

**The Outcomes of International Trade Conflicts:
the U.S. and Japan, 1968-1983.**

by

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(ABSTRACT)

Since 1960 national governments have increasingly found themselves in international trade disputes. Yet little research has attempted to analyze this important form of international conflict. The analysis of the U.S.-Japanese trade conflict shows that 11 significant commercial disputes occurred between 1968 and 1983, covering five industrial sectors. The outcomes varied in the degree to which each government achieved its initial objectives. This study proposes five hypotheses for explaining variations in bilateral conflict outcomes, and a technique for comparing outcomes is devised. Within the framework of the misalignment of the dollar-yen exchange-rate and the resulting trade deficit, the pattern of variations is explained by the decline of the U.S. hegemony and the political influence of the domestic industries in the U.S. as well as in Japan on the outcomes of the trade conflicts.

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Table of Contents

1.0	Introduction	1
2.0	The International Trade System	6
2.1	Introduction	6
2.2	Lessons from the 1930s	7
2.3	The Early Years of the GATT Regime	8
2.3.1	The Foundation of the GATT Regime	9
2.3.2	The General Principles of GATT	10
2.3.3	Theoretical Underpinnings of the GATT Regime	12
2.4	The Years of the American Hegemony	14
2.5	Forces of Change: The GATT System under Attack	16
2.5.1	Political Factors	16
2.5.2	Changes in the Global Economic System	17
2.5.3	Shifts in the Industrial Structure.	18
2.6	The Emergence of the New Protectionism	19
2.6.1	An Evaluation of the New Protectionism.	20
2.6.2	Theoretical Underpinnings of Protectionism	22

2.7	Conclusion	24
3.0	Macroeconomic Policies and the Trade Conflicts	28
3.1	Analysis of U.S.-Japanese Trade Balance	29
3.2	Macroeconomic Policies and Political Tensions	30
3.3	Conclusion	34
4.0	Determinants of the U.S.-Japanese Trade Conflicts	35
4.1	International Regimes: International Power Structures	36
4.1.1	Defining and Identifying International Regimes	36
4.1.2	The Theory of Hegemonic Stability	39
4.2	U.S. Trade Policy Formulation	44
4.3	Japanese Trade Policy Formulation	47
5.0	Analysis of U.S.-Japanese Trade Conflicts	51
5.1	Identification of U.S.-Japanese Trade Conflicts	51
5.2	Interpretation of Results	54
5.2.1	International Power Structure	55
5.2.2	Variations Due to the Political Influence of the American Industries	55
5.2.3	Variations Due to the Political Influence of the Japanese Industry	57
5.3	Conclusion	59
6.0	Summary and Policy Recommendations	61
	Bibliography	64
	Appendix A. Figures	74

Appendix B. Tables	77
Appendix C. Methodological Appendix	87
Appendix D. The Scaling of Conflict Outcomes: Four Case Studies	89

List of Illustrations

Figure 1. United States' Multilateral Trade Deficit (in billion \$), with Japan and the ECC, 1965-1985. 75

Figure 2. United States' Bilateral Trade Deficit (in billion \$) with Japan and the EEC, 1968-1985. 76

List of Tables

Table 1.	Number of Major Non-Tariff Barriers in Seven Industrial Countries, 1973-1984.	78
Table 2.	NTB Coverage Ratios by Product Category for the Major Industrial Countries, 1983.	79
Table 3.	Trade Balances for 25 Major Trading Nations, Total and with the United States, 1980-81 to 1984.	80
Table 4.	Trade Disputes Between the Governments of Japan and the United States, 1968-1983.	81
Table 5.	Conflict Outcomes and U.S. Import Penetration.	82
Table 6.	Conflict Outcomes and Employment (in 1,000s) in Affected U.S. Industries.	83
Table 7.	Industry Concentration for Selected Industries in the U.S., 1967-1982.	84
Table 8.	Conflict Outcomes and Employment (in 1,000s) in affected Japanese Industries.	85
Table 9.	Conflict Outcomes and Export/Output Ratio of Affected Japanese Industries.	86
Table 10.	Scale for Rating Conflict Outcomes.	88

1.0 Introduction

We are a developing nation supplying a more advanced nation - we are Japan's plantation: haulers of wood and growers of crops, in exchange for high technology, value-added products...(U.S. Congress, House Ways and Means Committee, 1979: 5).

The nail that sticks out will be hammered down (Traditional Japanese proverb).

Since the 1950s nation-states have engaged in bilateral conflicts arising from their mutual trade with increasing frequency. The growing number of commercial disputes has sparked much public debate; yet we have very little systematic knowledge about the causes or effects of this form of international conflict. This paper will develop techniques for identifying and comparing the outcomes of international trade disputes, as well as several hypotheses for explaining outcome variations. It is the purpose of this paper to analyze the development of the international trading system after WWII in general and then to focus on the trade conflicts between the U.S. and Japan in particular. It therefore consists of two parts, the first one introducing and analyzing the development of the international trading system after WWII and setting the background for the analysis of the U.S.-Japanese trade conflict. The second part of this paper will first analyze the development of the macroeconomic policies of the two countries and their effects on the exchange-rate misalignments and the resulting tensions in the economic relations between the two countries. Then I shall

focus on the analysis of the outcomes of the numerous trade conflicts which occurred between the two countries over the last 20 years due to the hegemonic decline of the U.S. and the political influence of the industries threatened by imports.

The first part of this paper will develop the background for the U.S.-Japanese trade conflict: the development of the international trading system after WWII. I shall argue that as the GATT trading system succeeded in reducing international tariffs significantly, the economic recession of the mid-1970s as well as structural changes in competitive advantages between industrialized and industrializing countries have stimulated the emergence of non-tariff trade barriers (NTBs). These NTBs were the result of bilateral as well as multilateral trade negotiations outside of the established GATT negotiation system. They represented the efforts of OECD countries to protect their declining industries via administered trade from fierce foreign competition. This development constitutes a big threat to the free trading system as it challenges its basic rules and impedes the structural adjustments granting more wealth for more nations.

The second part of this paper will focus on the U.S.-Japanese trade conflict. There are several reasons which make the numerous trade disputes between these two countries very interesting and will help us to get a better understanding of the origins and the nature of bilateral trade conflicts. The most important reason for focusing on the trade relationship is the fact that it involves the world's two largest trading powers. Therefore, the nature of the economic relationship between these two countries will have serious repercussions throughout the global trading system. In fact, it developed to become a model for the nature of trade relations between developed countries on the one hand, and the NICs (Newly Industrialized Countries) on the other. It also influenced the trade relations between developed countries, such as between the U.S. and the EEC. The most important development was the evolution of managed trade, which, as already noted, I shall discuss in the first part of this paper.

The second reason for focusing on U.S.-Japanese trade relations is the fact that it represents a painful, but *classical* adjustment process: on the one side, there is the U.S., a world power which is trying to maintain its current level of economic performance and social welfare, and which experienced a relative decline in its economic performance, especially affecting its traditional, labor-intensive industries. On the other hand, there is Japan, a flexible, energetic country, which is determined to improve its already very impressive economic success. Therefore, the trade conflict between the U.S. and Japan represents a *classical* case of international economic conflicts: a world power, used to relative affluence and economic supremacy due to its abundant resources, is seriously challenged by a newly emerged competitor, causing painful adjustment problems.

The trade conflict between the two countries also exhibits some unique features. Their common recent history adds an interesting dimension to the disputes: Japan developed in only 40 years from a defeated nation to the prime economic challenger of the U.S., from a country occupied by the U.S., to a country whose investments in the U.S. became a major issue in the bilateral relationship. This dimension is adding additional strain to the bilateral negotiations, as it makes it very difficult for American negotiators to accept the changing nature of the relationship of the U.S. with Japan.

In addition, the level of conflict increased due to the inappropriate response of the two countries to this new development. The American response to the Japanese threat was inadequate. Second place is not acceptable to a country with the accomplishments, economic size, and the political influence of a superpower. It seems that some of the challenged industries lacked the will, and not the capacity to respond more efficiently to the Japanese industrial surge (Cohen, 1985: 193). Instead of improving its industrial competitiveness, these industries chose to seek political protection from Japanese imports, slowing down the economic adjustment process and threatening their future competitive position.

Japan, on the other hand, considered her economic recovery and the following economic success as the path to restore her position as an international power and to reestablish her international

reputation. However, she never demonstrated any comprehension of the basic principle of international trading relations: reciprocity. Japan demonstrated remarkable insensitivity to the adjustment problems she was imposing on her trading partners. The Japanese seemed to think that the rest of the world would welcome their becoming the world's principal generator of internationally traded manufactured goods and would support the insularity of her economic system.

It is the purpose of this part of this paper to analyze the outcomes of the various trade conflicts between the two countries. I identified 11 trade disputes between the two countries between 1968 and 1983. The disputes involved only five industries, all of them seriously threatened by international competition. The review of the literature revealed that the macroeconomic policies of the two countries and the resulting exchange-rate misalignments and trade deficit are the dominant cause for the variance in the tension between the two countries. But within this framework analysts proposed additional explanations of the variance in the outcomes of the trade conflicts. Based on these explanations, I shall develop three *sets* of hypotheses, with which I shall try to account for variations in the outcomes of the trade conflicts. The first set of hypotheses is derived from the international politics literature. I shall introduce the concepts of *international regimes* and the hegemonic theory of regime change, which represents the main explanation forwarded by the American international politics literature. Although it exhibits several weaknesses, it seems to offer a good explanation of regime foundation and the era of hegemonic domination. The second set of hypotheses will be derived from *public choice theory* and other theories explaining the influence of protectionist pressures on the government. I will use these approaches to account for variances in the outcomes resulting from the political influence of the affected industries on the negotiations. The third set of hypotheses will try to account for the impact of the Japanese industry and government on the outcomes of the negotiations. The analysis will reveal that differences among the affected industries did not influence the outcomes of the trade disputes.

The analysis of this paper represents a fairly new approach of analyzing trade relationships between countries. Whereas the traditional international economics literature is focusing on economic is-

sues, the classical international politics literature on the systemic, regime level, this approach represents an attempt to integrate both, the systemic as well as the national level. It therefore tries to overcome the shortcomings of the traditional focus on the hegemonic decline and opens the field to new results and insights.

2.0 The International Trade System

2.1 *Introduction*

The purpose of this chapter is to outline and analyze the development of the international trade system after WWII. This chapter will elaborate the background for an analysis of the U.S.-Japanese trade conflict. It will introduce some basic concepts of international economics and apply them to the development of the international trading system over the last forty years.

I first shall give a short analysis of the economic depression of the 1930s and of how it influenced the policy-making process in the U.S. and ultimately led to the establishment of the GATT system. Then I shall introduce its general principles as well as its theoretical underpinnings. Although the so-called *liberal trading system* was founded on strong theoretical arguments and supported by the economic as well as political power of the U.S., it constitutes an historical accident. It was not

intended to be the legal and organizational framework of the liberal trading system, but only a procedural base for tariff negotiations then held in Geneva.

The challenges that faced the GATT system will be the content of the following section. Most of these developments are direct or indirect outgrowths of the declining hegemony, whereas others are the result of the economic crisis of the mid-1970s and of changing perceptions challenging the classical economic theory. These challenges encouraged the emergence of a new protectionist wave, which is inherently different from that of the 1930s. It is characterized by the emergence of non-tariff barriers and bilateral negotiation.

2.2 Lessons from the 1930s

The establishment of the liberal trade system after WWII was largely a result of the great depression experienced by all major industrialized countries in the 1930s. By the end of 1929, when the collapse of the American stock market brought on the economic depression, many nations had instituted at least moderate trade restrictions. These restrictions were rapidly increased as the world depression deepened, and as countries acted unilaterally to stimulate their economies and to prevent further increases in unemployment. In the U.S., the new Republican administration imposed high protective tariffs under the *Smoot-Hawley Act* of 1930. Although the initial intention had been to protect only agriculture, according to Cuddington and McKinnon (1979: 14), an orgy of political logrolling and lobbying power dramatically increased protection for many other products as well. As a result, some thirty countries retaliated almost instantly against American exports. In addition, with Britain reintroducing across-the-board tariffs and establishing the Imperial Preference System in 1932, the British free-trade era came to an end.

The massive retaliation was sufficient to turn a localized recession into a prolonged world depression. From then on, trade barriers outside the U.S. continued to rise for most of the decade. Not only tariffs went up, but also within a few years, virtually all imports into Europe, and a large part of those into Latin America, were under quantitative restrictions. In Europe, discrimination became the norm of commercial policy (Tumlir, 1985: 25). However, the expected stimulant to domestic output was small in relation to the tremendous decline in foreign demand. Greenaway (1983: 83) reported that industrial production in the leading OECD countries (excluding Japan) was still below its 1929 levels by 1937, the year when the recovery from depression reached its peak. The extent to which world trade was depressed can be gauged by the fact that in 1933, the value of exports from the main industrial countries stood at only 25 percent of its 1929 value.

2.3 The Early Years of the GATT Regime

The experiences associated with the economic chaos of the 1930s had a salutary effect. Even before the end of WWII, the Allies were planning a co-ordinated response to provide a framework within which international monetary and trade relations could be conducted in an orderly fashion.

The second important factor for the establishment of an international trade regime was the American willingness to lead the system. This recognition is reflected in a memorandum of the State Department from 1934:

The only nation capable of taking the initiative in promoting a worldwide movement toward the relaxation of trade barriers is the United States. Because of its relatively great economic strength, its favorable balance of payments position, and the importance of its market to the well-being of the rest of the world, the influence of the United States on world commercial policies far surpasses that of any other nation (cited according to Spero, 1985: 93).

2.3.1 The Foundation of the GATT Regime

As early as 1934 the U.S. began to press for the implementation of a system of free trade with the enactment of the *Reciprocal Trade Agreements Act*. Under this act, the United States concluded numerous agreements reducing certain high tariffs of the early 1930s. During the war, the U.S. used its international influence to obtain commitments to a postwar international commercial order based on free trade. In 1945, a plan for a multilateral commercial convention that would regulate and reduce restrictions on international trade was presented. It offered rules for all aspects of international trade and proposed an *International Trade Organization (ITO)* to oversee the system.

Agreement on the new international order for trade, however, proved to be very difficult. Although the United States played a leadership role in the negotiations, there was little consensus on the desired features of the system. In addition, each participant faced important domestic constraints, so that the U.S. was unable to impose its plan on others. Although the discussions began as early as 1943, a compromise, the *Havana Charter*, was not reached until 1947. However, due to domestic opposition in the U.S., in 1950 the Truman administration finally decided that it would not submit the Havana Charter to Congress, where it would face inevitable defeat; and once the U.S. withdrew, the charter was dead (Spero, 1985: 94-5).

But the consensus on the need to establish an international trading order survived, embodied in the *General Agreement on Tariffs and Trade (GATT)*, which had been drawn up in 1947 to provide a procedural base as well as guidelines for the tariff negotiations then being held in Geneva. It was intended to be only a temporary treaty to serve until the Havana Charter was implemented. But as the charter was never ratified, GATT, by default, became the expression of the international consensus on trade.

Therefore, Finlayson and Zacher (1983: 274) concluded that one could speak of an international trade regime only if the ITO had actually become the global trade policy forum and the legal framework that it was intended to be. The GATT was never intended to be the basis for the postwar trade order and was not even conceived of as an international organization. Thus, a large number of trade matters are neither discussed in, nor subject to regulation and supervision by this accidental international institution. Therefore, they suggested that the GATT is at the heart of the international trade regime, which, for the most part has been concerned with one international trade issue area, trade barriers. It does not encompass all the issues it is supposed to, however. Other trade barriers, such as prices and earnings derived from the export of primary commodities or the effect of private business practices on trade -- which were both brought within the framework of the ITO -- were not addressed by the GATT and have since then not been brought within the GATT regulatory-consultative framework to any significant extent. These gaps were to become a major problem for the management of international trade.

2.3.2 The General Principles of GATT

The central substantive and procedural norms of the GATT regime have been relatively few in number. They have varied in importance to the regime at particular times, and the salience of some of them has changed quite markedly since its establishment in 1947. The substantive norms are concerned with nondiscrimination, liberalization, reciprocity, and exceptions (Finlayson and Zacher, 1983; Greenaway, 1983).

1. *Nondiscrimination*: This is the most important principle of the GATT system. Its aim is to ensure that any alterations in tariff rates are applied in a non-discriminatory manner. Thus, if

two countries agree on a bilateral reduction in tariffs in a given line of goods, this concession should immediately be extended to all other contracting parties on a MFN (most favored nation) basis, so that all parties benefit to the same extent as the most favored nation. However, nondiscrimination has since suffered severe and regular blows, which have had a significant cumulative effect. Most of the original GATT rules concerning nondiscrimination remain "on the books," but they are often disobeyed and GATT does little to promote their implementation.

2. *Liberalization:* The norm of liberalization or free trade is often regarded as central to the GATT regime, but it did not have the importance of nondiscrimination in the immediate postwar years. Following the European recovery in the late 1950s, the norm achieved a fairly high profile, but receded in the 1970s with the emergence of the *new protectionism*. The norm still remains relevant to trade in manufactured products among the industrial countries and to trade in unprocessed commodities, whereas outside these areas protectionism has a significant impact.
3. *Reciprocity:* This norm represents the recognition that there might be free-rider problems associated with trade liberalization. Certain countries may benefit from lower tariffs in their export markets without offering concessions on imports to the home market. This norm was designed to encourage genuine multilateral trade liberalization and therefore increased global benefits from less restricted trade. Furthermore, it serves to help defuse domestic political resistance to tariff liberalization.
4. *Exceptions:* Exceptions to each of the GATT principles are permitted. These exceptions derive from a recognition that short-term exigencies may require exceptional measures, or that political constraints may impose limits on the freedom of individual governments to act. However, unanticipated trends and events have increased the size of the "holes" provided by the GATT's safeguard rules, as in the frequent loose application of safeguard provisions. More important

has been the tendency to avoid multilateral supervision by taking actions outside the regime's framework.

2.3.3 Theoretical Underpinnings of the GATT Regime

The postwar American ideal of free trade was based on classical liberal economic thought. It assumed a steady expansion of capital-intensive, standardized production within all industrialized nations and goes back to Adam Smith and David Ricardo, who had based their arguments for free trade principally on geographic differences in natural endowments, implying a quite static distribution of advantages. As machine-based industry developed and spread, later theorists refined the model to accommodate the importance of physical capital. This factor proportions model relied on the observations that some people were better than others at making and using machines. According to this approach, global as well as national economic growth and efficiency dictate that all states open themselves to foreign goods and capital and that they specialize in the production of those goods in which they possess a comparative advantage. Therefore, as long as the global economy as a whole and individual states' policies conform to the classical liberal economic principles, all states' growth and economic efficiency will be maximized (Blake and Walters, 1976: 5-8).

Blackhurst et al. (1977: 21-29) classified the possible benefits from trade liberalization into consumption gains, production gains, economies of scale, gains from a more competitive domestic economy, and a contribution to domestic price stability. Whereas the first three constitute the basic motivation for the pursuit of freer trade, the latter two are *fringe benefits* in the sense that they contribute to the achievement of goals that are being pursued principally through policies other than trade liberalization. It needs to be emphasized, however, that the following discussion presents the theoretical advantages of the liberal trading system, which are not necessarily reflected in reality.

1. *Consumption Gains:* As reduced tariffs will result in lower prices, all consumers will profit. Part of this gain represents a transfer from the beneficiaries of the artificially high price, generally domestic producers of the product, including the national treasury, if a tariff was involved.
2. *Production Gains:* At the same time, inefficiently produced domestic output is replaced by imports, permitting the reallocation of some domestic resources away from low productivity industries into more productive employment in those industries in which the country has a competitive advantage.
3. *Economies of Scale:* In addition, trade liberalization enlarges the market in which each country's tradeable goods industries compete, resulting in the opportunity to gain from the cost reductions that, under certain circumstances, accompany increases in the scale of operations.
4. *Gains from a More Competitive Domestic Economy:* The enlargement of the market via trade liberalization brings important benefits through its impact on the degree of competition between foreign and domestic firms in the domestic market. This seems to be particularly true for those industries in which efficiently sized firms are so large in relation to the domestic market that there are only a few firms in each country, forming an oligopolistic industrial structure. Free trade can prevent the disadvantages of protected oligopolistic industries, such as artificially high prices, low quality, and sluggish response to changes in consumer preferences. For example, American consumers are now able to buy higher quality cars at a cheaper price from Japan or South Korea than that offered by American automobile manufacturers. Given the increasing influence of multinational corporations, this argument may no longer be true.
5. *Contributions to Price Stability:* Trade liberalization can also be a very useful adjunct to the basic economic policy package. Lower prices as a result of tariff reductions will have a one-time beneficial effect on the wholesale and consumer prices indices. In addition, in the presence of

effective competition from foreign producers, and a credible commitment by the government to liberal trade, there will be a parallel restraint on both prices and wages.

2.4 *The Years of the American Hegemony*

The theory of free trade furnished powerful and convincing arguments for the establishment and justification of a free international trade system. But more important than these theoretical underpinnings were the economic gains the American industry enjoyed from the free trading system. In fact, the American postwar trade policy was shaped by attention to its dominant industries: steel, chemicals, automobiles, rubber, and electrical machinery. Stability and predictability, to ensure that fixed costs could be recovered, were the only principles of public policy necessary to encourage investment. In nearly every industry, therefore, free trade promised nothing but expanding American exports. Thus, accepting the principle of free trade was painless. But in the two cases where it would have called for substantial immediate adjustment on the part of significant economic groups in the U.S., such as textiles and agriculture, the principles were abandoned. These early departures from the ideal, according to Reich (1983: 780), foreshadowed its widespread breakdown today. Therefore, the postwar trade regime was appropriate to its time, an era of unprecedented mass consumption of standardized goods. Throughout the 1950s and 1960s the American economy grew less by innovating than by expanding the scale of its basic production processes and thus reducing unit costs. It was, as Blake and Walters (1976: 14) put it, *tailor-made* for the American interests.

During first two decades after its initiation, the GATT structure succeeded reasonably well because all parties (except for the less developed nations) had a stake in making the system work and therefore sharing in the American-led prosperity. This economic prosperity contributed to the political stability after WWII. In addition, a shared perception of threat from the Communist world

made advanced industrial states in the West relatively content to defer to Washington for reasons of security policy. Due to primacy of security concerns as well as the obvious dependence of Western states upon American capital and production to reestablish their economic health, there was little incentive to challenge the postwar economic order (Blake and Walters 1976: 13-4).

The prediction made by the liberal trade theory about the stimulating effect of free trade on economic growth and development seemed to be correct. Balassa (1978: 411-3) reported that between 1953, the first "normal" postwar year, and 1960, when the tariff reductions in the EEC and EFTA began to be felt, the export volume of the industrial countries increased at an average annual rate of 7.0 percent, while their combined GNP rose by 3.6 percent a year. During the same period of time, the industrial countries' imports of primary products from the developing countries increased at an average annual rate of 5.1 percent, exceeding the GNP growth of the industrial countries by about one-half, with even larger increases shown in regard to manufactured goods.

This trend continued and even accelerated after 1960, when trade liberalization in the framework of Western Europe, the Dillon and the Kennedy rounds, the integration of Western Europe, and the adoption of export-oriented policies in several developing countries gave added impetus to world trade. The exports of the developed countries rose at an average annual rate of 8.8 percent between 1960 and 1973, the last year before the quadrupling of oil prices and the world recession, exceeding the growth of their combined GNP, estimated at 4.8 percent a year, by a considerable margin. At the same time, their imports from developing countries averaged at 7.2 percent a year. Therefore, the rapid expansion of foreign trade contributed to economic growth in the developed countries during the postwar period. This growth, in turn, was transmitted to the developing countries through trade (Balassa, 1978: 413).

2.5 Forces of Change: The GATT System under Attack

During the 1970s, however, trade accords became progressively less coherent or conclusive because the premises on which the postwar free-trade ideal had been founded were no longer applicable to large segments of industrialized countries. In this section, I am going to analyze the developments which challenged the liberal trade system and caused the reemergence of protectionism. I shall distinguish between three different categories of developments: political factors, changes in the global economic system, and changes in the industrial structure of national economies. Most of these developments are a direct or indirect result of the decline of the American hegemony.

2.5.1 Political Factors

As pointed out previously, Blake and Walters (1976: 15/6) emphasized the importance of the cold war in causing the Western industrial nations to defer to Washington for security reasons. However, as a limited detente between the superpowers gradually superseded their intense cold war postures, intra-Western conflicts of interest previously subordinated to the dictates of alliance cohesion began to emerge. Conflicts arose over appropriate security policy and the desirability of continued dependence upon the U.S. in this domain.

At the same time, politicians and economists became increasingly concerned about the dangers and disadvantages of economic interdependence, which resulted from the liberalized international trade system. Politicians began to question whether further trade liberalization could yield worldwide welfare benefits commensurate with the costs of added insecurity and instability of economies, especially the vulnerability to "imported" macroeconomic disturbances. They also began to recognize that the scope and independence of national economic policies were becoming increasingly de-

pendent on the decisions of other industrialized countries or on the outcomes of international negotiations or summits (Jackson, 1978: 94).

2.5.2 Changes in the Global Economic System

During the 1960s, Japan and Western Europe became economically strong enough to challenge the American hegemonic position. Since 1958, the EEC has established a customs union, with free internal trade in manufactured products, a common external tariff on these goods, and a common agricultural policy. It constitutes a dynamic and powerful trading bloc, whose trade with the rest of the world has grown more rapidly than with the U.S. Equally important has been the rise of a highly competitive Japan as a force in world trade. In the 1970s it became the second largest developed economy after the U.S. and a trading power on a par with West Germany.

Another crucial challenge to the world trade management was the breakdown of the monetary system. The problems of the monetary system after 1967 led to various trade measures designed to protect payment balances that were weakening the norms of the GATT system. It also complicated the process of trade negotiations. Whereas under a fixed exchange rate system negotiators were able to estimate the impact of agreements on their trade and payments, under floating rates such calculations became more difficult. In fact, the problem of floating rates linked trade and monetary negotiations and therefore complicated both (Spero, 1985: 103). As further analysis will show, the adoption of floating exchange rates constitutes a major cause of distortions of trade balances and the resulting trade conflicts.

The international trade system also suffered under the recession and inflation period of the 1970s and 1980s. Whereas the postwar trade management took place during a period of unprecedented

growth and stability, inflation and recession have contributed to the emergence of protectionist pressures (Jackson, 1978: 93-4).

2.5.3 Shifts in the Industrial Structure.

A third important development was the shifting nature of production and comparative advantage world-wide. Changes in factor endowments led to the altered competitive positions of several industries in the developed countries, including autos, steel, textiles, shipping, petrochemicals, and consumer electronics. And the pace of this structural change was dramatic. Spero (1985: 100) argued that lags in capital investment in the developed countries plus rising labor productivity, lower labor costs, and aggressive export strategies in some of the LDCs (Less Developed Countries) led to a shift in comparative advantage toward newly industrialized countries like Taiwan, Korea, Brazil, and certain developed countries like Japan. Reich (1983: 782-8) emphasized that skilled labor has become the only dimension of production where advanced industrialized nations can create and retain a significant advantage. Therefore, comparative advantage is a matter of developing and deploying human capital. He compared the international economy to a mill wheel, which drives the process of structural change in each national economy, pushing each into higher value-added production, and generating, ultimately, an ever richer world. These shifts to higher-value production represent, according to Reich, a positive-sum game, whereas efforts to preserve the status-quo, to protect declining, less competitive industries, represent zero-sum efforts.

These structural transformations, however, cannot proceed smoothly and create problems of adjustment in declining industries. These problems, in turn, often give rise to efforts to reduce the speed of adjustment, especially if the adjustment is assumed to have been triggered by increased imports. Blackhurst et al. (1977: 45) reported that numerous economic indicators point to the late

1960s as the historical turning point at which long established growth trends began to change and a general difficulty of adjustment began to be felt in advanced industrial economies.

2.6 *The Emergence of the New Protectionism*

All the developments introduced in the previous section contributed to the rise of the *new protectionism*. By the mid-1970s the steady progress toward lower protection reached a turning point. Balassa (1978: 422) characterized the *new protectionism* by the employment of non-tariff restrictions on trade, the granting of government aids to domestic industries, with further attempts made at organizing world trade. In addition, this protectionism is concentrated in a small number of industries, mainly textiles and apparel, steel, television sets, footwear, automobiles, agriculture, and shipbuilding. All these industries losing their competitive edge to the NICs (Newly Industrialized Countries) and are therefore lobbying for protectionist measures. *Old protectionism*, in contrast, involved the application of tariffs. Spero (1985: 114) reported that from 1975 to 1977, new restrictions were applied from 3 percent to 5 percent of world trade flows, with an annual value of \$30 billion to \$50 billion. By 1980, an estimated 48 percent of the world's trade was managed, that is, subject to some non-tariff control by exporter, importer, or both. In manufactures, which account for 40 percent of world trade, it has been estimated that the ratio of managed to total trade rose from 13 percent in 1974 to 30 percent in 1982.

Table 1 on page 78 indicates that in the period of 1973 and 1984, industrial countries significantly increased the number of major NTBs to protect their declining industries from fierce international competition. The introduction of NTBs by several countries to protect the steel and footwear industry in 1977 marked a change in the trade policy of these countries. During this period, Japan was the only major industrialized country not to introduce any NTBs, presumably because her in-

dustries were already protected, whereas it was the major target of these trade restrictions. Among the other nations, France and the United Kingdom introduced the highest number of NTBs, whereas Canada introduced the lowest number of NTBs.

By 1983, France had the highest NTB coverage ratio with 57.1 percent, followed by the United States (43.0 percent), and Finland (34.9 percent). It is surprising to find the U.S., the former hegemon and founder of the free trade system, among the countries with the highest coverage ratios. This could be a result of its declining industrial competitiveness or its domestic political processes, which foster the implementation of protectionist policies; further analysis will have to decide on this question. In comparison, Japan's NTB coverage for all of the listed industries is below the average, with no NTBs for iron and steel, electrical machinery, and vehicles. This can be considered as a result of her superior competitive position as well as the international pressure on her to open her market to foreign products. Although, it might be possible that these industries are protected by covert, nonmeasurable trade barriers. The industries with the highest coverage ratio were textiles (44.8 percent), agriculture (36.1), iron and steel (35.4), and vehicles (30.4). These are the industries which are facing the fiercest international competition and at the same time possess the biggest political influence (see Table 2 on page 79).

2.6.1 An Evaluation of the New Protectionism.

As indicated above, the nature of the measures applied by the *new protectionism* were inherently different from tariffs, the primary instrument of the *old protectionism*. The following analysis will evaluate the costs inherent in the instruments by which protection is provided. The costs rise with the degree of distortion they cause in the price system. According to their costliness to the national economies, the various means of protection can be ranked as follows (Balassa, 1978: 422-24; Tumlrir, 1985: 7-9):

1. A *subsidy* granted to the import competing industry minimizes the overall cost of protection. It will give the subsidized industry a comparative advantage, but leave prices unchanged.
2. A *tariff* is an instrument of the market economy. It allows the domestic price of the protected product to exceed its international price by a given magnitude or proportion. But tariffs do not inhibit shifts in trade patterns in response to changes in comparative advantage that are reflected by changes in relative costs.
3. A *global quota* fixes the physical amount of the commodity that is allowed to be imported. It therefore, like all other non-tariff measures, interferes with the operation of the market mechanisms by restricting consumer choice and limiting competition between domestic and foreign producers. As a global quota is nondiscriminatory, it does not worsen the importing country's terms of trade. However, maintaining historical market shares in the allocation process discriminates against new exporters and is influenced by the bargaining power of the exporting countries. This process generally favors larger countries over smaller ones.
4. A *quota subdivided by negotiation* to particular exporting countries encompasses all the costs of a global quota and, in addition, raises the external cost of the imports that it restricts. This is due to the fact that the negotiated quotas suspend the competition between the exporting countries by taking away any incentive to produce below the wholesale price of the importing country. A special case of negotiated quotas are those subdivided by the supplying companies, such as voluntary export restraints (VER) or orderly marketing arrangements (OMA).
5. More or less comprehensive *multilateral sectoral arrangements* relying on restraints administered from the exporting side are the costliest form of protection. The world market for the product in question becomes virtually closed to new entrants. With actual as well as potential competition virtually eliminated, the rate of innovation in the sector subject to such an ar-

rangement will decline. The pricing system becomes paralyzed, no longer reflecting the true scarcity of the product.

Another form of the new protectionism are government aids to industry. Prior to the oil-crisis, government aids were used in the major European countries as well as in the U.S. principally in favor of the shipbuilding industry. Since the 1974-5 recession, however, government aids, often granted under the heading of *rationalization*, have come into greater use. They take a variety of forms, including direct subsidies as well as preferential tax and credit treatment. These aids will, if not applied carefully, protect weak industries that find it difficult to face foreign competition. The takeover of insolvent firms by the government, and the financing of their benefits as well as the deficits of other state-owned firms from public funds, will have similar effects. Apart from distorting competition, these government programs represent a further increase in the role of the state in the economy and extend the scope of bargaining. Also, government regulations concerning safety issues, product standards, or licencing can impede imports. Balassa (1978: 424) pointed out the danger of policy competition in the international arena. In recent years, a policy competition has emerged in the area of high-technology industries, which are considered strategic for the further development of a country's competitiveness and have therefore attracted special attention from politicians and policy-makers.

2.6.2 Theoretical Underpinnings of Protectionism

As protectionist pressures have increased, economists have tried to provide theoretical justifications for protectionism. In Britain, the *Cambridge Group* has provided theoretical justification for the protectionist attitude taken by the Labour Party. In the U.S., similar developments can be ob-

served.¹ This criticism of the traditional trade analysis is based on the recognition that its assumptions, such as the absence of externalities and public goods, the free availability of information, and the presence of markets for all goods and services, are no longer valid. In addition, the number of participants in some industries is small, and profit opportunities above and beyond the "normal" return to scarce factors of production are not ruled out, at least in the short run. Central to this approach is the question of whether changes in allocation of resources matter. Are there any *strategic* sectors in the economy, where labor and capital receive a higher return than they could elsewhere (Krugman, 1984: 14)?

One of the most prominent arguments used to defend protectionism is the *infant-industry argument*. The idea is that contemporary protection of an industry that could not concurrently compete with foreign and domestic rivals might be justified if the industry, because of the protection, would have a chance to grow, become more efficient and competitive. This argument was expanded on by Brander (1986: 32), who argued that, given a strategic industrial structure, if the domestic market is closed to foreign companies, the domestic firm will be able to raise its output in the domestic market, and due to economies of scale will be able to produce at lower costs and therefore even make profit in the foreign market. A closed domestic market allows the domestic companies to also move down faster on their *learning curves* than their foreign competitors. This policy is called *protection as export promotion* (Brander, 1986: 33). This policy constitutes a transfer of costs from the firm to the consumer. Brander claimed, however, that this policy, as it increases the competitive position of the domestic industry, will increase aggregate welfare.

This approach also argues that either import tariffs or export subsidies will improve national welfare. The effect of tariffs is that they raise revenue and that they increase the costs of foreign firms operating in the domestic market. This will result in a larger market share of the domestic industry at the expense of its foreign competition, which will again result in the advantages outlined above.

¹ For an overview of this discussion, see the contributions in Krugman (1986).

The reasoning for subsidies is similar. They will allow domestic firms to export more and move down their average cost curves, which causes domestic prices to fall and welfare to rise.

This approach constitutes a departure from multilateralism and sees international trade as a zero-sum game, where one country increases its welfare at the cost of others. It also does not consider a possible retaliation from, other countries, which would seriously challenge its assumptions and calculations and, in fact, make it a negative-sum game, where everybody will lose. Grossman (1986: 64-5) emphasized the problems that might arise out of the political and administrative processes involved in protectionist policies. It is likely that established industries would win out over emerging ones, those in politically contested regions of the country over those in areas clearly in the camp of one party or the other, and those that could most easily overcome the free-rider problem associated with industrywide lobbying campaigns over those that could not. In summary, the market failures in the political realm might easily outweigh those in the economic realm, leaving us with a set of strategic trade policies that would serve only the interests of those fortunate enough to gain favor.

2.7 Conclusion

It was the purpose of this chapter to outline and analyze the development of the international trade system over the last fifty years. The first important conclusion from this analysis is that the GATT system was never intended to be the legal or organizational framework of a liberal trading system under the leadership of the U.S. Rather, it constitutes an institution that assumed its function due to an historical accident. The survival of an international trading system, ironically, can be attributed to the U.S., the same country which was responsible for the failure of the ITO. This contradictory trade policy was an outgrowth of its domestic struggle between Congress and the

executive branch, a conflict that will be an important element in our further discussion of the American trade policy.

Despite the strong protectionist bias in Congress, for the first 30 years after WWII the executive branch was able to pursue a liberal trade policy. Despite the fact that the ITO was not implemented, the GATT system was very successful until the economic crisis of 1973-4. This success was largely due to the American hegemony, the influence it could bring to bear on the other Western industrialized countries. In addition, it proved to be an effective strategy for preserving American dominance in certain key industries and for linking strategic policy goals, such as the establishment of the NATO and the containment of the communist expansion, with its economic interests. It also reflected the existing consensus on the traditional economic theory, which strongly supported the establishment of a liberal trading system.

The analysis revealed that America played a crucial role in founding and extending the scope of the international trade system, and the system did appear strongest near the apex of American economic power, weaker as American power was waning (Lipson, 1983: 268). In fact, most of the developments that challenged the liberal trading system derived from the fact of the declining American hegemony: the shift in some comparative advantages toward the Newly Industrialized Countries in South-East Asia, the decline in its proportion of world trade, and the decline of its political influence in Western Europe and other industrialized countries. The analysis also suggests that the logic of regime maintenance may be distinct from that of regime initiation, that the costs of regime maintenance are lower than those of establishing a new regime. These lower costs of regime maintenance undoubtedly facilitated the transition to shared leadership within the existing framework. This might explain the fact that the trading system did not collapse despite the decline of the American hegemony.

The analysis also revealed that the specific measures of the *new protectionism*, which emerged in the 1970s, are fundamentally different from those of the *old protectionism*. By significantly increasing

the proportion of managed trade and by stimulating governmental intervention into international trade, these developments fundamentally altered the nature of the international trading system.

After all these developments and changes, is it still justified to speak of an international trade system? Analysts are in disagreement about the present status of the world trading system. Lipson contended (1983: 268) that most of the traditional regime norms other than nondiscrimination are still intact. Reciprocity, multilateralism, the right to safeguard against import surges, and the goal of liberalizing trade barriers are still the basic tenets of modern trade relations. However, the changes within the regime, concerning its rules and shared expectations, were extensive. These changes have been largely due to the rise of the *new protectionism*, especially the introduction of nontariff barriers and the increasing application of sectoral or product specific arrangements. Krasner (1979: 527-8) concluded that neither empirical evidence nor opportunity cost comparisons suggest that the international trading order is a disequilibrium system in which restrictions from the one area invariably lead to restrictions in others. However, he cautioned that in a multipolar world, even if all major actors support an open system, they may not be able to achieve the level of policy coordination necessary to generate the resources needed to preserve the system. Thus, the international trading system may continue, but it may also radically change. Reich (1983: 278), on the other hand, concluded that the free-trade ideal has become hopelessly inadequate for guiding the new economic and industrial shifts, international economic agencies and formal trade processes sponsored by the U.S., which have been gradually bypassed and enfeebled. Only the easiest disputes are settled within the GATT system, whereas most major issues of global economic change are dealt with outside.

What we were observing over the last 10-15 years were severe changes in the nature of the international trading system. The most important development was the decline of the American hegemony and the emergence of multilateralism. The decline of the American hegemony as well as the economic crisis of the mid-1970s and changes in perception resulted in the rise of a new protectionist wave, which significantly altered the nature of the international trading system. What

are the implications for the analysis of the outcomes of the trade disputes between the U.S. and Japan? It can be concluded that a systemic explanation which takes into consideration the international power structure can account for the broad changes in the international trading system, whereas we need to apply other approaches to account for a more detailed and precise analysis of the emergence of the new protectionism, namely the underlying political processes in the major trading powers. This analysis suggests that changes in the international trade system no longer justify an exclusive focus on the systemic level. Rather, these developments necessitate the expansion of the analytical focus, the inclusion of an analysis of bilateral trade relations and domestic political processes. It will be the purpose of the following chapters to first analyze the the development of the United States multilateral as well as bilateral trade deficits, and then to develop an analytical framework for the actual analysis of the outcomes of the trade disputes between the U.S. and Japan.

3.0 Macroeconomic Policies and the Trade Conflicts

The purpose of this chapter is to analyze the development of the trade deficit between the U.S. and Japan and its causes over the last two decades. In the first section, I shall analyze the growth of the trade gap between the two countries. In the second section, I shall introduce the econometric research that tried to explain the growth of the trade deficit over the last years. This research established that the growth of the trade gap can be fully explained by macroeconomic policies, by changes in the exchange rate and the rate of economic growth. The research also established that these macroeconomic policies and the resulting exchange-rate misalignments are the dominant cause for triggering and intensifying the outbreaks of trade conflicts between the U.S. and Japan.

3.1 Analysis of U.S.-Japanese Trade Balance

The U.S. had a multilateral trade deficit in every year since 1975, and this deficit has increased in most of the years from 1975 through 1984. The decline of the trade deficit accelerated significantly after 1982 as a result of the United States' domestic imbalance between the resources available from savings and resources used for private investment and government deficits. Net imports of goods and services and capital inflows were needed to fill this gap. A soaring trade deficit was the almost inevitable result of Reagan's economic policy of macroeconomic stimulation and increased government expenditures (see Figure 1 on page 75).

A look at the United States' bilateral trade balances reveals that it enjoyed a positive trade balance with the EEC until 1983, whereas it has had a bilateral trade deficit with Japan since 1965. This deficit increased in most of the years from 1965 through 1985. In 1984, its trade deficit with Japan was more than three times the size of its deficit with all the countries from the EEC together, accounting for almost 50 percent of its multilateral trade deficit (see Figure 2 on page 76).

However, when the change in the bilateral trade balance is viewed in relation to each country's bilateral trade turnover with the U.S. in 1980-81 and in 1984, many countries have a larger relative increase than Japan. Table 3 on page 80 indicates that the median increase in the bilateral surplus with the U.S. was 28.9 percent of bilateral trade turnover, while the increase for Japan was 17.6 percent. This comparison suggests that Japan's high visibility in U.S. political concern over the trade deficit stems primarily from the large scale of Japan's trade and the economic as well as political importance of the affected industries, such as automobiles or electronics, and from the public image of Japan as unfair in its trading practices, rather than from any exceptional percentage rise in its bilateral surplus with the United States. Moreover, the data show that Japan is only one of many major trading nations with similar trends in trade with the United States. This pattern suggests that the problem of large U.S. deficits is far broader than a bilateral U.S.-Japan problem.

Indeed, the most striking figure in this table is that, while the median country has increased its global nonoil trade balance from 1980-81 to 1984 by 5 percent of turnover, the U.S. balance has declined by 22 percent. This development suggests that the improving trade balances of most major trading countries from 1980 to 1984 were primarily the mirror image of a soaring U.S. deficit.

3.2 Macroeconomic Policies and Political Tensions

The soaring U.S.-Japanese trade deficit has stimulated a considerable amount of research. This research indicates that the entire increase in the U.S.-Japanese trade deficit from 1980 to 1984 can be fully explained by changes in the exchange rate and the rates of economic growth. There seems to be little if any room left to attribute the rising deficit to increased protection in Japan. At the same time, however, there is also no indication of any impact from Japanese trade liberalization during this period (Bergsten and Cline, 1985: 46). In other words, America simply priced itself out of the markets through the enormous rise in the value of the dollar vis-a-vis the yen. According to Bergsten (1987: 11), by late 1984 or early 1985 the dollar had become overvalued by about 40 percent compared with the underlying competitive relationship between the U.S. and the rest of the world.

The exchange rate misalignments were the result of opposite directions of economic policy in the two countries. By the beginning of the 1970s, the parities of the dollar and the yen -- which had been set in 1933 and 1949, respectively -- were clearly out of line with the underlying economic relationships between the U.S. and Japan and the rest of the world. With the onset of the U.S. inflation from the mid-1960s, stemming from the Vietnam War and simultaneous expansion of Great Society programs, the dollar became substantially overvalued. With the dramatic expansion of economic capacity and productivity in Japan, the yen became substantially undervalued. These

results began to accumulate in 1968-69 and accelerated rapidly until 1971 to the first postwar crisis in the economic relationship between the U.S. and Japan.

In 1973, even before the onset of the first oil crisis, Japan had returned to a global balance and the United States to a modest surplus. The bilateral merchandise account, on which the oil shock had little direct impact, returned during 1973-75 to the much lower levels of 1969-70. In 1975-76, however, a renewed exchange-rate misalignment began to develop. The dollar appreciated substantially during that period, though the U.S. account surpluses, which triggered the appreciation, were due primarily to the depth of the U.S. recession, which was far sharper than in Japan or other major industrialized countries. Meanwhile, Japan intervened massively in the foreign exchange markets throughout 1976 to block significant strengthening of the yen. This result was a renewed undervaluation of the yen and massive Japanese surpluses in 1977-78 -- including a fivefold rise in its bilateral trade surplus with the U.S. This development triggered the outbreak of another wave of major U.S.-Japanese tensions in 1977-78 (Bergsten, 1982: 1066-7).

After the Carter administration successfully convinced the Japanese government to let the yen rate respond to market forces, the U.S. trade balance improved, and the tension between the two countries decreased. However, with the policy mix of the Reagan administration, the dollar became significantly overvalued. It sharply increased the budget deficit, which, along with a return of private investment to normal levels without any substantial increase in domestic savings, has raised interest rates and the international value of the dollar. Japan, however, has been reducing its budget deficits, which until the early 1980s had soaked up most of the excess of the private sector, creating a sizable surplus of savings and pushing capital abroad. Moreover, recent policies adopted by the two countries, which aim directly at international capital flows, have made the yen-dollar problem worse. Japan's speeding of the liberalization of its capital markets, pushed by the U.S. during 1983-4, has increased capital outflow from Japan and thus has weakened the yen further. American elimination of its withholding tax on interest payments to foreign investors in U.S. Treasury secu-

rities, and Treasury's subsequent tailoring of its securities to the needs of such investors, further increased financial investments in the dollar (Bergsten and Cline, 1985: 7-8).

A closer examination of the trade deficit reveals that in 1981, U.S. imports rose briskly as a result of substantial appreciation in the real value of the dollar in relation to the yen in both 1981 and 1980. In addition, U.S. income growth and industrial expansion in Japan boosted imports as well. In 1982, the further real appreciation of the dollar in relation to the yen would have meant a major increase in imports if nothing else had happened, but the severe decline in U.S. cyclical demand and GNP level reduced potential import demand and neutralized the upward pressure from a strengthening dollar. By 1983 and especially 1984, however, the ongoing import pressure from dollar appreciation was augmented by a boost of import demand from U.S. domestic growth and return to a high cyclical level of activity. Although there was a moderating effect on U.S. imports in 1984 from Japan's cyclical recovery, the strong expansion in Japan's industrial capacity in 1984 more than offset this influence.

Based on their econometric model, Bergsten and Cline (1985: 48-9) estimated that an ongoing negative trade balance will exist even when both countries are in overall equilibrium. This *normal* bilateral trade deficit ranges from \$20 billion to \$30 billion, whereas its trade deficit with the rest of the world would disappear entirely. Bergsten (1987: 16) estimated that a rate of 160 yen to the dollar would be approximately correct for achieving global equilibrium for the U.S. and Japan, if all other currencies were to move proportionally. The inherent negative U.S.-Japanese trade imbalance is due to the fact that Japan, as a country scarce in resources, relies heavily on imports of oil and other raw materials and exports of manufactures to pay for them. This fact is especially emphasized by Japanese analysts. Hosomi (1978: 141-4) pointed out that in 1976 Japan imported 100 percent of her crude oil, iron ore, cotton, wool, bauxite and gum rubber. In the absence of these raw materials, Japan is destined to be a processing nation. Another Japanese observer described the fact that Japan is almost totally devoid of natural resources as being the reason for Japan's *vulnerability complex* (Nukazawa, 1980: 470). He characterized the skillful management of this

complex as the essence of effective government in Japan. In fact, over the last decades, Japan has been very effective in converting this *vulnerability complex* into an aggressive industrial policy aimed at developing and exploiting foreign markets. Much to the chagrin of its *victims*, who over the last 20 years were beginning to limit Japanese access to their markets.

This research was supported by Haynes et al. (1986, 1986a), who reported that during the 1960s and 1970s U.S. manufacturing exports to Japan and U.S. manufacturing imports from Japan were highly sensitive to exchange rate movements. However, from the beginning of the 1980s this has no longer been true: U.S. imports from Japan were unresponsive to exchange-rate changes. They explain this development with the fact that Japanese imports have been subject to several market restraints. These restraints inhibited Japanese exporters from exploiting their competitive edge. A second explanation for incomplete passthrough, as economists characterize this phenomenon, is that the U.S. would probably retaliate with further restrictions if Japanese exporters *passed through* the whole of the yen depreciation in the form of lower dollar prices in order to increase their market share. Instead, Japanese exporters quietly adopted a strategy of streamlining their operations to be efficient and profitable even if their currency strengthens to 200 yen to the dollar. This behavior was supported by statements from MITI officials as well as from executives of McKinsey and Company, Sony, Victor, and Fujitsu. Therefore, even if there is a significant increase in the dollar price of Japanese imports, the volume of imports will not decline as long as the restraints are effective. Only when the appreciation of the yen has reduced the U.S. demand for Japanese goods below the point at which restraints are effective will it be possible for the volume and thus the value of these imports to decrease.

3.3 Conclusion

The review of the econometric research revealed that the misalignment of the dollar-yen exchange rate and the rates of economic growth in both countries fully explain the bilateral trade deficit. This research also established that there is a close correlation between the exchange rate misalignment and the resulting trade deficit and the frequency and intensity of the economic tension between the two countries. The exchange rate misalignment were the result of the opposite directions of the economic policy in the two countries. These economic determinants therefore set the framework for the analysis of the outcomes of the trade conflicts. They represent the dominant cause of the trade conflicts. But within this framework, analysts have forwarded several approaches that might account for additional variance in the outcomes.

4.0 Determinants of the U.S.-Japanese Trade Conflicts

Within the framework of the macroeconomic determinants of the economic tensions between the two countries, analysts have forwarded several approaches that might account for additional variance in the outcomes. It is the purpose of this chapter to develop, based on these approaches, an analytic framework for the subsequent analysis of the outcomes of U.S.-Japanese trade conflicts. This framework represents an attempt to systematically analyze the outcomes of the various U.S.-Japanese trade conflicts, which constitute the dependent variable of this analysis. In this context, interstate conflicts, and trade conflicts in particular, are typically understood as a sequence of actions in which governments take or threaten to take actions that would cause harm to one or more other states.² The variance in the conflict outcomes will be explained by three approaches. The first one accounts for the influence of the international trade system, the second for the political influence of the American industry on the conflict outcomes, and the third for the political influence of the Japanese industry on the conflict outcomes.

² A precise definition of interstate conflicts will be given in the next chapter.

The first approach is based on the relative decline of the U.S. hegemonic position. For this purpose, I shall introduce the concept of *international regimes* and the hegemonic theory of regime change, which dominates the American international politics literature. The theory of hegemonic stability seems to offer a good explanation of regime foundation and the era of hegemonic domination. However, for the analysis of the more recent development of the trade regime, the rise of multilateralism and the emergence of protectionism, we will need to expand our analytical tools. This will be the purpose of the second section, where I shall introduce *public choice theory*, as well as other theories accounting for the influence of industries affected by international competition and interest groups on the domestic trade policy-making process. The third approach is based on the Japanese trade policy-making process, that is, the effects of the political influence of affected industries on the outcomes of the various trade conflicts. I shall conclude the discussion of each approach by proposing a set of hypotheses which will be tested in the subsequent analysis.

4.1 International Regimes: International Power

Structures

4.1.1 Defining and Identifying International Regimes

The concept of *international regimes* was first introduced by John Ruggie into the international politics literature in 1975. He defined a regime as "a set of mutual expectations, rules and regulations, plans, organizational energies and financial commitments, which have been accepted by a group of states" (1975: 570). More recently, a collective definition, worked out at a conference on the subject, defined international regimes as "sets of implicit principles, norms, rules and decision-

making procedures around which actors' expectations converge in a given area of international relations" (Krasner, 1983: 2). In this definition, principles represent beliefs of fact, causation, and rectitude; norms standards of behavior defined in terms of rights and obligations; rules specific prescriptions or proscriptions for action; and decision-making procedures prevailing practices for making and implementing collective choice.

Krasner distinguished between principles and norms on the one hand, and between rules and procedures on the other. As principles and norms provide the basic defining characteristics of a regime, changes in principles and norms constitute changes of the regime itself; when they are abandoned, there is either a change to a new regime, or the regime disappears. Changes in rules and decision-making procedures, on the other hand, represent changes within regimes, as there may be many rules and decision-making procedures that are consistent with the underlying principles and norms. A regime is weakening if the principles, norms, rules, and decision-making procedures become less coherent, or if actual practice is increasingly inconsistent with them (1983, 3-5).

Keohane pointed out the difficulty of distinguishing sharply between norms and rules, of telling the difference between an *implicit rule* of broad significance and a well-understood, relatively specific operating principle. As rules, norms, and principles are so closely interlinked, judgments about whether changes in rules constitute changes of regimes or merely changes within regimes necessarily contain arbitrary elements. He therefore developed the notion of *injunctions*: principles, norms, rules, and procedures all contain injunctions about behavior. They prescribe certain actions and proscribe others. Regimes consist of injunctions at various levels of generality. Some are far-reaching and extremely important. They may change only rarely. At the other extreme, injunctions may be merely technical, matters of convenience that can be altered without great political or economic impact. In-between are injunctions that are both specific enough that violations of them are in principle identifiable and that changes in them can be observed, and sufficiently significant that changes in them make a difference in the behavior of actors and the nature of the international political economy. For Keohane, only the intermediate injunctions, which are politically conse-

quential but specific enough that violations and changes can be identified, are the essence of international regimes, and help the analyst to identify major changes that require explanation (1984: 59-64). Even this definition does not clarify the concept of international regimes. The confusing discussion concerning this definition represents the initial stage the international politics literature is still in.

Krasner (1983: 5-10) introduced several approaches of how international regimes are used by international politics analysts.³ In the simplest meaning, regimes represent intervening variables standing between the basic causal variables, such as power and interests, and outcomes and behavior. According to this model, regimes do not arise of their own accord, are not regarded as ends in themselves, but once in place, they do affect related behavior and outcomes. This approach is represented by adherents of a structural realist orientation who see regimes as a phenomenon whose presence cannot be assumed and whose existence requires careful explanation. According to this view, regimes can have an impact when Pareto-optimal outcomes can not be achieved through uncoordinated individual actions of nation-states.

For adherents of a Grotian worldview, regimes constitute a pervasive and significant phenomena of the international system. For them, regimes exist in all areas of international relations, even those that are internationally looked upon as examples of anarchy. According to this view, patterned behavior which reflects calculations of interest tends to lead to the creation of regimes, and regimes reinforce patterned behavior (Puchla and Hopkins, 1983; Young, 1983).

³ For the discussion of these different approaches see the contributions in the spring issue of *International Organization* of 1982, later also published in Krasner (1983).

4.1.2 The Theory of Hegemonic Stability

In the past decade, the theory of hegemonic stability has become the conventional explanation of regime creation, persistence, and dissipation. Its major proponents are Charles P. Kindleberger (1973, 1976, 1981), Robert Gilpin (1973, 1975, 1977), and Stephen Krasner (1976, 1979). According to this theory, strong international regimes depend on hegemonic power; fragmentation of power between competing countries leads to the fragmentation of international regimes, whereas the concentration of power contributes to stability. In his analysis of the depression of the 1930s, Kindleberger (1973) argued that for the world economy to be stable, it needs a stabilizer, some country that would undertake to provide a market for distress goods, a steady if not countercyclical flow of capital, and a rediscount mechanism for providing liquidity when the monetary system is frozen in panic. In 1981, he added that the world leadership must also manage, to some degree, the structure of foreign-exchange rates and provide a degree of coordination of domestic monetary policies.

Kindleberger's strong claim for the necessity of a single leader rested on the theory of collective goods. He considered international regimes as public goods, whose benefits can be consumed by all participants: the hegemonic power will gain the ability to shape and dominate the international environment, while relatively small participants will attempt to secure *free rides* by avoiding proportionate shares of payment.

In political terms, the provision of the world public good of economic stability is best provided, if not by a world government, by a system of rules. However, it is difficult to obtain agreement on an adequate system of such rules or the means for enforcing them. This suggests that any international economic organization based on functional rules and institutions is likely to break down. In Darwinian fashion it will be replaced by a system in which one nation serves openly or covertly as leader and is accepted as legitimate in this role by its readiness to bear a disproportionate share of the cost of providing stability, as other countries take a free ride (Kindleberger, 1976: 37-8).

Criticizing this analysis, Keohane emphasized that in the postwar period many of the important goods provided by the U.S. were not collective at all. Loans and oil supplies could be distributed to selected recipients; countries that did not behave in ways considered acceptable by the United

States could be excluded. The principle of reciprocity in trade policy, for example, meant that countries refusing to follow the GATT rules and to liberalize their trade restrictions could be prevented from enjoying access to the huge American market on favorable terms. Therefore, much of what the United States offered was arranged in ways designed to avoid rewarding free riders (1984: 180). In addition, in international economic systems a few actors typically control a preponderance of resources. And, as Olson's original purpose of his *Theory of Collective Action* was to show, in systems with only a few new participants these actors can provide themselves with collective goods without relying on any positive inducement apart from the good itself (1965: 33). Therefore, hegemony should not be a necessary condition for the emergence of cooperation in an oligopolistic system.

The theory predicts that the more one such power dominates the world political economy, the more cooperative interstate relations will be, and as the distribution of these resources becomes more equal, international regimes should weaken. It therefore constitutes a power-as-resources theory, which attempts to link tangible state capabilities to behavior. It is, in its simplest form, what James G. March called a *basic force model* in which outcomes reflect the potential power of actors (March, 1966). A more refined version of the hegemonic stability theory does not assert this automatic link between power and leadership. Rather, hegemony is defined as a situation in which "one state is powerful enough to maintain the essential rules governing interstate relations, and willing to do so" (Keohane and Nye, 1977: 44). Here, decisions to "activate" the posited relationship between power capabilities and outcomes are necessary. This puts it into the category of what March called *force activation models* (March, 1966). Although the basic force models typically fail to predict accurately particular political outcomes, in part because differential opportunity costs often lead competing actors to use different proportions of their potential power, they offer clearer and more easily interpretable explanations than the latter models. In fact, force activation models are essentially post hoc rather than a priori, since one can always *save* such a theory after the fact by thinking of reasons why an actor would not have wanted to use all of its available potential power (Keohane, 1980: 137-8; 1984: 34-5).

In his analysis of three issue areas, oil, money, and trade, Keohane (1980) revealed that eroding U.S. hegemony helps to account for political reversals in petroleum politics, to a lesser extent for the disintegration of the Bretton Woods international monetary regime, and to a still lesser extent for the continuing decay of the GATT-based trade regime. He therefore concluded that the empirical evidence for the general validity of the hegemonic stability theory is weak. The prospect of discord created incentives for cooperation; and at least in money and trade, international regimes have been sufficiently well developed to facilitate a good deal of cooperation -- certainly more than would have been predicted by the theory of hegemonic stability alone.

Keohane explained this by the fact that once international regimes are established, they begin to benefit from the relatively high and symmetrical level of information that establishment generates, and from the ways in which it makes regime-supporting bargains easier to consummate. International regimes should be considered as information-providing and transaction cost-reducing entities rather than as quasi-governmental rule-makers. Thus, even if the hegemon loses its dominant position and power becomes more diffused among the members of the regime, making problems of collective action more severe, this disadvantage might be outweighed by the agreement-facilitating effects of the regime. In addition, just as in the contemporary world political economy there are many issue-areas as well as multiple contacts among governments, governments belong to many regimes. Therefore, disturbing one regime does not merely affect behavior in the issue-area regulated by it, but is likely to affect other regimes in the network as well. For a government to rationally break the rules of a regime, the net benefits of doing so must outweigh the net costs of the effects of this action on other international regimes as well (Keohane, 1984: 100-6).

Stein (1984: 338-9) concluded that the international trade regime did not emerge from the policies of one state, but that it is rather the product of tariff bargains: the hegemon must get others to agree to lower tariffs; without agreements, there can be no regime. Therefore hegemons may lead, but

they need followers. In order to gain followers, hegemons need to make concessions: they do not impose openness, they bear its cost.

He also introduced the *hegemon's dilemma*, which confronted Great Britain in the 19th century and the United States in the 20th: to maximize one's own returns requires a commitment to openness regardless of what others do. To maximize one's relative position, on the other hand, calls for a policy of continued protection irrespective of others' policies. Each strategy is dominant, maximizes returns, but according to a different decision rule: choosing to maximize absolute returns means that others will gain more, and therefore, that the hegemon undercuts its relative position; choosing to maximize relative returns, on the other hand, means that the hegemon gives up the possibility of greater absolute wealth (1984: 384). Therefore, as predicted by the *force activation model*, the hegemon is faced with a crucial political decision. Both Great Britain and the U.S. decided in favor of a liberal trade regime, which caused their relative economic decline.

Aside from the empirical adequacy of the theory, I would characterize this theory as very ethnocentric, emphasizing the importance and responsibility of the U.S. Strange (1983: 340) pointed out that the concern with international regimes is very much an American academic fashion, whereas European analysts focus on questions of moral philosophy or on questions of historical interpretation. For European analysts, the question of hegemonic decline seems to arise partly from an original overestimation of America's capacity to remake the whole world in the image of the United States and to maintain the bulwark of capitalism. In addition, Americans often seemed to exaggerate the economic and political *shocks* of the 1970s. As Strange put it (1983: 340), to non-American eyes there is something quite exaggerated in the weeping and wailing and wringing of American hands over the fall of the imperial republic. Nobody else saw the pre-1971 world as being quite so stable and ordered as the Americans did. And, although there is the nuclear parity of the Soviet Union and the depreciated value of the dollar in terms of gold, of goods, and of other currencies, the U.S. still dominates the security policy of the West and money markets in the U.S. still lead and others still follow.

The second criticism I would like to raise focuses on the value bias of this approach. Krassner's common call was for international order -- not justice or efficiency, nor legitimacy or any other moral value. This approach does not raise questions of economic and political dependency, of enhancing national identity and freer choice, although these questions over the last few years were raised frequently in the defense of protectionist measures in the U.S.

Can the theory help us to analyze the outcomes of the U.S.-Japanese trade conflicts? The previous discussion revealed that the theory in the area of international economic relations is still in its initial stages. However, it offers a starting point, a basic orientation. The theory of hegemonic stability seems to offer a good explanation of regime foundation and the era of hegemonic domination. For the analysis of the more recent development of the trade regime, the rise of multilateralism and the emergence of protectionism, we will need to expand our analytical tools. In summary, the hegemony argument holds that as the hegemon's relative global position slips substantively, the costs of defending free trade for all participants increase, and the hegemon is less able to capture the benefits for itself. Thus it loses its inhibitions against measures that would harm the trade of others. Therefore, as the U.S. position as hegemon is supposedly declining since the 1960s, we would expect the number of trade conflicts to increase over time. But at the same time, given the dependence of Japan on the United States' military protection of its own territory as well as serving as guarantor of supplying her with natural resources, the U.S.-Japanese relationship remains highly asymmetrical. Therefore we might expect a grossly unequal pattern of conflict outcomes, with the U.S. being able to impose its demands on Japan.

These considerations lead to the following hypothesis:

- The lower the U.S. hegemonic position, the higher the number of trade conflicts but not the more favorable the outcomes for Japan.

4.2 *U.S. Trade Policy Formulation*

In his analysis of U.S. trade policy, Pastor (1980: 192-4) identified the following pattern, which has repeated itself in every trade policy cycle since 1948: suffering from declining competitiveness or severe import competition, firms, industries, and/or labor unions have petitioned the Tariff (or International Trade) Commission and the Administration for some kind of subsidy or relief. Finding these escape valves closed, and the Executive unresponsive, the groups turn to Congress and specifically to their congressman for relief. The Legislator introduces a bill which attempts to respond to the problem, and if done so in an efficient manner, others will co-sponsor it. Hearings are held, and other groups interested in similar relief try to make the log roll. At this point, economists and free trade groups mobilize and demand protectionism. Foreign governments perceive this as a major change in the nature of the debate and take the threat of protectionist policies in the U.S. more seriously. As the debate proceeds, and restrictive measures become more threatening, several new developments occur. The Administration opens its escape valves; foreign governments search for ways to demonstrate their interest in maintaining a normal trading relationship; the Executive shows, in various ways, that it is listening to the Congress; some of the interest groups are satisfied, and others, which are not, can take satisfaction that the issue they raised was addressed. In short, the signals from Congress are received, and upon recognizing this, the congressional frustration quotient drops, and a liberal trade law is passed, or a restrictive bill fails.

Over the last few years, analysts developed several approaches with which to analyze this political process underlying the development and implementation of protectionist trade policies. This kind of analysis is at the center of *public choice theory*, which in recent years has emerged to study imperfections in the political process. This approach has helped to explain why governments often adopt policies favoring small but well-organized and politically influential groups at the expense of most of the general public as consumers and taxpayers. At the same time a burgeoning new literature has developed on quantitative explanations of import protection. This literature has tended

to build in successive layers that reinforced preceding analysis, rather than to swing between opposing views. Therefore, certain stylized facts of protectionist behavior are gradually emerging.

According to the *public choice approach*, the amount of lobbying effort by producers for state protection from competition will be influenced by the size of the group seeking protection as well as by their degree of organization. The first variable represents the political influence of the group; other things being equal, an industry that has wide voter support and strong representation in the legislature will be more able to obtain a protectionist response from the government. On the other hand, the smaller the group and thus the greater the gain or loss to any individual member, the more likely it will be for an individual to spend enough money to influence the voting outcome (Baldwin, 1976: 10). Since small, oligopolistic industries, like the steel or automobile industry, can minimize the free-rider problem, they will often be successful in seeking protection from international competition. Others, such as the textile industry, seem to be innovative enough in their organizational design to overcome the free-rider problem (Amacher et al., 1979: 58).

While consumers would be the prime beneficiaries of more liberal trade and investment policies, they are a large and widely dispersed group, which faces exceedingly high costs of organizing itself to oppose protectionist pressures. Individually, consumers gain small direct benefits from trade liberalization, and the efforts of any one of them would generate benefits primarily for others. Blackhurst et al. (1977: 32) gave the following example in order to illustrate this point: suppose that a reduction in a certain trade restriction would benefit each of 10 million consumers by an average of \$14 (for a total gain of \$140 million), while the same reduction would impose transitional adjustment costs totalling \$35 million on six firms employing a total of 5,000 employees. Although the reduction of the trade barrier would increase the national welfare by \$105 million and therefore be in the country's national interest, it is unlikely that many individual consumers will bother to incur the expense of becoming informed on the issue and the expense of lobbying. The individual adjustments costs for the employees or owners, however, are large enough that it would pay for them to be informed and to bring pressure to bear on politicians and policy makers. This might

explain why industries or companies threatened by international competition do most of the lobbying in the commercial policy area as well as why the U.S. Congress has traditionally been much more protectionist than the executive branch, which has played an important role in advancing the cause of liberal trade after WWII (Amacher et al., 1979: 61).

Other analysts consider protectionist policy-making as the consequence of the confrontation between pressures from industry and labor, on the one hand, and the disposition of the legislature and executive branch toward conferring protection, on the other. In economic terms, there is a market for protection: the firms and labor provide the demand side of this market while governing authorities provide its supply side. In his analysis of protectionist policies in industrialized countries, Cline (1984) identified the following variables as determining the demand for protection: industry concentration, import penetration (the ratio of imports to total consumption in a given industry), comparative advantage, and export dependence. Industry concentration is important because of the reasons discussed above in connection with *public choice theory*; import penetration will influence the scope of competition that will be cut back by imposing protectionist measures so that the benefits to the domestic producers will be greater. The demand for protectionism becomes lower, however, if the industry's inherent comparative advantage is stronger because it is more likely to avoid further loss to imports. Finally, the higher the dependence on exports, the lower the demand for protectionism because of fear of retaliation.

On the supply side of protectionism, Cline (1984) identified the following basic determinants: political importance, public sympathy, and adjustment costs. As discussed previously, other things being equal, an industry that has wider voter support and strong representation in the legislature will be more able to obtain a protectionist response from government. Further, a sector widely perceived as being composed of needy or deserving workers and firms (lower-paid workers with fewer skills of use in alternative work) may have more success in obtaining protection than an industry perceived as privileged by virtue of high wages and ease of transition to other employment. Finally, the supply of protection is influenced by the cost of adjustment required in the absence of

protection. Social costs of adjustment to increased imports cause reduced domestic output, and the higher these costs, the greater the argument for at least delaying the full burden of adjustment by temporary protection.

I am going to concentrate on the following variables for the subsequent analysis: import penetration, measured by the share of the domestic market occupied by foreign products; the political influence of the affected industries, measured by their number of employees and industry concentration. Based on the previous discussion, the following hypotheses can be derived:

- The greater the import penetration of an industrial sector, the greater the chance of an interstate dispute over the access to that market.
- The greater the domestic political influence of an industry competing with imports, the more positive will be the outcome of the trade conflict for the U.S.

4.3 Japanese Trade Policy Formulation

It is the purpose of this section to investigate whether the propositions developed for the American trade policy-making process can also be applied to the Japanese system. Therefore, in this section I am going to take a closer look at the historical development of the Japanese economic system as well as at its present trade policy-making process.

Japan began to modernize her social and political as well as her economic institutions with the *Meiji-Revolution* in 1868. This revolution was largely a transfer of power to those who had successfully overthrown the Shogunate; in a broader sense, it acquired the character of a revolution in that the old order, rooted in a feudal society, was replaced by leaders who transformed Japan into a modern state. It constituted a direct attempt to be competitive with the West in order to preserve her national sovereignty. The new leaders lost no time in adapting Western models for governmental, economic, and military development. They substituted a new national spirit for deep-seated feudal loyalties, making the Emperor the focal point of Japan's unity. With this new sense of direction and purpose, Japan's leaders were able to promote a remarkably rapid modernization of their country (Sebald and Spinks, 1967: 3). Japan also adopted a Prussian-style bureaucracy with tenured employment to enhance political stability. During this time, the civil service achieved its great prestige.

In a famous essay written twenty years ago, Maruyama Masao (1969) tried to give a rough sketch of the massive system of irresponsibilities that characterized Japan's fascist rule. He developed three basic types of political personalities: the Portable Shrine, the Official, and the Outlaw, with the first representing authority, the second power, and the third violence. This distinction still contains most of the essential insights that scholars have advanced to account for the nature of modern Japanese politics, either before or after the war: the marked separation between power and authority, the movement from policy initiatives from lower statuses toward higher statuses (*ringi-sho*), and the alleged system of irresponsibilities that comes to the fore whenever policy goes awry. Today, the Portable shrine seems to be the Liberal Democratic Party (LDP) leader, held aloft by the bureaucrats, and prodded by the new outlaws, the press, and the emerging forces of consumer protest and residents' committees. Fukuji (1968) referred to the quasi-monopolistic usurpation of the decision-making function by the *Triangular League*, made up of the top leaders of the ruling party, the senior officers in government, and the financial Tycoons (*zaikai*).

Johnson (1975: 10) pointed out that despite the fact that the constitution gives the power of policy-making and of enacting laws exclusively to the elected members of the Diet, the Japanese Parliament, it is the bureaucracy that actually initiates and drafts virtually all important legislation. It also contributes significantly to the passage of bills within the Diet and possesses extra legislative ordinance powers that are almost on a par with the statutes themselves. The most difficult coordination task is not inside the Diet, among the different fractions of the LDP or among the different parties, but among the ministries and agencies themselves; once an intraministerial agreement has been reached, the chores of taking the proposal or the bill through the party, cabinet, or Diet stages are relatively less onerous (Johnson, 1975: 11). In fact, 85 percent of the bills introduced in the Diet between 1945 and 1975 were sponsored by government ministries, and over 90 percent of all legislation passed in Japan was government sponsored. It is also extremely rare for a nongovernment bill to pass (Pempel, 1982).

The major differences between U.S. and Japanese policy formulation are due to dissimilarities in the presidential and parliamentary forms of government. Under the U.S. presidential system, the division of power is balanced among the legislative, executive, and judicial branches. In contrast, under the Japanese parliamentary system, the power of the Diet is more limited than that of the executive branch, partly because the cabinet is formed and dominated by the majority party's senior politicians, and partly because the central government bureaucracy has historically always occupied a more powerful position (Higashi, 1983: 33).

But with the increase of foreign trade and the reestablishment of the old *zaibatsus* in the form of mutual holding companies (*keiretsus*), Japanese industry and commerce are no longer under the direct control of the economic bureaucracy; Japan's industrial policy will be decreasingly effective and can even be perverse in its effects, much of its essential policy flexibility and the effectiveness of the all important administrative guidance has been lost (Yamamura, 1987: 203). It therefore seems to be legitimate to assume that in Japan, despite its century-long political and economic isolation and its unique cultural traits, basically the same political processes are at work as in the

U.S. Japanese industry, as well as the American industry, will try to exercise pressure on the government in order to protect its domestic market. This political pressure can be assumed to be, as in the case of the U.S., dependent on the employment size of the affected industries. But at the same time, Japan, as an export dependent economy, will try to protect its shares of foreign markets. It will be careful not to anger its negotiation partner because of fear of increased protectionist measures. Therefore, the greater the export dependency of an industry, the less aggressive will be the Japanese negotiation strategy, the more favorable will be the outcome for the U.S.

Based on the previous discussion, the following hypotheses can be derived:

- The higher the political influence of a Japanese industry, the more favorable will be the outcome of the trade conflict for Japan.
- The more dependent an industry is on its export to the U.S., the more favorable will be the conflict outcome for the U.S.

5.0 Analysis of U.S.-Japanese Trade Conflicts

It is the purpose of this chapter to identify the outcomes of the U.S.-Japanese trade conflicts between 1968 and 1983 and to test the hypotheses developed in the previous chapter. I chose this time frame because it reflects the emergence of managed trade as well as the intensification of the trade conflict between the two countries. Although there were some bilateral trade negotiations between the two countries before 1968, they did not exhibit the level of conflict or even hostility that was going to be characteristic for the subsequent relationship.

5.1 Identification of U.S.-Japanese Trade Conflicts

The methodology of this analysis is similar to that used by Odell (1985), who analyzed the outcomes of trade conflicts between the U.S. and South Korea. For identifying U.S.-Japanese trade conflicts I adopted his definition of interstate conflicts: interstate conflicts are typically understood as a sequence of actions in which governments take or threaten to take actions that would cause

harm to one or more other states. More precisely, an interstate commercial dispute begins when government B responds with a complaint, a counter-measure, or with resistance to a request or trade action by another government, A, which government B believes harms or would harm its trade or economy. Such a dispute ends either when the governments agree to an explicit settlement of their claims, or when communications referring to these episodes cease (Odell, 1985: 265). According to this definition, the analysis contains only trade disputes that involved bilateral negotiations between the two governments. It therefore excludes several investigations of the International Trade Committee (ITC) concerning alleged Japanese export subsidies and dumping .

In order to identify trade conflicts between the two countries, I analyzed the relevant literature as well as periodicals. Especially helpful were *The Annual Report of the President on the Trade Agreements Program*, which contains all activity of the U.S. government concerning international trade; *The Yearbook of U.S.-Japanese Economic Relations*, which gives a complete overview as well as an analysis of the economic relations between the two countries, with a focus on the trade negotiations; and the detailed analysis of 31 case studies of protectionism in the United States by Hufbauer et al. (1986).

Classifying and comparing trade conflict outcomes is not highly developed in the literature. For the purpose of this analysis, outcomes will be compared with the help of a nine point scale. Thus, for each conflict, the initial position (demand, request, or fait accompli) of each government is identified. The results of the negotiation are then compared with each initial position, and then classified according to the following scale. ⁴ The ideal result for the U.S. would be the one with all its requests granted and no concessions yielded, the least favorable outcome would be the reverse. If Japan fails to realize most of its stated objectives in a dispute while the U.S. generally is granted its demands, and if Japan receives no compensation whatsoever, the outcome is given a scale value of 1. If the U.S. is to grant minor compensations to Japan, a value of 2 will be assigned. A score

⁴ This procedure is again similar to the one used by Odell (1985).

of 3 will be assigned if the U.S. is to grant major, substantial compensations for B. Scores 9, 8, and 7 represent the comparable contrast among outcomes generally more favorable to Japan and unfavorable to the U.S. Scores 4, 5, and 6 represent outcomes midway between the two initial positions. A score of 4 and 6 was assigned when, for example, one government achieves roughly half of its goal while the other achieves somewhat less than half its goal. However, as Japan was never in a position to claim any demands from the U.S., the scores for the U.S.-Japanese trade conflicts will range from 1 to 5. In cases where it was not possible to identify the initial negotiation position of a country, the score was determined by drawing inferences from the available sources about the demands and outcomes of the negotiations.⁵

This procedure has several weaknesses which need to be pointed out. Anticipating that he will have to make concessions, a negotiator will open with a request that is more favorable to his side than its true minimum terms. However, it can be assumed that the higher the negotiator sets his demands, the higher will be the expectations in his home country, and the higher will be the disappointment if the outcome deviates significantly from his initial demand or offer. Therefore, the negotiator's self-interest will incline him to set at least reasonable demands which are likely to be accepted by the other side. In addition, one side's *padding* is likely to be offset by that of the other.

The analysis revealed 11 trade conflicts over commerce between 1968 and 1983, according to the criteria used here. Table 4 on page 81 summarizes these disputes. It shows a significant increase in the number of conflicts in 1981 and 1982. The disputes were concentrated in a limited number of industries, carbon and alloy steel, textiles and apparel, specialty steel, color TVs, and automobiles. The analysis does not include the dispute over communications equipment which dominated the relationship between the two countries in 1982. Whereas all the other cases were about limiting access of Japanese goods to U.S. markets, this dispute involved a fierce discussion about opening the procurement procedures of Japanese public corporations, in this case the procurement policies

⁵ For a synopsis of the scores and the decision rules as well as for the coding procedure, see the methodological appendix.

of NTT (Nippon Telephone and Telegraph Company), to U.S. manufacturers. With the exception of agricultural trade, this case represents a new development in the trade negotiations between the two countries. Whereas the previous discussion focused on restricting access of Japanese manufactures to U.S. markets, in fall 1981 the Reagan administration began to emphasize more and more the access of American products to the Japanese market, arguing that import barriers were at least partly responsible for the bilateral trade imbalance (Yearbook of U.S.-Japanese Trade Relations, 1983: 45). Whereas in 1982 this discussion urged Japan to dismantle nontariff barriers to establish a fair and reciprocal trade relationship, in 1983 it began to focus on the issue of Japan's industrial policy. It drew support from those in the United States who were looking for either improved access to Japanese markets or for protection in the U.S. markets from Japanese products believed to benefit from government aid. The issue of access to Japanese markets will occupy an increasing importance in the bilateral negotiations. However, as this conflict is of different nature than the other cases covered in this analysis, I will exclude it from the analysis.

5.2 Interpretation of Results

The following section will use the previously developed hypotheses to help interpreting and explaining the outcomes of the 11 trade conflicts between 1968 and 1983. I will first discuss the implications of the international power structure, then the variations across the industrial sectors due to American and Japanese policies respectively.

5.2.1 International Power Structure

The global hegemony idea allows us to take a look at the development of the trade conflicts over the whole period of the analysis. It implies that the lower the U.S. hegemonic position, the higher will be the number of trade conflicts but not the more favorable the outcomes for Japan. As, according to the literature, the U.S. hegemonic position decreased over the period of this analysis, we would expect the outcomes to remain unfavorable for Japan over the whole period, but the number of conflicts to increase over time. Table 4 on page 81 suggests that the data support only the second part of the hypothesis. The number of trade disputes increased over time. Between 1968 and 1977 there were as many trade conflicts as between 1981 and 1983. But whereas the U.S., in the steel disputes of 1968 and 1972, was able to impose its position on Japan, it had to make more and more concessions to Japan beginning with the second half of the 1970s. As the theory of hegemonic change does not account for this overall trend of more favorable outcomes for Japan, we will have to seek another explanation for this development.

5.2.2 Variations Due to the Political Influence of the American Industries

As the trade disputes involved only five sectors, the influence of sectoral market conditions cannot be tested conclusively. However, I will use the five industries where conflicts occurred to draw preliminary conclusions about the protectionist influence of these industries.

The hypotheses developed in the previous chapter suggest that the likelihood that a conflict would occur is dependent on the import penetration, the share of the domestic market occupied by foreign products. Concerning the outcomes of these disputes, they suggest that the protectionist pressure an industry can exert on Congress and the administration is dependent on its domestic resources,

measured by its number of employees and industry concentration. Therefore, the greater the import penetration, the employment, and the concentration ratio of an industry, the more favorable will be the outcome for the U.S.

The analysis revealed that import penetration does not yield any significant results. Table 5 on page 82 contains the import penetration ratio by conflict level. This table was compiled by first calculating the import penetration ratios of the affected industries over the period of the study, by then identifying the import penetration ratio for the year a trade dispute was settled, and by finally categorizing these selected ratios by the score of their outcomes. According to our hypothesis, we would expect the trade conflicts to be distributed from the bottom of the left corner to the top of the right corner of the table. However, the distribution of the cases does not correspond to our hypothesis. The table indicates that 6 out of the 11 trade conflicts occurred when the industry was penetrated between 15 and 19 percent. In addition, the three trade incidents involving the automobile industry, which experienced significantly higher ratios of import penetration than the other industries investigated, achieved the most favorable outcomes for Japan.

The analysis of the employment size of an industry and its impact on the outcome of the trade disputes helps to account for the protection the textile and apparel industry received. Table 6 on page 83 presents the average employment size of an industry during the years in which trade conflicts it was involved in were settled by conflict outcome. It was compiled by categorizing the various conflict outcomes of an industry according to the score of their outcomes. According to our hypothesis, we would expect the conflicts to be distributed from the bottom of the left corner to the top of the right corner of the table. But our data do not confirm this hypothesis. The table shows that the textile and apparel industry's huge average workforce of over two million during the time of the trade conflicts is significantly larger than that of all the other industries. But the steel industry, which had only an average number of employees of 374,000 during the years a conflict was settled, enjoyed the only two outcomes with a score of one for the U.S. In addition, the automobile industry, which had an average employment of 552,000 during the years it was involved

in trade conflicts, received the least favorable outcomes for the U.S. These results suggest that the employment size of an industry is no good predictor of the conflict outcomes.

A look at the industry concentration ratios, which are given for the textile and apparel, primary metals, radio and TV, as well as motor vehicle industry for the years of the census, ⁶ in Table 7 on page 84 may explain the export protection received by the steel industry. The data show a relatively high industry concentration for the primary metals industry as a whole, suggesting its concentration as being an important factor for it receiving import protection. The data also support the fact that the motor vehicle industry, which shows the highest concentration ratio, received protection. But the data do not account for the favorable outcomes in this sector for Japan. The table also does not show a relatively large industrial concentration index for the radio and TV industry in 1977, the year it received protection from Japanese imports, leaving the protection this industry received unexplained.

So far, the hypotheses forwarded are to a large extent not consistent with the observed outcomes of the trade conflicts, suggesting that the potential political influence of the affected industries is not a good predictor of the outcomes of trade negotiations between the U.S. and Japan. However, they seem to correspond at least partially to the protection received by the textile and apparel industry, the steel, and the automobile industry.

5.2.3 Variations Due to the Political Influence of the Japanese Industry

The hypotheses developed in the previous chapter concerning the influence of Japanese domestic processes on the outcome of the trade disputes are similar to those forwarded in the case of the

⁶ Due to the lack of statistical sources, more precise data was not available for this indicator.

U.S. They suggest that the higher the political influence of an industry, the more severe the trade conflict. In addition, since Japan as an export-oriented country is dependent on its foreign market, it was suggested that the more dependent an industry is on its exports, the more it will concede to American demands.

Unfortunately, due to the lack of sources, the data for Japan is not as precise as that for the U.S. However, information is sufficient for a rough test of the proposed hypotheses. As not all of the available data are broken down into the industries analyzed in this section, I had to use aggregated data for all of the industries with the exception of textiles and apparel. Therefore, the employment data will be inflated.

Table 8 on page 85 indicates that the available data do not support the hypothesis that the larger the employment of an industry, the more favorable the outcome for Japan. This table presents the variations of conflict outcomes by industry, indicating their average employment size during the years in which conflicts were settled. This table was compiled by categorizing the various conflicts of an industry according to the score of their outcomes. According to our hypothesis, we would expect the outcomes to be distributed from the top of the left corner to the bottom of the right corner of the table. However, the data indicate the opposite trend: the steel industry with the lowest employment out of the four sectors had 2 of its conflicts settled at a score of 3, and the transportation industry, with an average of 871,000 employees during the years conflicts were settled, was able to achieve the most favorable deals. The electric machinery and appliances as well as textile and apparel industry with an average employment of over one million employees during the years conflicts were settled, could not use their big employment size successfully to bring pressure to bear on the Japanese government in favor of more favorable outcomes.

Fortunately, the data for the export dependency is more precise than the data just presented for employment. Table 9 on page 86 presents the conflict outcomes by export dependency. It was compiled by first calculating the export/output ratios of the affected industries, by then identifying

the export/output ratios of the years a trade dispute was settled, and by finally categorizing these selected ratios by the score of their outcomes. According to our hypothesis, we would expect the the outcomes to be distributed from the bottom of the left corner to the top of the right corner of the table. The table in fact indicates a certain pattern: the higher the export dependency, the more favorable the outcomes for Japan. This pattern, however, is contrary to the presented hypothesis, which claims that the more dependent an industry is on its exports, the more it is willing to accept demands by the U.S. The results suggest that a high export dependency by an industry did not prevent the Japanese government from achieving favorable negotiation outcomes for these industries.

The analysis of the data suggests that the influence of the Japanese industry, as measured by the indicator employment size, on the negotiation position of its government does not account for variations in the conflict outcomes. The export dependency of an industry, measured by its export/output ratio, also does not seem to be a good predictor of the variations of the conflict outcomes.

5.3 Conclusion

The analysis of the data revealed that 11 trade conflicts occurred between 1968 and 1983 within the flow of U.S.-Japanese commerce. All disputes were about restricting access of Japanese imports to U.S. markets or falling U.S. employment. The theory of the hegemonic decline of the U.S. helps to account for the increasing number of trade conflicts, but it does not help explain the more favorable outcomes for Japan. The variables accounting for protectionist pressure in the U.S. did not prove to be responsible for variations in the outcomes of the negotiations. The same seems to be true for the variables accounting for the political influence of the affected industries in Japan.

These results suggest that politically influential industries do not seem to be able to convert their political clout into more favorable negotiation outcomes. As the influence of affected industries on the outcome of trade disputes does not seem to be significant, further research about the U.S.-Japanese trade conflict will have to shift its focus. It seems to be more promising to concentrate on intra-governmental decision-making processes concerning trade policies and the influence of negotiation strategies adopted by the two governments.

These results, however, need to be interpreted carefully. The small number of cases and other variables, not included in this study, that might have an influence on the outcomes of the trade disputes, limit inferences and conclusions regarding the proposed hypotheses. Further research, therefore, should increase the number of cases by including the analysis of the trade conflicts between several countries, e.g. between the industrialized countries, or between the U.S. and developing countries. At the same time, careful policy studies of the trade conflicts should identify variables that might influence the outcomes of the trade conflicts. This will ensure that analyses of trade conflicts will include all causative variables.

6.0 Summary and Policy Recommendations

Over the last 20 years, the world economy experienced a profound transformation due to the rise of the developing countries, which now, as so-called Newly Developed Countries, constitute a major threat to the industries in the developed countries. This development touched off a series of bilateral trade conflicts that shows little sign of an early end. Yet we have very little systematic knowledge about these or other interstate commercial disputes. This paper proposes techniques for identifying and comparing them, as well as several hypotheses for explaining outcome variations.

This paper revealed that the American and Japanese governments engaged in 11 substantial trade conflicts during the period from 1968 to 1983. The outcomes were systematically closer to Washington's initial objectives and negotiation position than to those of Tokyo, but they varied significantly from case to case. The analysis revealed that the macroeconomic policies of the U.S. and Japan and the resulting exchange-rate misalignments are the dominant causes for the tensions in the economic relationship between the two countries. In particular, from two-thirds to three-fourths of the increase in the overall American current account deficit can be traced to the rise of the dollar. The primary cause of the present crisis and the resulting increase in the number of trade

conflicts thus seems to lie with the macro-economic policies of the two countries and their underlying economic structures.

The analysis also showed that structures of international power imprint themselves on the international relations. However, although the superpower does clearly come out ahead of the weaker power, Japan was able to achieve more favorable outcomes over time. The power structure left spaces within which the negotiation strategy could make a difference in the disputes' outcomes.

Another hypothesis suggested that differences in U.S. import penetration would affect interstate outcomes, but this idea contributed little to the interpretation of the outcomes. Their variations were also virtually unrelated to the domestic political clout of the American import-competing industries. These results are inconclusive, however, as they represent only a very small number of sectors. These bilateral data permit some speculation about the conditions under which states experience or avoid commercial conflicts. The observed trend toward greater frequency is consistent with the erosion of American hegemony during the last thirty years, but it is also consistent with other simultaneous trends, such as the increasing import penetration of foreign goods into the American market. The hypotheses based on the American political structure help explain the protection the textile and apparel industry as well as the carbon and alloy steel industry received at the beginning of the 1970s; despite the relatively low import penetration of these industries at that time. But other evidence was inconsistent with the domestic politics hypotheses. Investigating a larger number of sectors and countries would, however, permit firmer and more accurate inferences regarding the proposed hypotheses.

If we were to follow this analysis of the trade relations between the U.S. and Japan, the trade disputes between the two countries need to be settled on another level, the macroeconomic coordination between the two countries. Therefore, the trade issue needs to be put and analyzed in the broader context of macroeconomic policy. Fortunately, policy changes in the two countries are available which offer promising results. However, it is at the level of macroeconomic policy where

there has apparently been the least dialogue between the two countries. According to our analysis, any lasting solution to the current problem will thus require substantial changes in exchange rates and in economic policy, particularly regarding government budgets, in both countries. The United States, with its overriding responsibilities for global economic stability, must assure a substantial correction of the exchange rate of the dollar and put its fiscal house in order. Japan as the second largest economy in the world and perhaps the major beneficiary of an open trading system, must alter her fiscal and consumer policies substantially and go the extra mile to deal with the criticism so widely leveled against its trade policies.

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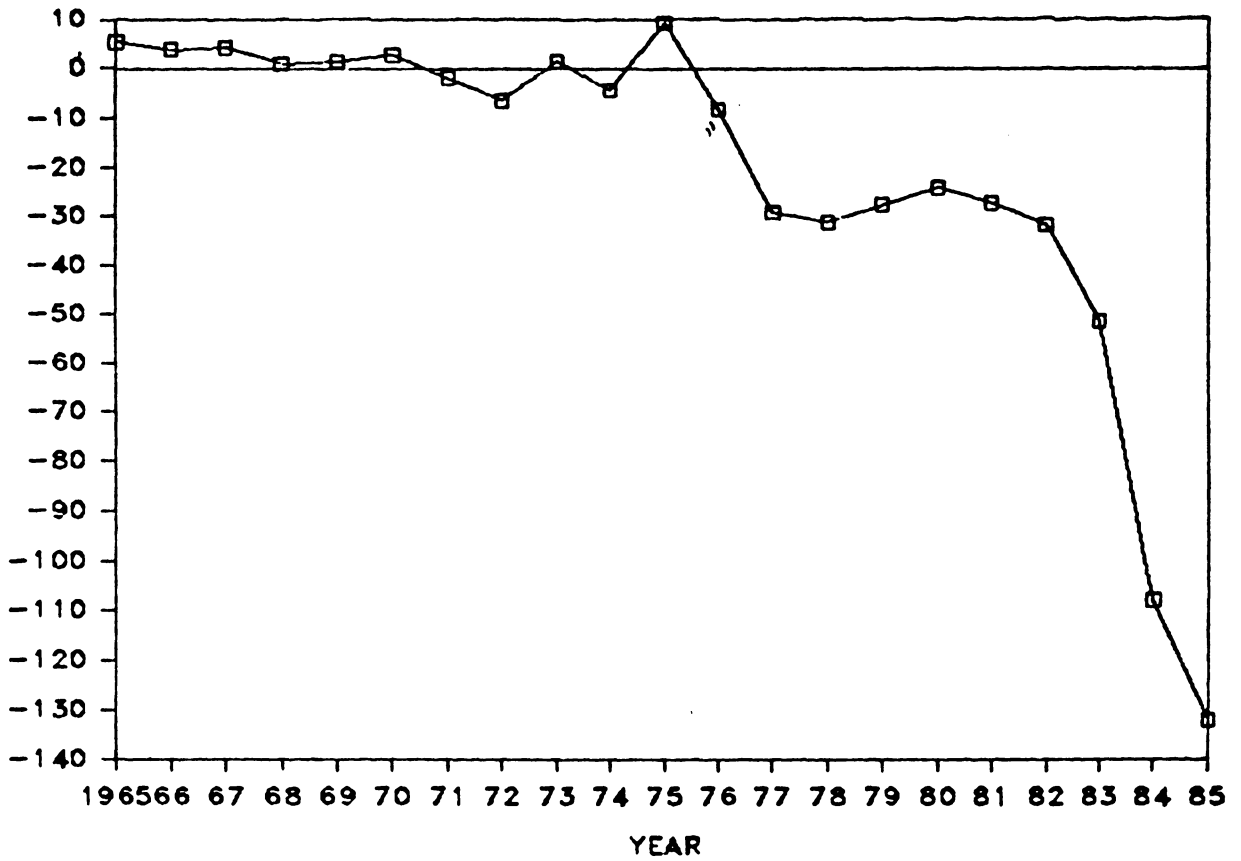
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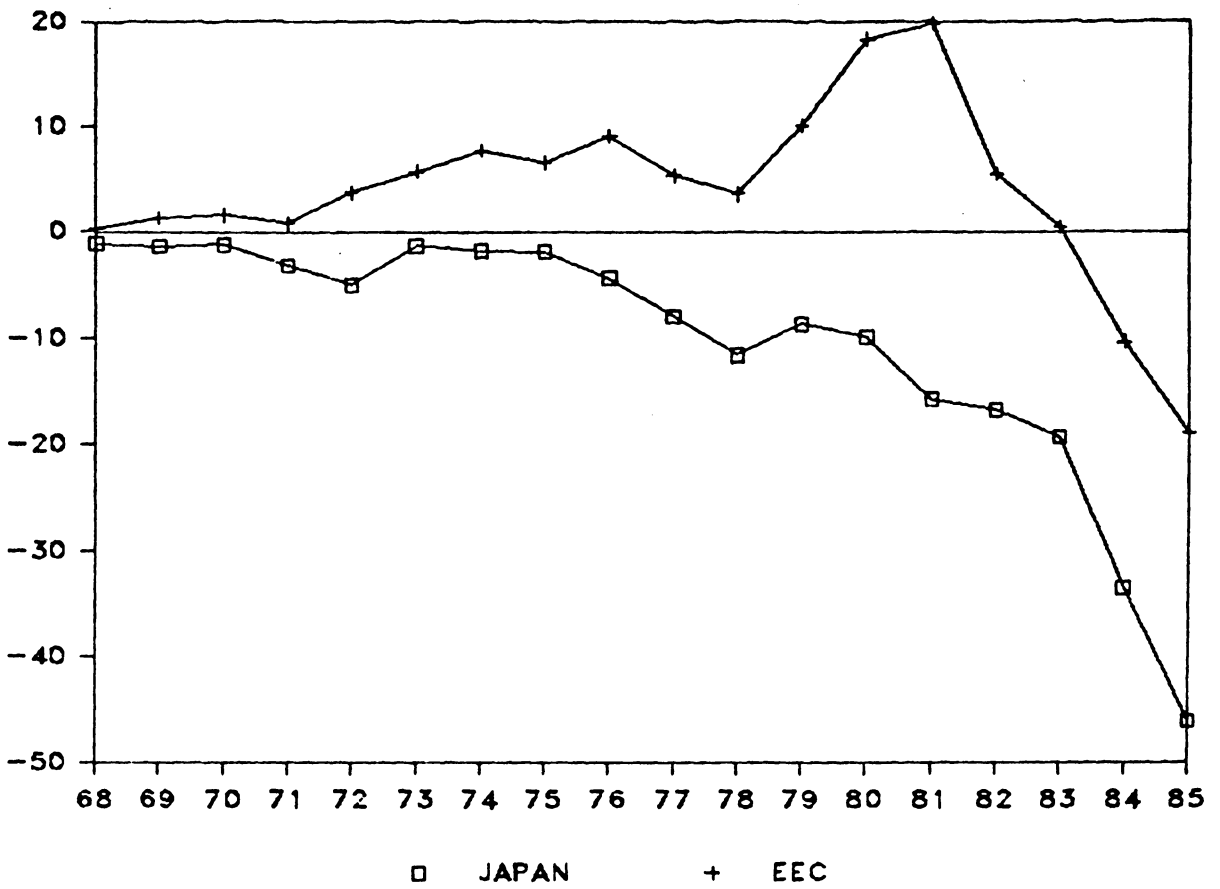
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Appendix A. Figures



Source: U.S. Bureau of the Census, various issues.

Figure 1. United States' Multilateral Trade Deficit (in billion \$), with Japan and the ECC, 1965-1985.



Source: U.S. Bureau of the Census, various issues.

Figure 2. United States' Bilateral Trade Deficit (in billion \$) with Japan and the EEC, 1968-1985.

Appendix B. Tables

Table 1. Number of Major Non-Tariff Barriers in Seven Industrial Countries, 1973-1984.

Year	United States	West Germany	France	Italy	UK	Canada	Japan
1973	2	1	1	2	1	1	0
1974	2	1	1	2	1	1	0
1975	2	1	1	2	2	1	0
1976	2	1	1	2	2	1	0
1977	2	2	3	3	4	0	0
1978	2	2	3	2	4	1	0
1979	3	2	3	3	5	1	0
1980	3	2	4	4	6	1	0
1981	5	1	3	2	4	2	0
1982	2	2	4	3	3	2	0
1983	4	4	6	4	5	2	0
1984	4	4	6	5	4	1	0

Source: Compiled from *Annual Report of the President on the Trade Agreements Program (1983)*.

Table 2. NTB Coverage Ratios by Product Category for the Major Industrial Countries, 1983.

Industrial country markets	All products	All less fuels	Agriculture	Manufactures	Textiles	Footwear	Iron and steel	Electrical machinery	Vehicles	Rest of manufactures
EEC	22.3	21.1	36.4	18.7	52.0	9.5	52.6	13.4	45.3	10.3
Belgium-Luxembourg	26.0	33.9	55.9	33.6	38.2	12.3	47.4	19.5	54.3	30.6
Denmark	11.7	15.9	28.5	13.2	46.5	13.6	49.9	6.7	35.0	5.4
France	57.1	28.1	37.8	27.4	48.4	6.6	73.9	41.7	42.9	19.4
West Germany	12.4	18.3	22.3	18.5	57.0	9.7	53.5	6.8	52.0	6.6
Greece	13.4	23.2	46.4	20.4	21.8	22.8	54.5	13.5	65.5	8.5
Ireland	13.4	15.0	24.8	13.8	31.7	8.8	23.0	0.5	65.8	6.6
Italy	6.9	14.6	39.5	9.3	37.2	0.2	48.6	7.1	10.2	2.6
Netherlands	25.5	28.0	51.9	17.8	57.3	12.0	35.5	4.0	49.7	10.7
United Kingdom	14.3	17.3	34.9	14.8	59.6	12.2	42.1	12.7	44.3	6.7
Australia	34.1	24.1	36.1	23.6	30.9	50.0	55.6	48.7	0.7	21.6
Austria	4.9	6.0	41.7	2.4	2.2	0.1	0.0	0.0	2.9	3.0
Finland	34.9	9.2	31.5	6.7	31.0	68.8	43.9	0.0	0.0	0.4
Japan	11.9	16.9	42.9	7.7	11.8	34.1	0.0	0.0	0.0	7.7
Norway	5.7	5.8	24.2	4.1	42.9	5.4	0.1	0.0	0.2	0.4
Switzerland	32.2	23.6	73.4	17.6	57.4	0.0	3.9	28.1	1.1	14.6
United States	43.0	17.3	24.2	17.1	57.0	11.5	37.7	5.2	34.2	6.1
All industrial country markets	27.1	18.6	36.1	16.1	44.8	12.6	35.4	10.0	30.4	8.8

Source: Deardorff et al., 1985: 29.

Table 3. Trade Balances for 25 Major Trading Nations, Total and with the United States, 1980-81 to 1984.

Country	Bilateral US 1980 level				Change, 1980-81 to 1984				Total annual ^a change, 1980-81 to 1984			
	Million dollars	Rand	Percentage of bilateral turnover	Rand	Million dollars	Rand	Percentage of bilateral turnover ^b	Rand	Percentage of total country turnover ^c	Rand		
Argentina	141	20	7.3	18	1,549	17	48.5	2	38.8	2		
Australia	-908	22	-10.5	22	1,015	20	15.5	19	-3.1	22		
Austria	365	18	33.9	9	446	23	41.2	6	3.0	15		
Belgium	-2,014	23	-23.5	23	1,991	15	24.1	15	1.9	16		
Brazil	5,633	7	51.6	5	5,282	6	47.5	3	32.5	3		
Canada	20,387	2	18.0	14	13,653	2	9.5	22	0.8	20		
Denmark	913	14	43.0	6	955	21	45.5	4	1.0	19		
France	2,479	11	17.8	15	4,048	8	28.9	12	1.1	18		
Germany	8,726	4	32.4	10	7,257	5	26.0	13	1.4	17		
Hong Kong	5,837	6	48.8	4	3,105	12	14.9	20	6.2	10		
Italy	4,129	8	32.1	11	4,446	7	35.1	9	12.2	6		
Japan	26,795	1	43.8	5	21,664	1	17.6	18	5.1	11		
Korea	4,044	9	25.3	12	3,991	9	24.7	14	5.0	12		
Mexico	6,275	5	20.7	13	9,319	3	30.9	11	39.7	1		
Norway	1,145	13	40.0	7	-625	24	-10.2	24	6.8	9		
Netherlands	-3,224	24	-27.1	24	3,151	11	31.1	10	3.4	14		
China, P.R.	337	19	5.0	19	2,443	13	44.9	5	7.3	8		
Denmark	720	15	59.1	1	857	22	71.7	1	15.4	4		
Singapore	446	17	5.7	20	1,374	18	23.9	16	-6.2	24		
Spain	66	21	1.3	21	2,009	14	40.5	7	12.5	5		
Sweden	1,803	12	37.9	8	1,941	16	39.5	8	4.1	13		
Switzerland	636	16	11.0	16	1,352	19	22.8	17	0.8	21		
Taiwan	11,065	3	52.2	2	7,391	4	4.7	23	11.9	7		
United Kingdom	2,834	10	10.4	17	3,607	10	13.6	21	-5.0	23		
Subtotal	108,632	n.a.	n.a.	n.a.	102,003	n.a.	n.a.	n.a.	n.a.	n.a.		
United States	-123,209	25	-22.1	25	-85,395	25	-14.4	25	-14.4	25		

n.a. Not applicable.
Source: Calculations from IMF, *International Financial Statistics* various issues; IMF, *Division of Trade Statistics Yearbook 1984*; US Department of Commerce, *Highlights of US Exports and Imports Trade*, December 1981 and December 1984.

a. Country exports are from US data on exports, c.i.f.; country imports are from US data on exports, f.o.b. Includes oil.
b. Based on country's own data on exports, f.o.b., and imports, c.i.f.
c. 1984 ratio of bilateral balance to bilateral turnover versus average ratio for 1980 and 1981.
d. Round.

Source: Bergsten and Cline, 1985: 22-3.

Table 4. Trade Disputes Between the Governments of Japan and the United States, 1968-1983.

Date Ended	Products	Outcome	Outcome Ranking a)
Dec. 1968	Carbon and Alloy Steel	J accepts VER	1
Oct. 1971	Textiles and Apparel	J accepts VER	2
Jan. 1972	Carbon and Alloy Steel	extension of VER	1
June 1976	Specialty Steel	J accepts VER	3
May 1977	Color TVs	J industry agrees to 3 year OMA	2
Dec. 1977	Carbon and Alloy Steel	U.S. adopts TPM	3
May 1981	Automobiles	J accepts 3 year VER	5
March 1982	Automobiles	extension of VER	4
Sept. 1982	Textiles and Apparel	quotas on 11 items until 1986	3
Oct. 1983	Specialty Steel	J agrees to OMA until 1987	2
Nov. 1983	Automobiles	extension on VER 10.1 increase	3

Note: a) For the definition of the ranks see text.

Table 5. Conflict Outcomes and U.S. Import Penetration.

Conflict Outcome	Import Penetration (in percent)							
	40+	35-39	35-34	25-29	20-24	15-19	10-14	0-10
5	-	-	1	-	-	-	-	-
4	-	1	-	-	-	-	-	-
3	1	-	-	-	-	3	-	-
2	-	1	-	-	-	1	-	-
1	-	-	-	-	-	2	-	-

Source: Hufbauer et al. (1986), various tables.

Table 6. Conflict Outcomes and Employment (in 1,000s) in Affected U.S. Industries.

Conflict Outcome	Textile and Apparel 2012a)	Automobiles 552a)	Steel 374a)	Color TV 27a)	Specialty Steel 15.5a)
5	-	1	-	-	-
4	-	1	-	-	-
3	1	1	1	-	2
2	1	-	-	1	-
1	-	-	2	-	-

Note: a) Average employment of this industry during the years a conflict was settled.

Source: Hufbauer et al. (1986), various tables.

Table 7. Industry Concentration for Selected Industries in the U.S., 1967-1982.

Year	Textiles & Apparel	Primary Metals	Radio and TV	Motor Vehicles
1967	68.29	187.36	215.58	276.26
1972	73.35	168.28	113.95	238.27
1977	61.26	151.05	75.96	206.89
1982	61.41	120.94	63.65	158.92

Note: industry concentration = number of employees / number of establishments in a given industry.

Source: Bureau of the Census, *Statistical Abstract of the United States*, various issues.

Table 8. Conflict Outcomes and Employment (in 1,000s) in affected Japanese Industries.

Conflict Outcome	Electric Machinery and Appliances 1,219a)	Textile and Apparel 1,164a)	Transportation 871a)	Iron/Steel 459a)
5	-	-	1	-
4	-	-	1	-
3	-	1	1	2
2	1	1	-	1
1	-	-	-	2

Note: a) Average employment of this industry during the years a conflict was settled.

Source: Oriental Economist, *Japan Economic Yearbook*, various issues.

Table 9. Conflict Outcomes and Export/Output Ratio of Affected Japanese Industries.

Conflict Outcome	.50-.54	.45-.49	.40-.44	.35-.39	.30-.34	.25-.29	.20-.24	.15-.19
5	1	-	-	-	-	-	-	-
4	1	-	-	-	-	-	-	-
3	1	-	1	-	2	-	-	-
2	-	-	2	-	-	1	-	-
1	-	-	-	-	-	-	1	1

Source: Oriental Economist, *Japan Economic Yearbook*, various issues.

Appendix C. Methodological Appendix

Table 10. Scale for Rating Conflict Outcomes.

Score	Decision Criterion
1	The U.S. is able to impose all of its demands on Japan, all its requests are granted, no concessions yielded. Japan fails to realize most of its objectives.
2	The U.S. grants minor concessions or compensations to Japan. Japan is able to realize some of its objectives.
3	The U.S. grants major, substantial concessions or compensations to Japan. Japan is able to realize many of its objectives.
4	The U.S. is able to achieve roughly half of its demands or goals, while Japan receives somewhat less than its initial demands.
5	This score represents a compromise between the two countries. Both countries were able to achieve roughly half of their demands.
6	Japan is able to achieve roughly half of its demands or goals, while the U.S. receives somewhat less than its initial demands.
7	Japan grants major, substantial concessions or compensations to the U.S. The U.S. is able to realize many of its objectives.
8	Japan grants minor concessions or compensations to the U.S. The U.S. is able to realize some of its objectives.
9	Japan is able to impose all of its demands on the U.S., all its requests are granted, no concessions yielded. The U.S. fails to realize most of its objectives.

Note: This scale is devised as an ordinal scale. It is a rough measure for classifying the outcomes of the trade conflicts between the U.S. and Japan.

Source: Adopted from Odell (1985).

Appendix D. The Scaling of Conflict Outcomes: Four Case Studies

In the following methodological appendix I will introduce four of the trade conflicts and explain why I assigned a certain score for the outcome of the conflict. The four cases represent the four industries analyzed in this study as well as four different outcomes.

Textiles and Apparel, 1971:

In this case, the Nixon administration was committed to fulfill its campaign promise to introduce protectionist measures to protect the textile and apparel industry. It was faced with a stubborn, no-compromise negotiation position on the Japanese side. Japan's position reflected both the intransigence of the Japanese textile industry and government and their misreading of the U.S. position. The Japanese side was slow to comprehend the determination of President Nixon to fulfill his campaign pledge. This commitment was reflected in the law chosen as the legal basis of the potential action of the U.S. against Japan: *the Trading with the Enemy Act.*, which was originally passed during WWI to delegate broad authority to the President to regulate foreign commerce in

periods of declared national emergency. Although there existed considerable legal doubts as to the relevance of Japanese textile imports to the intent of the Act, the "the Japanese capitulated to U.S. demands for "voluntary" export restraints on the last possible day (Cohen, 1985: 21)."

The position of the American government is reflected in the *The United States Aide-Memoire of October 2, 1969* and *The Second U.S. Proposal*, presented on January 2, 1970. The position of the Japanese government is reflected in *The Japanese Aide-Memoire* of March 9, 1970. The final agreement is reflected in *The Bilateral Agreement of January 3, 1972*. All these documents are reprinted in Destler et al. (1979: 339-59). An analysis of these documents and the additional sources revealed that the U.S. was able to realize most of its objectives, that Japan had to *capitulate* to the demands of the American government. However, the Japanese government was able to ease the demands to a small degree, so that the actual agreement was a little bit more favorable than the initial American position. Therefore, a score of 2 was assigned.

Carbon and Alloy Steel, 1972:

In the fall of 1968, Senator Vance Hartke (D-Ind.) introduced a bill to limit steel imports to 9.6 percent of the U.S. market (the 1964 to 66 import share). To forestall this initiative, both Japan and the EEC agreed in December 1968 to restrict voluntarily their steel exports to the United States (accounting for 82 percent of total U.S. steel imports) for three years (Hufbauer et al., 1986: 154).

Under this voluntary restraint agreement, the Japanese were to limit steel steel exports to the United States to 5.75 million tons in 1969, 6.04 million tons in 1970, and 6.35 million tons in 1979. The VER affected the level of total imports; they did not restrict specific steel products from individual countries. As a result of the VRA, suppliers shifted their export product mix toward more expensive stainless and alloy steel products, notwithstanding Japan's promise to try not to change greatly the product mix and pattern of distribution of trade as compared with the present (Mintz, 1973: 79-81).

In this case, the Japanese government was presented with a demand of the U.S. government to limit her exports to the U.S. This demand was supported by the threat to introduce quota legislation through congressional action. Japan was never in a position and therefore never tried to mediate the demands from the U.S. It had no choice but to accept the American demands (Walter, 1983: 491). Therefore a score of 1 was assigned.

Carbon and Alloy Steel, 1977:

In September 1977, responding to an overwhelming number of antidumping petitions filed with the Treasury Department, President Carter directed Under Secretary of the Treasury Anthony Solomon to devise a relief plan for the U.S. steel industry. The Carter administration, which had just concluded an OMA with Japan on color-television imports, was generally reluctant to handle steel in the same way or through any other quantitative import restrictions. The administration believed that because the steel industry was an oligopoly, quantitative import restrictions would give U.S. steel producers an additional incentive to raise prices. The centerpiece of the Solomon Report was a systematic import-relief scheme designed to protect the U.S. industry from the possible sale of foreign steel products at less than fair value, a legal benchmark used in the U.S. antidumping statute.

In January 1978, as recommended in the Solomon Report, the Carter administration introduced the trigger price mechanism (TPM). The TPM established *fair value* import reference prices for steel products constructed on the basis of Japanese unit costs of production, profit margins, and the cost of transportation to the U.S. market. Under the TPM, steel imports entering the U.S. market below the trigger prices were presumed to be dumped and therefore subject to fast-track antidumping investigations (Hufbauer et al., 1986: 162/3; Walter, 1983: 491/2).

The Japanese steel industry, under the leadership of Yoshihiro Inayama, chairman of the Nippon Steel Corporation and head of the Japan Iron and Steel Federation (JISF), was willing to volun-

tarily limit its exports to the U.S. The major reason for this can be found in the realization of the interdependent nature of the industry, a fear of losing its share of the very important U.S. steel market, and the expectations that quantitative export restraints will raise steel prices and therefore improve profit margins for the industry. The Japanese government, which became increasingly worried about the negative impact of the unresolved steel issue on the overall U.S.-Japanese relationship, were looking for a solution. However, they were at a loss as to how the issue might be resolved best. They were sandwiched between the Japanese industry, which wanted voluntary export restraints, and the U.S. government, which was opposed to such a quantitative approach. Although MITI officials were favorable toward trigger price-related solutions at the very beginning, Japanese industry leaders were skeptical at first. Until the end of October, they had adhered to the view that anything other than a quantitative solution would be unlikely to work. In fact it turned out that the decline in the volume of steel exports to the U.S. was not a painful experience for the Japanese steel industry, because profits actually increased rather than decreased during the implementation of the TPM (Sato and Hodin, 1982).

Although due to the final outcome of the conflict, the adoption of the TPM by the U.S., the Japanese market share of the American steel market decreased in 1978 by about 17 percent, it represented by far the better alternative to the regular U.S. antidumping procedures. Therefore, as the U.S. is granting major concessions to Japan, I assigned a score of 3 to this case.

Automobiles, 1982:

The crisis experienced by the automobile industry during spring 1980 caused certain manufacturers and the United Auto Workers to apply strong pressure on the government to negotiate export restrictions with Japan. Throughout 1980, the Carter administration resisted these demands, and the action came to a temporary halt in November, when the U.S. International Trade Commission found that Japanese auto imports were not the principal cause of injury to the domestic industry and that the industry was not entitled to temporary export relief. However, the UAW and the Ford

Motor Company continued to solicit direct congressional action. With the U.S. auto slump continuing into 1981, the new administration yielded by working out an arrangement, by which Japan would cut back modestly on her sales for at least two years (Winham and Kabashima, 1982: 73).

The first move of the Reagan administration toward this problem was the announcement by Transportation Secretary Drew Lewis at the end of January of the formation of an interagency task force to address the problems confronting the U.S. auto industry. On April 6, the task force announced its results. The proposed package included the elimination, modification, or postponement of 34 environmental and safety regulations for cars or trucks. However, there were no calls for import restrictions. At the same time, the administration was in frequent intergovernmental discussions at the cabinet and working level, indicating that they, like the Japanese government, preferred a negotiated rather than a legislated restriction on automobile imports (Yearbook of U.S.-Japan Economic Relations, 1981: 40).

The Japanese government tried to encourage Japanese automobile manufacturers to invest in the U.S. High-ranking MITI officials conducted a series of meetings, but the negotiations were not successful. Initially, MITI was reluctant to undertake voluntary export restrictions because of the possibility that U.S.-based import dealers might sue Japanese manufacturers for not supplying enough cars or that U.S. consumer groups might charge that the practice was contrary to U.S. antitrust laws. But the growing protectionist pressures in The U.S. and the possibility that protectionist trade laws would be established caused the Japanese administration to favor a negotiated voluntary export restraint. After negotiations between the U.S. Trade Representative Brock and MITI Vice Minister Amaya in February 1981, MITI was willing to restrict car exports to the U.S. by 1.5 to 1.6 million units.

Therefore, notwithstanding the unilateral form of the final action, the final agreement was in fact a negotiated arrangement. In this arrangement, Japan agreed to cut auto exports to the U.S. in 1981 by 7.7 percent. This would mean a ceiling of 1.68 million vehicles, down from 1.82 million shipped

in 1980. The Japanese plan would extend for two years beyond 1981, but future export levels would be based in part on the amount of growth that occurs in the U.S. market. At the same time, the administration publicly assured Japan that, in light of the restraint plan, they now saw no prospect of legislation passing Congress. This agreement represents a compromise between the two countries, in which Japan was able to prevent a trade bill from passing Congress by voluntarily restricting its exports to the U.S. Therefore I assigned a score of 5, reflecting the fact that the agreement can be characterized as a compromise between the two countries.

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