Trade Conflicts between Japan and the United States over Market Access: The Case of Automobiles and Automotive Parts

The conspicuous feature of bilateral trade conflicts between Japan and the United States in the 1980s and early 1990s was the shift from protecting the US market from Japanese exports to negotiating greater US access to the Japanese market. This paper takes the negotiations over automobiles and automotive parts as a case study to examine why the market-access policy evolved in the United States and how Japan responded. The US government had two main strategies: a managed-trade approach and a harmonisation approach. The managed-trade approach of the Framework Talks in the early 1990s was intensely resisted within Japan, and the Japanese government rejected the approach. The harmonisation approach has been consistent with Japanese policy, as represented by the Mayekawa Report, and the Market-Oriented, Sector-Specific (MOSS) and Structural Impediments Initiative (SII) talks between the United States and Japan were more successful and harmonious. The intensity of the trade conflicts in the early 1990s has not been a feature of trade talks in recent years, and the paper looks into the factors behind this change.

Introduction

Trade conflicts between Japan and the United States can be traced back to the 1930s when increasing exports of Japanese textiles to the United States led to accusations of unfair competition. Almost all the conflicts since then have arisen from complaints about a surge of imports from Japan to the US market. Complaints about the lack of access to the Japanese market have been quite recent, and it was only in the late 1970s that bilateral negotiations on market access were opened between the two countries.[2]

Postwar trade conflicts with the United States began with a surge in imports of Japanese cotton textiles in the middle of the 1950s. Protectionism grew in response to complaints from the textiles industry and labour unions. Rather than itself taking unilateral measures such as imposing import quotas, the US government asked Japan to set a limit on its exports. This was the beginning of a long history of voluntary export restraints (VERs).

Between the late 1950s and early 1980s, the Japanese and US governments agreed several formal export restraint arrangements, including the Japan–US Textiles Agreements in 1970 and the orderly marketing agreement on colour televisions in 1977. The aim of these arrangements was to solve trade conflicts arising from increasing Japanese exports. Most VERs were informal – Japanese exporters 'voluntarily' limited exports to the US market without any formal governmental agreement. These informal arrangements applied not only to major Japanese exports such as textiles, steel, colour televisions, machine tools, automobiles and semiconductors, reflecting changes in Japan's economic structure, but also to minor products such as pottery, china and cutlery.

The volume of Japanese exports ceased to be the main issue between the two countries from the middle of 1980s. Instead, trade talks became dominated by issues of market access. Bilateral talks on market access originated from US demands to open the Japanese beef and citrus markets in the late 1970s. In the 1980s trade conflicts over market access spread to manufacturing and services industries. Between the mid-1980s and the early 1990s, the United States introduced a new style of talks specifically aimed at opening up sectors seen as closed to competition, including the Market-Oriented, Sector-Specific (MOSS) talks, the Structural Impediments Initiative (SII) and the US–Japan Framework for a New Economic Partnership (Framework Talks).

The conflict in the automobile industry provides an interesting case study of the way trade talks changed. The auto conflict was sparked by a surge of Japanese cars into the American market in the late 1970s and ended with a VER introduced by Japanese automakers in 1981 after intense pressure from the United States. Four years later, however, the US government announced it would not call for a renewal of the VER but would instead lobby for increased access to the Japanese market. Despite this announcement, the Japanese government asked auto manufacturers to extend the VER. The manufacturers accepted this request and, as a result, auto VERs continued until March 1994. The United States then increased its demands for greater access to the Japanese market. The Japanese government accepted the United States' demand to include the issue of access to auto and auto parts markets in the MOSS talks, which started in 1985. Issues of market access were also discussed in the Framework Talks. Although the Japanese government agreed to negotiate on market access in the auto sector, the relationship between the two governments had been deteriorating and in 1994 the Framework Talks collapsed during a top-level meeting between Presidents Clinton and Hosokawa.

The purpose of this study is to clarify the nature of the trade disputes over market access between Japan and the United States, using the conflict over autos and auto parts as a case study. Two questions are posed. First, why did the talks shift from VERs to market access? Since almost all the trade talks have been initiated by the United States, the answer requires that the evolution of US trade policy on market access be examined. Without Japan's agreement, however, the trade talks would not have begun. The second question is, therefore, how has Japan responded to US demands for increased access to the auto and auto parts markets?

This paper traces the early stages of the auto conflict, examines the reasoning behind VERs and looks at why US trade policy shifted to favour talks on improving access to Japanese markets. Although the value of US trade policy on market access has been much debated,[3] there has been little discussion on how the policy evolved. Japan's attitudes and response to US trade policy, which have been both harmonious and antagonistic, are examined. The openness of the Japanese auto and auto parts markets is assessed. The paper then considers the important shift that occurred in the nature of Japan–US trade conflicts in the 1990s. In contrast to the intensity of the Framework Talks of the early 1990s, trade talks in the late 1990s were quiescent.

The rise and fall of VERs

The rise of VERs

The United States began to pay attention to Japanese auto exports in the late 1970s when imports from Japan were rapidly increasing. In 1973 only 740,000 Japanese passenger cars were sold to the United States, representing 6.5 per cent of the market. Sales almost doubled by 1977 and reached 1.9 million units (21.3 per cent of the market) by 1980 (Harada 1995: 21). In contrast, the US auto industry was in a heavy slump: industry earnings that were positive in 1978 turned negative in 1980, when domestic sales and production were at their lowest for 19 years. In two years production had dropped by 30 per cent, 300,000 auto workers had been laid off and 500,000 jobs had been lost in the auto parts, steel and support industries (Lochmann 1996: 100–1).

The depressed state of the auto industry was linked to the surge in auto imports from Japan. At the beginning of 1980, little action had been taken apart from the introduction of several protectionist bills in Congress. In early March 1980, the Subcommittee on Trade of the Committee on Ways and Means (1980) held hearings on world automobile trade. The hearings focused on whether import restrictions could assist the depressed auto industry. The testimony was pessimistic on this respect. For instance, the Council of Economic Advisers presented a projection of the economic effects of import restrictions, indicating that any import restrictions 'would cost the US economy far more than it would gain from increased production and employment in the United States' (Winham and Kabashima 1982: 89).

The US Trade Representative (USTR) argued that the cause was:

> the sudden shift in consumer demand toward small, fuel-efficient quality automobiles, which occurred in response to the gas shortages and rising gas prices, both part of the ongoing energy crisis facing the United States ... The U.S. industry was unprepared to meet this shift, partly because it had failed to draw the proper conclusions from the long gas lines, spot shortages, and sharply increasing world oil prices after 1973. (Winham and Kabashima 1982: 89)

The policy proposal, derived from both statements in the testimony, was that:

> [The] role of the government was not to restrict foreign imports … but rather to encourage the United States' trading partners to conduct as open a regime as the United States did in matters of trade and investment. In the case of Japan, this would require efforts to encourage the Japanese to removing [sic] the remaining barriers to automobile imports from the United States and, particularly, to persuade the Japanese automobile industry to follow the precedent set by Volkswagen of building plants in the United States. (Winham and Kabashima 1982: 90)

In accordance with this proposal, the Carter administration announced that the government would: (1) neither restrict auto imports nor request Japan for VERs; (2) request Japanese automakers to invest in the US; and (3) ask the Japanese government for a further reduction in tariffs and non-tariff barriers on autos and auto parts. This was the US government's basic stance toward Japan during the auto crisis in the early 1980s.

What was the stance of the United Auto Workers, the group most affected by the auto slump? Although the UAW was the party most responsible for initiating the auto dispute, because of its traditional support for free trade it did not seek import restrictions. Rather, it urged Japanese automakers to build assembly plants in the United States. The president of the UAW visited Japan in February 1980 and met with business and union leaders in the Japanese auto industry, as well as politicians, urging them to lobby for direct investment or export restraints. Although he repeated his support for free trade, he held that Japanese exports were responsible for unemployment in the US auto sector and pointed out that unless Japanese auto manufacturers made investment decisions quickly, the UAW might be forced to support import restrictions.

Despite the strong representations made by the president of the UAW, Japanese auto manufacturers were reluctant investors. Honda had already established an assembly plant in Ohio, but Toyota and Nissan, the two major firms, had resisted investing in the United States. Japanese firms were extremely concerned about higher wages, frequent strikes, the lower standard of workmanship, the lack of an established system of parts suppliers and the different legal system in the United States, all of which were perceived as increasing the cost of manufacturing in America. Nissan finally decided to establish a plant in Tennessee in July 1980, but the slow response of the Japanese automakers disappointed both the UAW and the US administration.

The third solution, an expansion of market access through liberalisation of tariffs and non-tariff barriers by the Japanese government, also proved disappointing to the US administration. Japanese auto tariffs were completely removed in 1978, and in May 1980 the government announced that the remaining tariffs on auto parts would be reduced. Under the Tokyo Round of the General Agreement on Tariffs and Trade (GATT), tariffs on tyres and tyre cases were to be reduced from 7.7 per cent to 5.8 per cent. With respect to non-tariff barriers in the auto sector, the United States regarded Japan's safety regulations and import inspection system as too stringent.

In response to US demands for deregulation, the Japanese government promised to revise 8 of the 12 items requested by the United States.[4] Japan's import inspection system was found to be no more stringent than the US system, however. For example, the inspection period for type notification in Japan was no longer than that in the United States and Europe. This was because Japan's Ministry of Transport had been accepting European Community test results and sending Japanese inspectors to undertake on-site examinations in the United States and the European Community since 1977. Regulations concerning the inspection period were further relaxed in the early 1980s.[5] But there was a general view in the United States, as well as Japan, that this deregulation had a minimal effect on US exports (Subcommittee on Trade of the Committee on Ways and Means 1980; and Ikema 1981).

Efforts by the US administration to solve the crisis in the auto industry in line with principles of free trade, to deal with pressure from the industry and Congress, and to maintain the liberal front of the labour unions, ended in failure. The auto industry and the labour unions put increasing pressure on the administration to impose import restrictions. In June 1980 the UAW and Ford Motor Company petitioned the United States International Trade Commission (USITC) for temporary import relief under Section 201 of the Trade Act of 1974. This petition required the ITC to determine whether the surge of imports had caused substantial injury to the domestic industry. If this were found to be the case, the ITC would recommend that the President take measures to restrict imports.

The ITC findings came down as negative by a close margin in November 1980, and no recommendation for increased import restrictions was forwarded to the President. The principal causes for the difficulties of the US auto industry were attributed to the recession in the US economy, higher oil prices and the shift in consumer preferences to small cars. The auto industry, however, was not satisfied with this decision. Congress quickly moved to press the President to negotiate an orderly marketing agreement with Japan. A succession of bills was proposed to Congress to restrict auto imports. The most protectionist was a bill proposed by Senators Danforth and Bentsen to limit imported automobiles by up to 1.6 million units a year over the following three years.

The first test of the new Reagan administration was whether it would maintain its commitment to the free market and reject protectionist demands, or submit to protectionism. The administration was divided. The ministers of Transport and Commerce supported import restrictions, but the other departments opposed them. In the bargaining process, VERs were settled on as a compromise. The administration sent a signal to Japan to restrict its exports.[6] After several 'consultations', not 'negotiations', with the USTR, in May 1981 the Japanese government announced a three-year VER on autos. The agreement was to limit exports of passenger cars by up to 1.68 million units for the first year, with 16.5 per cent of the first year's sales added to sales in the second year. An extension of the restrictions would be considered at the end of the third year.

The fall of VERs

As the first term of the VER drew to a close, discussion was heated within the US administration over whether it should be extended. In March 1984 it was decided to request a one-year extension for the time being. The controversy continued during the year. On 1 March 1985, President Reagan finally announced that the US government would not request a renewal of Japanese VERs, commenting: 'we believe that it is wise to maintain fair and free trade principles for consumers all over the world' (*Nihon Keizai Shinbun*, 3 March 1985). In the same speech, Reagan stated that negotiations on market access would be conducted among high-level officials and expressed the expectation of the United States that the Japanese government would comply with its request. The question remains – why did the US government make this decision?

There are three possible reasons.[7] First, the US economy had undergone a rapid recovery by the mid-1980s (Table 1). The US auto industry, like other industries, had gained from the strengthening US economy and the protection provided with further assistance by the VER.

By 1983 the US auto industry had recovered from its loss-making position and in 1984 the industry recorded a US$10.4 billion profit, the best result since 1977. The recovery led to a pay increase for workers and executives in the industry, who already enjoyed relatively high wages as a result of the industry's oligopolistic structure (Hufbauer, Berliner and Elliot 1986: 255). According to one Japanese newspaper, such a high pay increase aroused severe criticism in the United States (*Nihon Keizai Shinbun*, 17 May 1984).

Second, many empirical studies on the auto VER, appearing a few years after VERs started, reconfirmed that VERs were detrimental to the overall US economy (Gomez-Ibanez et al. 1983; Dardis and Decker 1984; Crandall 1984; and Feenstra 1984). Crandall's (1984) calculation, for example, showed that the price of imported Japanese cars had increased by US$900 on average, while domestic cars had risen in price by around US$400, causing a cost to consumers per job protected of US$160,000 a year.[8] It was also emphasised that because of the way rents were distributed, the welfare loss from VERs was greater than that from imposing tariffs or quotas.

Table 1 Real GDP growth (per cent)

Year	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98
US	-0.2	2.5	-2.0	4.3	7.3	3.7	3.4	3.4	4.2	3.5	1.8	-0.5	3.0	2.7	4.0	2.7	3.6	4.4	4.4
Japan	2.8	3.2	3.1	2.3	3.9	4.4	2.9	4.2	6.2	4.8	5.1	3.8	1.0	0.3	0.6	1.5	5.1	1.6	-2.5

Sources: US Department of Commerce (2001), *Bureau of Economic Analysis*, at <http://www.bea.doc.gov/>; Economic Planning Agency (2000), *Annual Report on National Accounts*.

Third, the restrictions on exports through the VER had led an increasing number of Japanese auto manufacturers to seriously consider investing in assembly plants in the United States. Each firm feared that it would lose its share of the US market if other firms launched investment earlier. In February 1984 Toyota came to an agreement with General Motors to establish an assembly plant for producing small cars while Mazda set up a joint assembly plant with Ford in January 1985. In October 1985 Mitsubishi announced plans to establish a joint plant with Chrysler. These investments meant the achievement of one of the two goals that the US administration sought for in vain in the early 1980s.

These improved economic circumstances must have made it easier for the Reagan administration to change its ‘rhetorical’ free trade to ‘real’ free trade.[9] But Reagan’s decision did not only reflect a dislike of VERs and the emergence of conditions unfavourable to VERs. Rather, the shift should be understood in relation to the administration’s new focus on market access. The administration proposed market-access talks on a sectoral basis in 1985. The administration considered this approach to be trade expansive and thus better than trade-restrictive VERs. Auto parts and automobiles were taken up in the MOSS talks in 1986 and 1990, respectively.

While the Japanese auto manufacturers unanimously welcomed the US decision to drop VERs, Japan’s Ministry of Trade and Industry (MITI) requested the auto industry continue its VER. MITI was concerned about ‘excess competition’ among auto manufacturers, believing that if the auto VER were to be removed, each firm would again compete with each other to expand its share of the US market (*Nihon Keizai Shinbun*, 29 March 1985).[10] Japan continued with VERs until they were abolished in March 1994 under the World Trade Organisation (WTO) agreement.

Japan enlarged the quota of passenger cars sold to the United States to 2.3 million units but, after reaching a peak in 1986, exports decreased and the quota has not been filled since 1987. In contrast, Japanese production in the United States has been growing. The number of cars produced by US affiliates in 1986 accounted for less than one-fifth of Japan’s exports that year, but by 1990 had reached 1.49 million – approximately 67 per cent of exports (Table 2). As a result, total sales in the US market, including both exports and production by Japanese plants, have been largely stable.

Table 2 Japan's auto exports and production by transplants in the United States (10,000s)

Year	84	85	86	87	88	89	90	91	92	93	94
Exports											
Trucks	73	92	109	88	64	49	36	31	19	16	20
Passenger cars	185	222	239	220	205	194	188	176	158	145	144
Total	258	314	348	308	269	243	224	207	177	161	164
Production											
Trucks	10	11	11	10	10	12	17	19	27	29	37
Passenger cars	14	25	51	63	77	113	132	136	142	154	179
Total	24	36	62	73	87	125	149	155	169	183	216
Total	282	350	410	381	356	368	373	362	346	344	380

Sources: Japan Automobile Manufactures Association (1995), *The Motor Industry of Japan*; Japan Automobile Manufactures Association (1994), *Automobiles: Annual Statistics*.

Evolution of the market-access policy in the United States

The MOSS talks

In January 1985, two months before President Reagan publicised his decision on VERs, the MOSS talks were opened. The MOSS talks, modelled from the Yen–Dollar talks initiated by the Treasury Department in 1983, aimed at removing Japanese trade barriers in sectors in which the United States considered it had competitiveness through intensive negotiations at the subcabinet level. Clyde Prestowitz, a senior official of the Commerce Department at that time, reported later that there had been disagreement within the administration over the strategy of the MOSS talks (Prestowitz 1988: 296). The Commerce Department and the USTR proposed that a certain quantity of imports be set as a target. The other departments insisted on a procedural, issue-by-issue approach under which barriers would be removed in the chosen industry by means of intensive, high-level negotiations. Finally, it was decided that the latter approach would be taken and four sectors – electronics, wood products, medical equipment and pharmaceuticals, and telecommunications products – were selected for the first round of negotiations.

In 1986 the US government proposed that auto parts be included in the MOSS talks. The proposal came from a belief that US exports of auto parts to Japan were obstructed by the tendency of Japanese automakers in *keiretsu* (conglomerates) to favour parts suppliers with whom they had ties. Although Japanese auto manufacturers were initially opposed to the inclusion of auto parts in the MOSS talks, claiming that the MOSS talks were not the place to discuss private business practices, they finally accepted it. In 1990 Japanese automobiles were added to the MOSS agenda. The decision to include automobiles was based on a similar argument. The United States believed the low penetration of US-made cars in the Japanese market was due to exclusionary dealerships controlled by the automakers through financial and relational ties such as the allocation of the most desirable models and cooperation and technical support. Vertical and distribution *keiretsu* ties were included in the MOSS talks as obstacles to US exports.

It is interesting that although it was agreed that the goal of MOSS talks would be the removal of trade barriers rather than securing Japanese markets for American firms, this principle has not necessarily been upheld by US officials. Indeed, the emphasis of the MOSS talks shifted away from a 'rules-oriented' approach to a 'results-oriented' approach. Schoppa (1997) argued, however, that:

> The MOSS approach suited the Reagan team ... because it aimed to remove barriers to exports on a most-favoured-nation basis rather than to restrict imports, and because it focused on 'rules' (product standards, testing, licensing, and government practices) rather than 'results'. In all these ways, it was perfectly consistent with the administration's liberal economic ideology. (Schoppa 1997: 65–6)

It is questionable whether the MOSS talks focused only on government 'rules', as Schoppa stated. In his 1997 book, Schoppa referred to the views of the chair of the National Economic Council, Laura D'Andrea Tyson (1993), but Tyson believed the MOSS talks aimed to remove Japan's 'structural impediments', including private practices such as *keiretsu* ties. As this paper has pointed out, the US decision to include Japanese auto parts and automobiles in the MOSS talks was based on the perception that these ties had impeded US exports to Japan.

The Reagan administration announced a further new trade policy strategy in September 1985. In the announcement the President showed his intention to make more frequent use of Section 301 of the 1974 US Trade Act. Section 301 allowed the President to take retaliatory action if foreign trade practices were found to impede American exports in an 'unjustifiable and unreasonable' manner. The idea, first embodied in Section 252 of the 1962 Trade Act, had been incorporated into Section 301 of the 1974 Act and amended to extend the definition of unfair trade practices and expand the range of retaliatory measures. But the provision had rarely been utilised until Reagan's announcement of the new trade policy.[11] The active and frequent use of Section 301 aimed opening up foreign markets alleged by the United States to be closed and also helped American negotiators at market-access talks place pressure on foreign countries to either continue with ongoing negotiations or sit down at the negotiating table.[12]

The MOSS talks were not the first bilateral negotiations on market access between Japan and the United States. Demands for access to the Japanese beef and citrus markets had begun in the late 1970s and continued until 1988 when the complete elimination of import quotas was finally agreed. But the MOSS talks were quite different from the negotiations over agriculture. First, the MOSS talks included the manufacturing sector, in which trade barriers had been almost completely removed and Japan was usually thought to have the competitive edge. Second, they extended the range of trade barriers to private business and consumer practices. Third, these sectoral access talks were supported by the government's new strategy of aggressive use of Section 301.

Fair trade, trade deficits and economic benefits

Fair trade

The deep involvement of the US administration in market-access policy can be attributed to three factors. The first is the evolution of principles of 'fair trade'. The notion of fair trade is not new in the history of trade policy and has two origins. The first is opposition to exports that are subsidised by foreign governments and dumped into local markets by foreign producers. Protection of domestic interests from unfair trade has been justified under US trade rules since the late 1890s and has been included in the GATT since 1948, although the term fair trade is not mentioned anywhere in the articles of the GATT or the WTO.

A second source of support for fair trade grew out of complaints about a lack of reciprocity regarding tariff levels. The fair trade movement developed in Britain during the 1870s and the 1880s, originating from mounting frustration over increasing imports from Germany and the United States. There was a perception that US and German producers enjoyed easier access to the British market than did Britain to foreign markets (Bhagwati and Irwin 1987). Britain had been seeking unilateral tariff reductions for many years. 'Fair trade' became the slogan of politicians and industrialists who strongly demanded a policy change from unilateral free trade to one of seeking reciprocity of market access in terms of tariff levels.

The fair trade debate in the United States has a surprising resemblance to the British campaign, as Bhagwati and Irwin (1987) have noted. Destler (1995) describes mounting frustration in Congress, repeating a testimony by a senator in the Senate Committee on Finance Hearings on the Trade Reform Act of 1973:

> [T]he United States could no longer afford to be the world's 'least flavoured nation', exposing our markets while the rest of the world employed 'practices which effectively bar our products'. Destler (1995) p. 115.

It appeared to the United States that Japan was able to unfairly compete in the US market and was acting as a free rider in the open world trading system. In what became termed as 'Japan bashing', Japan's trade policy, industrial policy and even Japanese society itself were accused of unfair trade practices.

Fair trade demands equal market access. The United States has taken two approaches to achieve equal market access. The first plan was the reciprocal trade bill, presented to Congress in the early 1980s, which proposed that the government restrict imports from a foreign country if US firms could not have equivalent market access to that of foreign firms to the United States. Because of the bill's protectionist nature, however, the US administration avoided this approach and decided instead to demand that foreign countries harmonise regulations with the United States by opening markets and increasing market access. US demands concerning Japan were justified by the premise that Japanese markets were closed.

Japan's low import ratio or low intra-industry trade provided the evidence for this belief. Whether Japan's 'peculiar' trade structure can or cannot be explained by legitimate factors such as scarcity of natural resources or distance from trading partners has been subject of many empirical studies.[13] The demands for market access were made on the basis of the one-sided argument that the Japanese market was closed while the US market was open, even though these studies so far have not produced a definite conclusion.

Fairness has two elements – equality of opportunity and equality of outcomes. In international trade, equal opportunity is secured by the principle of national treatment – that is, the equal treatment of foreign products, firms and people with home products, firms and persons once they enter the country. Therefore, national treatment demands equal treatment within a country but does not extend beyond its borders. The principle of fair trade, as encapsulated in US trade policy on market access, demands harmonisation of rules between countries. However, the United States sometimes seeks to harmonise with the American system not only regulations and standards but also private practices. Prestowitz (1988) explained that the US 'objective' of access negotiations over telecommunications 'was to obtain an environment similar to that in the United States' (Prestowitz 1988: 273).

The latter element, equality of outcomes, demands reciprocity of market access in terms of volume (or value) of imports. Fairness is measured in terms of import success. The 'targeting approach' considered by the US administration for the MOSS talks is an example of this approach. Prestowitz (1988) described the evolution of this approach in the first USTR meeting of the Reagan administration in 1981 in the following way:

> [H]e had called on the Japanese to establish an overall target for imports of manufactured goods. The motivation ... lay in the fact that Japan's imports of manufactured goods were about the same as those of Switzerland, a country with about 5 per cent of Japan's population. In fact, Japan's manufactured goods industries showed a strange profile ... Whenever Japan had a strong exporting industry, imports in that industry were likely to be close to zero ... had concluded this was because the structure of Japanese industry tended to reject imports. (Prestowitz 1988: 297)

This approach was rejected in the meeting, as it had been for the MOSS talks, as running the risk of violating principles of free trade. But in the end, the results-oriented, managed-trade approach did gradually erode the harmonisation approach in the MOSS talks on the auto sector.[14]

Trade deficits

The second factor that gave rise to the US policy on market access was the perception that the trade deficits had been caused by Japan's unfair trade practices. The US overall current account was in surplus in 1980 and 1981, but went into deficit in 1982. Trade deficits rapidly increased after 1983, reaching a record high of US$145 billion in 1985. The deficit with Japan was the largest of the US bilateral deficits. Deficits with Japan increased from US$15.1 billion in 1982 to US$58 billion in 1986 (Table 3), accounting for one-third of the overall deficit.

Between the late 1970s and the early 1980s, the Japanese government took various measures to liberalise trade. As a result, the level of Japanese protection of manufactured products was no higher than American and European levels in the early 1980s. It was therefore thought by the United States that the widening of the bilateral trade deficit must indicate that invisible, hidden barriers in Japan's economy were obstructing US exports to Japan. Congress attributed the large deficits to Japan's unfair trade practices. In March 1985 the Senate passed a resolution declaring that the bilateral trade imbalance with Japan had costed the United States hundreds of thousands of jobs, and that while Japan had extensive access to the US market, US exporters lacked access to the Japanese market for products in which the United States had a comparative advantage (Destler 1995: 271).

The auto sector accounted for more than half of the US deficit with Japan (Table 3). This led to the naive view that reducing the auto deficit would improve the overall deficit.[15] Another factor strengthening the perception that the Japanese auto and auto parts markets were enclosed by persisting hidden barriers was the failure of yen's appreciation in the late 1980s to reduce the auto deficit. In the early 1980s it had been generally accepted that the 'overvalued' dollar was responsible for weakening American industry. This belief led to the Plaza Agreement. Cooperative intervention promised by the Plaza Agreement appears to have played a role in reducing the US deficit with Japan to some extent, but it had little impact on the sectoral deficits of the auto sector, as shown in Table 3.

Table 3 Japanese trade deficits with the United States: autos, auto parts and overall (US$100 million)

Year	1986	1987	1988	1989	1990	1991	1992	1993	1994
Automobiles	266	260	231	224	213	226	215	222	239
Auto parts	60	73	89	100	95	91	98	112	128
Total	326	333	320	324	308	317	313	334	367
Overall deficits	580	600	520	491	411	434	494	593	659

Source: United States Information Service (1995).

Economic benefits

The promise of economic benefits is the last, but not the least significant, factor behind the market-access policy. As discussed earlier, the policy is based on fair trade, which demands both harmonisation of rules and managed trade.

If Japanese standards and regulations were harmonised in line with those of United States, US producers exporting to Japan or doing business in Japan would clearly benefit.

Managed trade is also likely to benefit the United States. Market access is defined as a promise of import expansion in excess of present volume (or value) by the importing country. Bhagwati (1987, 1988) has called this 'voluntary import expansion'. From the exporting country's point of view, this is an export expansion resulting from the efforts of the importing country.

If we assume that two finished products are traded between two large countries under a situation of perfect competition and no externalities, it can be shown that import expansion by the importing country either through import subsidies or (expanded) quotas increases the welfare of the exporting country through a favourable movement in its terms of trade, reduces the welfare of the importing country and causes a loss to world efficiency.[16] This is in sharp contrast to a policy of export expansion through subsidies, which decreases the welfare of the exporting country through a deterioration in its terms of trade. By contrast, the subsidies benefit its trading partner through a decline in import prices. Export subsidies act in the same way as an import expansion in causing a loss to world efficiency. In the case of a small country, both import and export subsidies act to expand its own imports and exports but make both trading partners worse off. This is because the cost of the subsidy is greater than the benefits to consumers in the importing country and to producers in the exporting country.

From a global point of view, neither export nor import subsidies can be justified. But if market failures exist in the market for exportable products (such as a lack of information about consumer preferences for new products or risks involved in a new marketing or sales activity in the foreign market), a case for export subsidies would emerge (Bhagwati 1968).

A similar argument might apply to the import side. A lack of information on the characteristics of the products or the existence of risks in importing the product might deter an importer and keep imports at a level less than optimal. The remedy for this type of market failure could be the establishment of import subsidies by the government of the importing country.

Since the early 1980s, the Japanese government has had an extensive import promotion policy, using tax incentives, low-interest loans and publicity to boost imports. In justification of import subsidies, the Ministry of International Trade and Industry states that:

> Expanding imports of manufactured products is a costly and risky undertaking which involves searching for new products, promoting sales, altering manufacturing processes, and providing maintenance. (MITI 1996: 1)

If there were genuine market failures in Japanese import markets, import subsidies offered by the Japanese government would help importers and exporters (including US firms) overcome impediments to imports and would improve Japanese welfare. Japanese import subsidies are a substitute for US export subsidies, even if not a perfect substitute, and therefore act to reduce the cost to the US government of export promotion.

Japan's responses: acceptance and resistance

Acceptance

In response to strong pressure to open its markets, the Japanese government took unilateral liberalisation measures in the early 1980s, ranging from tariff reduction to improvements to its standards and certification system. Although the protection of manufactured products, both in terms of tariffs and non-tariff barriers, was no higher in Japan than in the United States or Europe,[17] complaints about Japanese protectionism had not diminished. Japan's Office of the Trade and Investment Ombudsman,[18] established in 1982, and Prime Minister Nakasone's Action Plan in 1985 are only a few examples of government policies on market opening in this period.

In 1986 an important document, the Mayekawa Report, was produced by the advisory group of the Prime Minister.[19] On a basis of the perception that Japan has to 'make a historical transformation in its traditional policies on economic management and the nation's lifestyle', it stated that:

> The large current account surplus is basically linked with Japan's economic structure such as being export-oriented, and there is an urgent need for Japan to implement drastic policies for structural adjustment and to seek to transform the Japanese economic structure into one oriented toward international coordination. (Mayekawa Report in Miyazaki 1990: 226–7)

Setting 'reducing the current account imbalance' as a national goal, the report made several recommendations in order to achieve that goal. Apart from some macroeconomic policy matters such as expansion of domestic demand and management of fiscal and monetary policy, these recommendations were all internationally oriented, as expressed in such statements as 'transformation to an internationally harmonious industrial structure', 'further improving market access and encouraging imports of manufactured goods' and 'promotion of international cooperation and Japan's contribution to the world economy commensurate with its international status'. The Mayekawa Report firmly stated Japan's positive commitment to international harmonisation.

The report saw Japan in almost the same way as the US critics who supported the MOSS-type, harmonisation approach. In this sense the MOSS talks were consistent with Japan's new direction. In addition the Nakasone administration considered the reduction of the growing trade imbalance to be the most important issue in Japan–US relations and that opening the domestic market and increasing foreign direct investment would contribute to the reduction of the trade surplus. There were many criticisms of the Mayekawa Report, but since the mid-1980s it has been the Japanese government's central statement on the trade imbalance.[20] Thus, acceptance of the MOSS talks proposed by the US government must have come relatively easily to Japan's bureaucrats, although tough work remained in managing pressure from the groups most likely to suffer from harmonisation of government regulations and standards.

A conspicuous feature of the MOSS talks on autos and auto parts was the consideration of both vertical and distribution *keiretsu*. At first the Japanese government rejected US demands to include these arrangements, maintaining that *keiretsu* ties were private business matters. But, finally, the demand was accepted in order to counter the threat by Congress to impose import restrictions on Japanese auto parts needed by assembly plants in the United States (*Nihon Keizai Shinbun*, 27 January 1987).

As far as the MOSS talks on auto parts were concerned, however, a harmonisation approach did not appear to have been genuinely sought by the US government.[21] In the 1987 final report of the auto parts MOSS, the Japanese Automobile Manufacturers Association (JAMA) promised that auto manufacturers would expand their purchasing of auto parts – both imports and local purchasing at US plants – by six categories, every six months for the following five years. This was regarded as a de facto obligation to expand imports. The purchase of US-made auto parts by Japanese automakers increased from US$2.5 billion in 1986 to US$9.1 billion in 1990, as shown in Table 4.

The US economy was in recession in the early 1990s. The real growth rate dropped from 3.8 per cent in 1988 to –1.0 per cent in 1991 (Table 1). The US Vice-President visited Japan in May 1991 and requested that Japanese automakers sell US cars through their own distribution channels. In the automobiles MOSS established in July 1991, Japan agreed to set up a purchasing plan for foreign-made auto parts, the so-called voluntary plan, together with conducting a fact-finding investigation on the standards and certification system. The five Japanese auto manufacturers announced that they would increase purchases of foreign-made auto parts by up to US$1.635 billion in 1994, exceeding the 1990 figure by 90 per cent. More than 80 per cent of these purchases would be accounted for in purchases by the transplants in the United States.

At MITI's request, private companies have enacted voluntary plans to purchase foreign-made products since 1989 under the 'international cooperation program'. MITI also initiated an 'international exchange plan', which included 40 exporting corporations and electricity and gas companies. It aimed to expand imports, boost local purchasing by requesting that firms set import and local purchasing targets over three years, and assist foreign firms to gain access to the Japanese market. The inclusion in the MOSS agreement of the purchasing plans of the private companies placed a greater obligation on firms to meet these plans.

The managed-trade approach reached its peak when President Bush visited Japan in January 1992, accompanied by 21 business leaders. The US requested the purchase of

Table 4 Purchases of US-made automobile parts by Japanese automobile manufactures (US$100 million)

Year	1986	1987	1988	1989	1990	1991	1992	1993	1994
Imports	4.0	6.4	10.5	14.9	19.5	20.8	24	26	30
Purchases by transplants	20.9	24.9	38.6	56.3	71.2	84.5	112	129	170
Total	24.9	31.3	49.1	71.2	90.7	105.3	136	155	190

Source: Japan Automobile Manufactures Association, JAMA News, 14 July 1995.

imported auto parts additional to those announced in the most recent MOSS talks. The proposal was for the purchase of 20,000 US passenger cars and the revision of 14 types of automobiles and auto parts that the US alleged were affected by non-tariff barriers. The Japanese side finally agreed to increase purchases of auto parts by up to US$19.0 billion and promised to make greater efforts to buy more foreign automobiles and to revise some of the non-tariff barriers.

Resistance

The managed-trade approach brought complications and confrontation in the Framework Talks proposed by newly elected US President Bill Clinton, in 1993. The Japanese government opposed the managed-trade approach of the talks, resisting the setting of 'numerical targets'. It also argued over how the term 'objective criteria' should be interpreted. The US negotiators sought to set concrete numerical goals. In the talks on the macroeconomy, the United States requested that Japan reduce its trade surplus by setting a target of, for example, 'up to 1–2 per cent within 3 years'. The Japanese government rejected the use of specific figures, instead insisting on a vague wording – 'significantly sufficient reduction in the medium term' – which was finally adopted. The joint statement was announced in July 1993, but the disagreement between the two governments over targets led to the collapse of the Framework Talks in the next round of meetings between President Clinton and Prime Minister Hosokawa in February 1994.

Although the Framework Talks as a whole had been complicated, in no other element had agreement been harder to reach than in the talks on autos and auto parts. The seed of the difficulties was planted in the joint statement on the goals of these talks, which listed as their aim 'achieving significantly *expanded sales opportunities* to result in a *significant expansion of purchases* of foreign parts by Japanese firms in Japan and through their transplants, as well as removing problems which affect market access, and encouraging imports of foreign autos and auto parts in Japan' (MITI 1995c: 2) (emphasis added).

While the Japanese government insisted that the goal of talks was not to promise an increase in purchases by Japanese automakers but to expand the opportunities, as emphasised in the first phrase, the US government's emphasis was on the expansion of purchases, as stated in the second phrase.

There were three separate issues in the auto talks. The most intractable proved to be over the purchasing of parts by Japanese automakers. The United States requested an upward revision of the voluntary plan announced by the Japanese auto manufacturers in March 1994. The Japanese government dismissed this request as de facto managed trade, which it considered would force Japanese automakers to purchase US-made auto parts irrespective of quality, price or service. A further objection was that the US request was out of the reach of the government to achieve. However, the United States claimed that it had asked neither for numerical targets nor for negotiations with the government over the voluntary plans. Discrepancies in the interpretations of two governments did not seem to have been reconciled even after the announcement that the final talks would be held in July 1995.

The second issue was governmental regulations on after-market parts. The United States saw Japanese regulations regarding the repair, inspection and modification of vehicles as a means to:

> encourage consumers to have their vehicles repaired at automobile dealerships and other 'certified garages' that utilise only original equipment (OE) parts ... The effect of these regulations has been to channel repairs to automobile dealerships and other certified garages which tend to use the manufacturer's replacement parts almost exclusively. Parts distributors/wholesalers seldom, if ever, stock non-OE parts; thus, the dealers and garages have no choice but to use OE parts. (USTR 1995: 22)

On the basis of this perception, the US government demanded: (1) the reduction of the number of critical parts that were classified as 'important for safety'; (2) the reduction of modifications that were subject to inspection; and (3) the relaxing of requirements to use certified garages. Although the Japanese government insisted that the share of parts subject to regulation was only 3.6 per cent and that those parts were not treated in a discriminatory way, it agreed to accept all these demands. The Japanese government, however, rejected one of two additional requests that the US government made in March 1995, in the final stage of talks on the Japanese inspection system. They were: (4) the establishment of a certification system for specialised garages for certain critical parts; and (5) the separation of inspection from repair services. The Japanese government accepted (4) but rejected (5) for safety reasons.

The third issue was dealerships. The US government attributed the low import penetration of American cars in the Japanese market to the control Japanese automakers had 'over their dealers through financial ties (equity, loans, rebates, transfers of personnel to dealerships) as well as through practices found in the automobile industry, such as allocation of the most desirable models, and other forms of cooperation and technical support' (USTR 1995: 21). The United States saw Japanese dealers as 'captive distributors of the vehicle manufacturers, rather than independent businesses ... Such structural barriers to the distribution system suppress sales and therefore prevent foreign vehicle manufacturers from obtaining economies of scale on certification and homologation costs,[22] driving up the unit cost of imports' (USTR 1995:22).

The following five requests were made by the US government: (1) set up a contact point to deal with complaints about the relationship between dealers and auto manufacturers; (2) a thorough enforcement of anti-trust laws; (3) financial assistance to aid efforts by foreign manufacturers to develop and market appropriate models; (4) a commitment on the future number of car dealers selling foreign cars as a downpayment; and (5) Japanese car manufacturers should influence their dealers to begin handling 'Big 3' models. The Japanese government accepted the first three demands but rejected the last two, considering (4) as a numerical target and (5) as being contradictory to market principles.

The auto talks were not settled in the ministerial meeting held in May 1995. The disagreements had resulted from a difference in perception over regulations on after-market parts and dealerships, and the US insistence on the voluntary plans being revised. On 11 May the US government announced its intention to submit a file to WTO on barriers to market access and to impose retaliatory tariffs of 100 per cent on Japanese luxury cars under Section 301 of the 1974 Trade Act. The Japanese government quickly responded by petitioning the WTO on the basis of a violation of principles and requesting bilateral consultations with the United States. The retaliatory act was to be made within 30 days after the publication of a final list of cars, on which tariffs would be imposed through public hearings. Thus, unless an agreement was reached by 28 May, the dispute would move to the multilateral negotiations phase of the WTO's dispute settlement process after the imposition of tariffs.

In June the US withdrew its request for an upward revision of the voluntary plan and instead requested the raising of the local content ratio, as applied to transplants in the United States. But Japan rejected this request and the talks came to a deadlock again. When the negotiations between Ryutaro Hashimoto, Minister of MITI, and Micky Kantor, the head of the USTR, were made on 26 July, the day before the retaliatory action by the US was to be taken, it was expected that a compromise would be impossible because of the large differences between the two governments. But the situation was suddenly resolved and the agreement was concluded. The resolution came after Japanese automakers announced plans to reduce export ratios, promote globalisation, localise production sites, expand imports, increase purchasing of integrated and replacement parts, among other measures. This was a revision of the overseas business plan previously announced by the automakers, with the addition of the promise to increase purchasing of foreign parts.

In the Framework Talks, the basic stance of the Japanese government was clear. It basically accepted the relaxation of government regulations and standards, and rejected a managed-trade approach. But this stance had not been always upheld in the MOSS talks. On the subject of *keiretsu* ties, the Japanese government denied US claims that such ties discriminated against foreign producers of autos and auto parts and contributed to the low import penetration in these markets. The openness of the Japanese auto market has been another source of conflict between the two governments.

The question of openness

Table 5 shows the share of imported autos and auto parts in each country, as taken from the data published by the two governments. According to the US data, Japan's share of imported automobiles (row A) is only 4 per cent, which is extremely low compared with other advanced countries, but the Japanese data (row B) do not show such a significant difference. Japan's share is 8.1 per cent, higher than those of France and Italy, while the US share is 16.2 per cent, only half of the US figure in row A. The difference between the two sets of data is partly because the figures in row A include trucks and minicars while those in row B do not,[23] but it is mainly because the US figures in row A include imports from Canada and Mexico, its NAFTA partners, while those in row B do not.

Row C shows the share of US-made automobiles in each market. These data are used by the Japanese government to show that Japan is more open to US cars than is Europe, a region regarded as open. The figures in row D are the share of auto parts in each market. They show a large difference between Japan and other countries, although the US and European figures include imports from NAFTA partners and the European Union respectively.

It is clear that a simple correlation between import share and market openness is misleading. Other 1994 Japanese government data showed German passenger vehicles had a 3.6 per cent of the Japanese market but only a 3.0 per cent share of the US market. The Japanese

Table 5 Share of imported, US-made autos, and imported auto parts in the United States, Japan and EU (per cent)

		US	Japan	Germany	Britain	France	Italy
A	Imported vehicles	33.0	4.0	39.0	54.0	38.0	55.0
B	Imported passenger vehicles	16.2	8.1	15.7	13.5	5.0	5.2
C	US-made vehicles	2.7	1.4	0.4	0.1	0.2	n.a.
D	Imported auto parts	32.5	2.4	25.0	60.0	49.0	16.0

Notes: Row A is US data, including imported passenger cars and trucks. The US share includes imports from Canada and Mexico. The share of each EU country includes imports from other EU countries. Row B is Japanese data. The US share excludes imports from Canada and Mexico. The share of each EU country excludes imports from other EU countries. Row C is Japanese data. Row D is US data. n.a. = not available.

Sources: The US data is from the US Information Service (1995); the Japanese data is from MITI (1995b).

government has used this data as evidence that the Japanese market is more open to German vehicles than the US market is (MITI 1995a). The US government opposes this argument, pointing out that these figures do not include 'cars made by the Big 3 in Germany as European models' (United States Information Service 1995). But this criticism misses the point. The real question is why European cars, whether they include US cars made in Europe or not, have successfully penetrated the Japanese market but the 'Big 3' US manufacturers have not.[24]

Another indicator often used to measure the openness of the Japanese market is the price differential with other markets. The United States is critical of the prices of Japanese auto parts, claiming they are 200 to 300 per cent higher than the prices of US parts. It says that higher prices are caused by 'non-tariff barriers and regulations to prevent price competitive imports from reaching consumers as cheaply as they ought to' and 'the inefficiencies of the Japanese markets are well documented by the price differentials' (United States Information Service 1995: 5). The grounds for the US claim are the findings of the joint investigation conducted on the prices of after-market auto parts by the Japanese government and the US Department of Commerce in 1991 (United States Information Service 1995: 22).

The results of the two investigations showed significant differences (*Nihon Keizai Shinbun*, 28 June 1991). For example, according to the US investigation, the minimum prices of auto parts, including US-made parts sold in the Japanese market, are 4.4 times higher than those in the US market, although average prices are only 87 per cent higher. On the other hand, the Japanese investigation showed that the minimum prices of auto parts sold in Japan are twice as high as those in the US market and that average prices are only 2–11 per cent higher. The large differences in the findings can be partly attributed to the inclusion of auto parts for US-made cars in the US investigation, but they are mainly due to the comparison of different types of parts retailers. The US investigation compared the prices of US-made parts sold by the authorised dealers in Japan with the prices of the discount sales shops in the US, where non-pure parts are sold very cheaply. In contrast, the Japanese investigation focused on the shops and garages that dealt with Japanese parts in the United States. The results of this investigation show the difficulty of carrying out an accurate international comparison even of the prices of individual products.

Trade conflicts in the late 1990s

After the resolution of the auto talks in July 1995, the Framework Talks were substantially over, although discussions on deregulation and competition policy continued into the late 1990s – the period of the second Clinton administration. Trade disputes in the late 1990s changed in two main ways: the number of conflicts decreased and the nature of the conflicts changed. The number of bilateral talks on market opening decreased in the late 1990s because neither side proposed any new trade negotiations, although the negotiations on deregulation and competition policy were renewed in June 1997 under the title of the Enhanced Initiative on Deregulation and Competition Policy. Almost all issues taken up in the late 1990s concerned the surveillance of the agreements negotiated in the early 1990s, covering many sectors ranging from autos and auto parts to insurance.

The focus of the trade talks shifted to services, such as insurance or legal services, rather than goods, and tended to be about government regulation or practices. Second, the managed approach to trade seen under the first Clinton government in the early 1990s changed in the late 1990s to focus on harmonising regulations. The Japanese government was fairly accepting of the negotiations on harmonisation in the 1980s and therefore the intensity of conflict in talks such as MOSS or SII was relatively low. Similarly in the late 1990s, US demands for deregulation of various markets were not rejected by the Japanese government. The third feature of trade talks in this period was that the US government did not resort to the use of Section 301 as often as in the early 1990s. Instead trade issues, such as over the distribution and sale of imported consumer photographic film and paper in Japan, tended to be taken to the Dispute Settlement Body of the WTO.

The decrease in the number of trade talks in the late 1990s and the change in their nature can be attributed to many factors, but three reasons stand out in particular. The first is macroeconomic changes such as stronger US growth and the reduction in the bilateral balance of trade. As shown in Table 1, the US economy had made a recovery by the late 1990s but Japan had not yet come out of recession. As the depression of the 1930s taught, difficult times lead to import protection and export expansion. Since the import expansion of the importing countries is the other side of the expansion of the exporting countries, it is understandable that demands for market access are stronger during a recession than in a boom. The United States put intense pressure on Japan to expand purchases of automotive parts in the early 1990s when its economy was in deep recession. As the US economy gradually recovered, the pressure for market access has weakened.

Although the US trade deficit did not decrease in the 1990s, Japan's share of the deficit declined from 52 per cent in 1992 to 21 per cent in 1999, as shown in Table 6. The trade deficit with China, on the other hand, increased rapidly. In 1999 the bilateral deficit with China was 3.75 times larger than in 1992. The improvement in the bilateral trade balance with Japan must have played a role in easing the US complaints against Japan.

The second factor behind the easing in trade conflicts in the late 1990s was a drastic change in Japan's import structure. According to data compiled by Japan's Institute for International Trade and Investment (1999), the share of food and raw materials in total imports declined from almost 60 per cent to 40 per cent throughout the 1990s. The share of capital goods increased from 30 per cent in 1989 to 50 per cent in 1998, while the import share

Table 6 US balance of trade (US$100 million)

Year	1992	1993	1994	1995	1996	1997	1998	1999
A Balance of Trade	961	1,326	1,662	1,736	1,912	1,967	2,469	3,456
B Balance of Trade with Japan	496	594	657	591	476	561	640	734
B/A (%)	51.6	44.8	39.5	34.1	24.9	28.5	25.9	21.2
C Balance of Trade with China	183	228	295	338	395	496	569	687
C/A (%)	19.0	17.2	17.8	19.5	20.7	25.3	23.1	19.9

Source: US Census Bureau, *Foreign Trade Statistics*, at <http://www.census.gov/foreign-trade/>.

of consumer durables and undurables remained stable.[25] These changes showed that Japan's trade structure with the United States has changed from being vertical to horizontal, which is a similar pattern to that between the United States and the EU.

The third factor is the change in the trade policy of both countries. The Japanese government was successful in its rejection of a managed-trade approach in the Framework Talks. When the US pursued unilateral retaliation, the Japanese government counteracted by petitioning the WTO in a bid to resolve the trade conflict in a multilateral rather than a bilateral manner.

It was fortunate for Japan that other countries in Asia and Europe also opposed the approach of managed trade cum retaliation that was pursued by the first Clinton administration. The voice against 'aggressive unilateralism' (Bhagwati and Patrick 1990) soon spread beyond academic economists to senior government officials. For example, a Japanese newspaper reported that Laura D'Andrea Tyson had described the United States' aggressive trade policy as ineffective and had requested the policy be revised (Nihon Keizai Shinbun, 18 May 1994). It also reported that Jeffery Garten criticised the excessive resort to retaliatory measures by the US government, after his resignation as Secretary of the Commerce Department (Nihon Keizai Shinbun, 3 December 1995).

In the second Clinton administration, under the influence of Finance Minister Robert Rubin, the United States began to see Japan's macroeconomy as to blame for the low import demand, and supported an expansion of domestic demand and the deregulation of Japan's economy. For example, the Trade Policy Agenda (USTR 1998) stressed not only market opening, but the importance of Japan's demand-led growth and structural reform. This was in sharp contrast with past agendas, which concentrated on opening markets.

Conclusion

The United States has used the concept of fair trade to justify its market-access policy. Fair trade has two elements – equality of opportunity and equality of outcomes. The first aim points to a harmonisation approach and the second to a managed-trade approach. In the 1980s US trade policy on market access adopted both approaches, but the latter gradually gained influence, a product of increasing frustration with persistent bilateral trade deficits. Japan's attitude to the harmonisation approach, as in the MOSS talks, has been accepting but, as the focus of US policy shifted to a managed-trade approach, resistance grew and resulted in the collapse of the Framework Talks. The shift in US trade policy away from VERs to a market-access policy can be partly explained by the economic benefits. The market-access policy was more attractive than the earlier VERs because the effects on the US terms of trade were more favourable and the burden on the US government was less.

There are many questions about the development of US trade policy on market access that remain unanswered. This paper has examined the policy in the context of the debate on fair trade and the concern of the United States about the huge trade deficits. What is lacking is a consideration of the political economy of trade policy, for instance there has been work in the United States on the activities of new export lobby groups.[26] A similar lack of analysis of political economy applies on the Japanese side. In particular, the question of why the Japanese government strongly rejected a managed-trade approach in the Framework Talks has not been answered.

The US trade policy of the 1980s had tremendous economic effects, not only on Japan but also on other East Asian economies. For example, many Japanese manufacturers invested in the United States in the early 1980s to ease the trade conflict even though the goods could have been produced more competitively in Japan. The yen's appreciation was intended to reduce the trade imbalance but it propelled Japanese manufacturers to invest not only in the United States but also in Asia, leaving the trade imbalance with the United States unchanged but affecting industrial structure in both Japan and other Asian countries. The economic impacts of trade conflicts are also subjects for further study.

In the late 1990s, some favourable conditions arose to ease the stress stemming from trade conflicts. These include the economic prosperity in the United States, an increase in US exports of manufactured products to Japan and greater use of the WTO's Dispute Settlement Body. The absolute trade imbalance, however, is not expected to disappear in the near future. As long as the bilateral trade imbalance is misleadingly connected with the perception that the Japanese market is closed, US demands for market access are also unlikely to disappear.

Notes

1 A large part of this paper, not including Section 6, is an edited extraction from 'Trade Conflict between Japan and the United States over Automobiles and Automotive Parts', which was published in the *Journal of the Graduate School of International Cultural Studies*, Tohoku University, 1999. The journal article was based on a presentation at the Australia–Japan Research Centre on 8 December 1997 during my

visit to the Centre as a research fellow funded by Monbusho (the Ministry of Education, Culture and Science). I am grateful to Professor Peter Drysdale for his suggestion to consider the change in trade conflicts in the 1990s and to Michael Sutton and Noriko Takahashi for their assistance and their comments on Section 6.

2 For the long history of accusations of unfair trade by the United States and Europe against Japan, see Saxonhouse (1996).

3 The evaluation of US market-access policy has always been controversial, as views are split on whether the policy has been beneficial. Supporters regard the market-access policy, unlike VERs, as free-trade oriented and trade expansive, while detractors see it as discriminatory and as managed trade. While supporters of the policy describe the Japanese market as closed, the detractors question this view. For the former view, see Johnson, Tyson and Zysman (1989); Tyson (1993); and Bergsten and Noland (1993). For the latter, see Bhagwati and Patrick (1990); and Krueger (1995).

4 Among remaining four items, two were withdrawn after the US side recognised there had been misunderstandings and the remaining two items were rejected by Japan for safety reasons. They were: (1) the adoption of rear reflectors with a diameter of less than 3 centimetres; and (2) the abolition of the obligation to install a warning device that would operate at a speed of more than 100 kilometres an hour. Ikema (1981) p. 48.

5 Ikema (1981), in discussing these examples, concluded that it was not correct to say that Japan had prevented the import of vehicles by extending non-tariff barriers (p. 47).

6 Later, the 1989 Advisory Committee for Trade Policy and Negotiations (ACTPN) described the US administration's insistence on auto VERs as 'a non-agreement resulting from a non-negotiation'. Law (1995) rejects this view as 'disingenuous', citing Reagan's autobiography (pp. 113–15). Winham and Kabashima (1982) noted that the auto 'VER was in fact a negotiated arrangement, notwithstanding the unilateral form of the final action' (p. 115).

7 It is surprising that Destler (1995) made no comment about the reasons for the decision in his comprehensive survey of American trade policy.

8 The cost to the economy of each job created as calculated by a later study (Collyns and Dunaway 1987) was between US$110,000 and US$145,000. It is interesting to compare these figures with those of projections by the CEA (US$50,000 to US$100,000), which were estimated before VERs were introduced. Studies undertaken after the VER calculated greater costs to the economy than the pre-VER studies.

9 Far from supporting the free-market system, protection was tightened in the first term of the Reagan administration. The protectionist measures the administration took during its first term were: a new steel VER agreement with the European Community; a revival of sugar quotas; support for extending and strengthening the Multifibre Agreement; and a rise in tariffs on speciality steel and motorbikes.

10 The article also reported that Prime Minister Nakasone firmly intended to renew the VER.

11 Between 1975 and 1979, only 18 petitions were made under Section 301 and no retaliatory measures were taken by the President. Although this provision was more frequently utilised after the amendment of the 1979 Trade Act, retaliation was not resorted to. See Milner (1990).

12 Bhagwati and Patrick (1990) have criticised the use of Section 301 as 'aggressive unilateralism'. On the other hand, a comprehensive study by Bayard and Elliott (1994) concludes that Section 301 has succeeded in opening up foreign markets, and not brought about a trade war or the collapse of the multilateral system.

13 For a survey of this literature, see Lincoln (1990); Srinivasan (1991); Saxonhouse (1993); Lawrence (1993); and Drysdale (1995).

14 In September 1989, the Brookings Institution held a research conference entitled 'An American Trade Strategy: Options for the 1990s'. Two of the three main papers presented at the conference defended the managed style of trade policy. One of the two who defended managed trade was Laura D'Andrea Tyson, later appointed the chair of the National Economic Council under the Clinton administration. See Lawrence and Shultze (1990).

15 This view was rejected by the 1983 *Economic Report of the President*, which stated: 'Large trade deficits are not the result of unfair trade competition. Large projected US deficits are result of macroeconomic forces, particularly large budget deficits. The main sources of the US trade deficit are not to be found in Paris or Tokyo but in Washington'. Council of Economic Advisers (1983), p. 56.

16 For a traditional analysis using an offer curve, see Dinopolous and Kreinin (1990).

17 Studies using an inventory approach have shown that in the early 1980s Japan had the lowest level of non-tariff barriers on manufacturing products among the advanced countries (Cline 1984; and Balassa and Balassa 1984).

18 The OTO was established in January 1982 for the purpose of settling grievances related to the openness of the Japanese market.

19 The formal name was 'The Report of Advisory Committee on Economic Structural Adjustment for International Harmony'.

20 Among the critics were included two prominent Japanese economists, Osamu Shimomura and Ryutaro Komiya. Komiya (1986) questioned the appropriateness of reducing the trade surplus as a goal and the lack of consistency between this goal and its measures. For a defence of the Mayekawa Report, see Miyazaki (1990) pp. 71–6.

21 *Nihon Keizai Shinbun* reported that the issues of *keiretsu* and the inspection system had been withdrawn from the talks because the US government had admitted that there had been misunderstandings over these issues. The focus of the talks shifted to local content in Japanese production in the United States.

22 Expenses incurred when modifying a vehicle to meet the importing country's safety and emission standards.

23 The Japanese government claims that the US data is inappropriate because trucks are rarely traded internationally and minicars are not sold in the United States and Europe. Minicars (*Kei jidosha*) are defined as having a displacement volume of no more than 660 cubic centimetres and a length not exceeding 3.4 metres.

24 The share of European automobiles in the Japanese market was 5.4 per cent in 1994 while that of US autos was 2.7 per cent, with 1.0 per cent being sold by the 'Big 3'. The increase in imports of US-made cars was rapid. In 1991 the US share of imported cars in Japan was 16.6 per cent but it increased to 36.3 per cent in 1994, almost the same as Germany's share.

25 I owe this point to Professor Masahiro Nagata of Saitama University.

26 Bhagwati (1988, 1989); Destler and Odell (1987); and Milner (1988) point out the rise in the lobby groups supporting the interests of US exporters. Although Destler and Odell, and Milner seem to consider the growth of export interests as a development that counteracts protectionism, Bhagwati is critical of this growth. 'While all authors consider the benign role of these interests in shifting trade policy away from import protectionism to exports and "opening markets", the first [Bhagwati] considers also the down side of the phenomenon – that these export interest may capture trade policy to foster "export protectionism"' (Bhagwati 1989, Note 50).

References

Balassa, Bela and C. Balassa (1984) 'Industrial protection in the developed countries', *The World Economy*, 7: 179–96.

Bayard, Thomas O. and Kimberly Ann Elliott (1994) *Reciprocity and Retaliation in U.S. Trade Policy*, Washington DC: Institute for International Economics.

Bergsten, C. Fred and Marcus Noland (1993) *Reconcilable Differences? United States–Japan Economic Conflict*, Washington DC: Institute for International Economics.

Bhagwati, Jagdish (1968) 'The theory and practice of commercial policy: departures from unified exchange rates', *Special Papers in International Economics*, 8, Princeton University.

Bhagwati, Jagdish (1987) 'VERs, quid pro quo DFI, and VIEs: political-economy-theoretic analyses', *International Economic Journal*, 1(1): 1–14, reprinted in Douglas A. Irwin (ed.) *Political Economy and International Economics*, Cambridge: The MIT Press, 1991.

Bhagwati, Jagdish (1988) *Protectionism*, Cambridge: The MIT Press.

Bhagwati, Jagdish (1989) 'U.S. trade policy at crossroads', *The World Economy*, 12(4): 439–79, reprinted in Douglas A. Irwin (ed.) *Political Economy and International Economics*, Cambridge: The MIT Press, 1991.

Bhagwati, Jagdish and Douglas A. Irwin (1987) 'The return of the reciprocitarians: U.S. trade policy today', *The World Economy*, 10(2):109–30, reprinted in Douglas A. Irwin (ed.) *Political Economy and International Economics*, Cambridge: The MIT Press, 1991.

Bhagwati, Jagdish and H.T. Patrick (1990) *Aggressive Unilateralism*, New York: Harvester Wheatsheaf.

Cline, William R. (1984) *Exports for Manufactures from Developing Countries: Performance and Prospects for Market Access*, Washington DC: Institute for International Economics.

Collyns, Charles and Steven Dunaway (1987) 'The cost of trade restraints: the case of Japanese automobile exports to the United States', *IMF Staff Papers*, 34: 150–75.

Council of Economic Advisers (1983) *The Economic Report of the President*, Washington DC: US Government Printing Office.

Crandall, Robert W. (1984) 'Import quotas in the automobile industry: the costs of protectionism', *The Brookings Review*, 4.

Dardis, Rachel and Susan Decker (1984) 'The welfare loss of the voluntary export restraint for Japanese automobiles', *The Journal of Consumer Affairs*, 18(1): 47–63.

Destler, I.A. (1995) *American Trade Politics* (Third Edition), Washington DC: Institute for International Economics.

Destler, I.A. and John S. Odell (1987) *Anti-Protection: Changing Forces in United States Trade Politics*, Washington DC: Institute for International Economics.

Drysdale, Peter (1995) 'The question of access to the Japanese market', *The Economic Record*, 71(214): 271–83.

Feenstra, Robert C. (1984) 'Voluntary export restraint in U.S. autos, 1980–81: quality, employment, and welfare effects', in Robert Baldwin, and Anne O. Krueger (eds) *The Structure and Evolution of Recent U.S. Trade Policy*, Chicago: The University of Chicago Press.

Gometz-Ibanez, J.A., R.A. Leone and S.A. O'Connell (1983) 'Restricting auto imports: does anyone win?', *Journal of Policy Analysis and Management*, 2(2): 196–219.

Harada, Keniich (1995) *Beikoku Jidosha Sangyo Yakusin no Senryaku* (The US Auto Industry's Winning Strategies), Tokyo: Kogyo Chosakai.

Ikema, Makoto (1981) 'Nichibei boeki masatsu – nihon no baai', (Japan–US trade friction – The Case of Japan), *Kikan Gendai Keizai*, 58.

Institute for International Trade and Investment (1999) *Keizai Kozo tou Hikaku Chosa* (Comparative Studies on Economic Structures), Tokyo: Institute for International Trade and Investment.

Johnson, Chalmers, Laura D. Tyson and John Zysman (1989) *Politics and Productivity*, Cambridge: Ballinger Publishing.

Komiya, Ryutaro (1986) 'Nichibei keizai masatsu to kokusai kyocho' (Japan–US economic conflict and international cooperation), *Shukan Toyo Keizai*, 6 July and 14 July, reprinted in *Gendai Nihon Keizai*, Tokyo: Tokyo Daigaku Shuppankai, 1988.

Krueger, Anne O. (1995) *American Trade Policy – A Tragedy in the Making*, Washington DC: American Enterprise Institute.

Law, Patrick (1995) *Trading Free: The GATT and US Trade Policy*, New York: The Twentieth Century Fund Press.

Lawrence, Robert Z. (1993) 'Japan's different trade regime: an analysis with particular reference to keiretsu', *Journal of Economic Perspectives*, 7(3): 3–19.

Lawrence, Robert Z. and Charles L. Shultze (1990) (eds) *An American Trade Strategy: Options for the 1990s*, Washington DC: The Brookings Institution.

Lincoln, Edward J. (1990) *Japan's Unequal Trade*, Washington DC: The Brookings Institution.

Lochmann, Michael W. (1996) 'The Japanese voluntary restraint on automobile exports: an abandonment of the free trade principles of the GATT and the free market principles of United States Antitrust laws', *Harvard International Law Journal*, 27: 99–157.

Milner, Helen (1988) *Resisting Protectionism*, Princeton: Princeton University Press.

Milner, Helen (1990) 'The political economy of U.S. trade policy: a study of the Super 301 provision', in Jagdish Bhagwati and Hugh Patrick, Aggressive Unilateralism , 163–80.

MITI (1995a) 'Misconception', *News from MITI*, February.

MITI (1995b) 'Is the Japanese auto and auto parts market closed?', *News from MITI*, June.

MITI (1995c) 'What is written in the final conclusion between the government of Japan and the government of the United States regarding autos and auto parts', *News from MITI*, September.

MITI (1996) 'Overview of Japan's import promotion policy', *News from MITI*, November, at <http://www.jef.or.jp>.

Miyazaki, Isamu (1990) *The Japanese Economy*, Tokyo: Simul Press.

Prestowitz, Clyde V. Jr. (1988) *Trading Places*, New York: Basic Books.

Saxonhouse, Gary R. (1993) 'What does Japanese trade structure tell us about Japanese trade policy?' *Journal of Economic Perspectives*, 7(3): 21–43.

Saxonhouse, Gary R. (1996) 'A short summary of the long history of unfair trade allegations against Japan', in Jagdish Bhagwati and Robert E. Hudec (eds), *Fair Trade and Harmonization: Prerequisites for Free Trade? Vol. 1: Economic Analysis*, Cambridge: MIT Press.

Schoppa, Leonard J. (1997) *Bargaining with Japan*, New York: Colombia University Press.

Srinivasan, T.N. (1991) 'Is Japan an outlier among trading countries?', in Jamime de Melo and Andre Sapir (eds) *Trade Theory and Economic Reform*, Cambridge: Blackwell.

Subcommittee on Trade of the Committee on Ways and Means: US House of Representatives (1980) *Task Force Report on United States–Japan Trade,* Washington DC: Government Printing Office.

Tyson, Laura D'Andrea (1993) *Who's Bashing Whom?*, Washington DC: Institute for International Economics.

United States Information Service (1995) 'Common questions about the U.S. position on auto issues, *Background Bulletin*, 27 April, Washington: United States Information Service.

USTR (1995) *1995 National Trade Estimates: Japan*, at <http://www.ustr.gov>.

USTR (1998) 'The 1998 Trade Policy Agenda and 1997 Annual Report of the President of the United States on the Trade Agreements Programme', at <http://www.ustr.gov>.

Winham, Gilbert R. and Ikuo Kabashima (1982) 'The politics of U.S.–Japanese auto trade', in I.M. Destler and Hideo Sato (eds) *Coping with U.S.–Japanese Economic Conflicts*, Lexington: DC Heath and Co.

Previous *Pacific Economic Papers*

309 Subregional trading arrangements among APEC Economies: managing diversity in the Asia Pacific
Andrew Elek, December 2000

308 Weathering the Asian crisis: the role of China
Yongzheng Yang and Rod Tyers, October 2000

307 The internationalisation of the yen: essential issues overlooked
Tetsuji Murase, September 2000

306 Japan's local governance at the crossroads: the third wave of reform
Purnendra Jain, August 2000

305 Some key issues for the East Asian food sector
M. Honma, R. Trewin, M. Bosworth, R. Stringer and Y. Godo, July 2000
(special volume)

304 Food embargoes against China: their likelihood and potential consequences
Yongzheng Yang, June 2000

303 Foreign direct investment and intra-industry trade – the case of the United States
Tina Yiping Chen, May 2000

302 Implications of recent Japanese legal reforms
Leon Wolff, Veronica Taylor and Akiyoshi Horiuchi, April 2000
(special volume)

301 Toward reform and transparency in Japanese policymaking processes
J.A.A. Stockwin, Jennifer Amyx and Gregory Noble, March 2000
(special volume)

300 A way forward for Japanese agriculture?
Masayoshi Homna, Ray Trewin, Jennifer Amyx and Allan Rae, February 2000
(special volume)

299 Japanese foreign direct investment in the world economy 1951–1997
Roger Farrell, January 2000

298 The genesis of APEC: Australian–Japanese political initiatives
Takashi Terada, December 1999

297 Is shutting Krugman's 'liquidity trap' the answer to Japan's problems?
Dominic Wilson, November 1999

296 Japanese government–business collaboration and the operations of Japanese corporations in Asia: A telecommunications case
Hidetaka Yoshimatsu, October 1999

295 Free trade champion? Australian views of the US crusade against Japan
Julia Lowell, September 1999

294 Governance and Australian financial institutions
Kevin Davis, August 1999

293 The changing climate for foreign direct investment into Japan
Peter Drysdale, Ray Trewin, Toshi Naito and Dominic Wilson, July 1999

292 The Japanese origins of PAFTAD: The beginning of an Asian Pacific economic community
Takashi Terada, June 1999

291 Not just a question of multilateral free trade: Australia's bilateral trade liberalisation agenda towards Japan
Jamie Anderson, May 1999

290 Perspectives on Japanese investment, employment and management in Australia
Roger Farrell and Peter Drysdale, April 1999

289 Predicting banking crises: Japan's financial crisis in international comparison
Michael Hutchinson and Kathleen McDill, March 1999

288 Japan's financial reform Volume I
Hugh Patrick, Takatoshi Ito, February 1999

287 International trade and environmental policy: how effective is 'eco-dumping'?
Xinpeng Xu, January 1999

286 Open regionalism going global: APEC and the new transatlantic economic partnership
Andrew Elek, December 1998

285 Realism and postwar US trade policy
John Kunkel, November 1998

284 Attracting FDI: Australian government investment promotion in Japan, 1983–96
Jamie Anderson, October 1998

283 The Multi-function polis 1987–97: an international failure or innovative local project?
Paul Parker, September 1998

282 Organisation, motivations and case studies of Japanese direct investment in real estate 1985–94
Roger Farrell, August 1998

281 Japan's approach to Asia Pacific economic cooperation
Peter Drysdale, July 1998

280 The politics of telecommunications reform in Japan
Hidetaka Yoshimatsu, June 1998

279 Sustainability of growth in the Korean manufacturing sector
Chang-Soo Lee, May 1998

278 Export performance of environmentally sensitive goods: a global perspective
Xinpeng Xu, April 1998

277 Modelling manufactured exports: evidence for Asian newly industrialising economies
Francis In, Pasquale Sgro and Jai-Hyung Yoon, March 1998

276 Laos in the ASEAN free trade area: trade, revenue and investment implications
Jayant Menon, February 1998

275 Globalisation
Heinz Arndt, January 1998

274 The WTO and APEC: What role for China?
Stuart Harris, December 1997

273 The APEC air transport schedule
Christopher Findlay, November 1997

272 Japanese foreign direct investment in real estate 1985–1994
Roger Farrell, October 1997

271 China and East Asia trade policy volume 4: Trade reform and liberalisation in China
Yang Shengming, Zhong Chuanshui, Yongzheng Yang, Feng Lei, Yiping Huang, and Pei Changhong, September 1997
(Special volume)

270 The politics of economic reform in Japan
T.J. Pempel, Tony Warren, Aurelia George Mulgan, Hayden Lesbirel, Purnendra Jain and Keiko Tabusa, August 1997

269 Diplomatic strategies: the Pacific Islands and Japan
Sandra Tarte, July 1997

268 Interest parity conditions as indicators of financial integration in East Asia
Gordon de Brouwer, June 1997

267 Consensus in conflict: competing conceptual structures and the changing nature of Japanese politics in the postwar era
Lindy Edwards, May 1997

266 The role of foreign pressure (*gaiatsu*) in Japan's agricultural trade liberalisation
Aurelia George Mulgan, April 1997

265 Transformation in the political economy of China's economic relations with Japan in the era of reform
Dong Dong Zhang, March 1997

264 Economic relations across the Strait: interdependence or dependence?
Heather Smith and Stuart Harris, February 1997

263 Has Japan been 'opening up'?: empirical analytics of trade patterns
Jayant Menon, January 1997

262 Postwar private consumption patterns of Japanese households: the role of consumer durables
Atsushi Maki, December 1996

261 East Asia and Eastern Europe trade linkages and issues
Jocelyn Horne, November 1996

Annual subscription rate for twelve issues:

Individuals A$65.00
Institutions A$110.00

Cost for single issues:

A$15.00
A$10.00 (Students)

No postage required within Australia

Available from: Publications Department
Australia–Japan Research Centre
Asia Pacific School of Economics and Management
The Australian National University
Canberra ACT 0200, Australia
Facsimile: (61 2) 6249 0767
Telephone: (61 2) 6249 3780
Email: ajrc@anu.edu.au
URL: http://ajrcnet.anu.edu.au/