unusually effective in stimulating import penetration into Japan. The normative conclusion is that, although they have stimulated imports, it is less clear that their impact enhanced welfare for either Japan or third parties that may have been disadvantaged by import diversion.

In any event, this is a moot point. The experience of the past 20 years has set the Japanese government against entering into any more agreements containing market-share targets backed by penalties. At the same time, the formation of the WTO has severely reduced the ability of the United States to demand such agreements. The bottom line is that, whatever their impact in the past, VIEs are not an option for the future. Instead, Japan and the United States need to develop alternative policy approaches to improving market access through the multilateral channels of the WTO. Specific recommendations will be detailed in chapter 7.

Conclusions

Japan is clearly changing. It is becoming less distinct in international terms than it was 10, or even 5, years ago. This is not to say that Japan is no longer distinct—its inward FDI is minuscule for a country its size; the role of foreign firms in its economy remains far smaller than their role in other major industrial economies; and its prices still appear to be

49. Noland (1997a) reaches a similar conclusion.

high, indicating less than complete integration between its markets and those elsewhere in the world. Nevertheless, these differences are diminishing.

At the same time, Japan's share of world output is shrinking. And, from a US perspective, Japan is becoming less important. This is not to say it is unimportant—Japan remains the world's largest importer of agricultural goods and the largest market for US farm products, and Japan and the United States will remain rivals in high-technology products and services for the foreseeable future. This is simply to say that in relative terms, the importance of Japan in US trade and investment is declining.

From a US perspective, this fall in relative importance, together with Japan's declining distinctiveness internationally, undercuts the justification for a Japan-specific US economic policy. Again, this is not to say that the United States should ignore Japan, or that the USTR Japan desk should close up shop. Indeed, in some regards, the changing agenda will require the focus of even more specific resources on Japan-related issues, as will be discussed below. It is simply to say that Japan-specific policies will more and more be undertaken in the context of US multilateral, plurilateral, and regional policies.

Forty years of tedious and at times corrosive bilateral negotiations have yielded a mixed bag of uncertain results. From the US standpoint, it is not from lack of trying: The United States has, at times, devoted extraordinarily high-level resources to Japan-related issues, which almost surely could have been better spent dealing with other problems. Nor is the United States solely responsible for this state of affairs: The lack of a credible opposition to governance by the LDP, in effect, has forced the US government to play the role of the opposition party in Japanese politics.

Ultimately, this is untenable: The US government is not the political opposition in Japan, and the US government will never play this role skillfully in Japanese domestic political terms. As the agenda shifts more and more toward domestic regulatory issues, the US government will be less and less able to usefully play its traditional role. The fact that the trade policy agenda is shifting more and more toward the services sector and regulatory issues implies that the principal beneficiaries of reform will be domestic residents (even more so than in the case of traditional traded-goods liberalization), and the justification for this traditional US role is even further weakened. Indeed, by becoming so embedded in Japanese domestic politics and playing a role for which it is fundamentally ill-suited, the United States risks compromising its ability to pursue its conventional and legitimate foreign policy interests or constructively intervening when it really counts—in real crises (see box 5.5).

Indeed, to most Japanese, the United States has lost its aura as a legitimate exorter of *gaiatsu*. Many commentators who hailed the United States as acting as an effective opposition party pushing deregulation against the

Box 5.5 The last gasp of *Gaiatsu*?

Gaiatsu, or foreign pressure, has a long history in Japan–United States trade relations—extending back to the Black Ships, some might say. When Japan and the United States launched the Enhanced Initiative on Deregulation and Competition Policy in 1997, one of the key sectors identified in the negotiations was telecommunications. NTT, the Japanese national telecommunications monopoly, was being transformed into a holding company for a long-distance carrier, NTT Communications, and into two companies providing local telephone service, NTT East and NTT West. The process of deregulating Japan’s huge, complex telecoms market created a vast array of issues for the Japanese government—and US negotiators.

US firms in the international telecoms services market feared that Japanese regulators would set the interconnection fees between the local and long-distance provider in such a way as to facilitate NTT Communications’ penetration of the international services market, in effect using the captive local market to cross-subsidize the international subsidiary. Moreover, new entrants into the Japanese domestic market were charging that the NTT group was using its unique access to the system to impede competition—for example, by denying them physical access to relevant facilities, charging a higher fee to foreign carriers to link a call into the NTT network than it charged its own retail customers, or bundling different types of service lines together and requiring that foreign service providers lease the whole bundle to gain access to a specific asset. (The issue of access denial led to a JFTC investigation in October 2000.) A similar set of interconnection fee issues had arisen in the wireless market with respect to the dominant carrier, NTT DoCoMo. Foreign equipment suppliers claimed that NTT was using the establishment of unique technical standards to frustrate those wishing to sell “off the shelf” into the Japanese market, in contravention to existing procurement agreements. The foreigners found an ally in METI, representing the interests of the Japanese electronics firms that would see their markets grow with the spread of information technology.

The US industry argued that the USTR would have substantial leverage in future negotiations with Japan, insofar as NTT Communications, the new international service provider, would have to apply for a license in the United States to provide service between Japan and the United States. In March 1998, Deputy USTR Richard W. Fisher began pressing his Japanese counterpart on a number of telecoms issues, including the issue of interconnection fees. In June, the United States extracted a commitment from the Japanese side to adopt a cost-based standard at the end of 2000, while reducing fees in the interim. The action then shifted to the issue of the interim rate cuts, which had been left undefined in the agreement. The two sides continued to negotiate for another year, with the United States at one point threatening a WTO case against Japan.

A broad agreement was reached in July 2000, a few days before the Japanese government hosted the G-7 summit on Okinawa. The agreement included provisions to cut by about 35 percent the interconnection fees of greatest interest to the US side (other fees, of greater interest to Japanese consumers, received smaller cuts), to establish the rights for firms to provide high-speed Internet access and build their own networks, and to open new points of access by “unbundling” subscriber lines and special equipment.

The agreement should improve the competitiveness of the Japanese telecommunications market, bringing some benefits to Japanese consumers of telecommunications services (including Japanese businesses) and help US service providers. Even so, METI made the need for additional liberalization of the telecoms market the centerpiece of its 2001 White Paper. What is notable about this case is how it harkens back to now-familiar themes: the US government uses denial of market access to support one Japanese faction against another, for the ill-defined benefit of a US producer lobby.

vested interest-ridden LDP became disillusioned after the semiconductor imbroglio, the auto and auto parts showdown, and the Kodak-Fuji dispute. From the Japanese perspective, the United States evolved from the promoter of an efficient market economy to a narrowly self-interested demandeur. Now, United States-initiated *gaiatsu* is almost a dirty word in Japan. To the extent that the United States is willing to insert itself into Japanese politics, it should do so only when the stakes are high, and preferably when pressure can be multilateralized through concerted action with others. We will return to this theme in chapter 7.