

Demanding Results:
US Market Access Policies Towards Japan

John H. Kunkel

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Declaration

Unless otherwise indicated this thesis
is my own work.



John H. Kunkel

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Abstract

America's problem of access to Japanese markets has been one of the most salient issues in US-Japan relations in the last quarter century. This historically-grounded study seeks to explain the shift in US policy, beginning in the 1980s, away from traditional, "process-oriented" negotiations and towards a "results-oriented" policy of demanding quantitative indicators in market access agreements with Japan.

The policy sequence that culminated in America's results-oriented Japan policy was part of a broader response to a crisis in the institutions, laws and norms of the American trade policy *regime* in the first half of the 1980s. This crisis saw a resurgence of congressional trade activism that forced the second Reagan Administration in September 1985 to adopt a more aggressive bilateral market access policy, in contrast with the dominant multilateral approach of the postwar era. The interaction of long-term change in America's international economic position and macroeconomic policy decisions of the first Reagan Administration were the fundamental determinants of this regime crisis. Japan was the primary target of American grievances about unfair trade barriers given the scale of its competitive challenge and the size of the bilateral trade imbalance.

To explain more fully the changes in US market access policy towards Japan, this study traces the progressive ascendancy of "hardliners" over "free traders" in the American trade policy community. The regime crisis had a far-reaching impact on the political fortunes of these key *advocacy coalitions* contesting America's Japan policy. The postwar US trade strategy of process-oriented multilateralism reflected the institutional power and preferences of free traders concentrated in the executive branch, the national security policy community and among the ranks of professional economists. Heightened exposure to Japanese behind-the-border practices in the late 1970s helped to crystallise a hardline coalition drawn from Congress, sections of the US traded goods sector and manufacturing-oriented policy analysts.

The policy regime crisis relaxed the institutional checks on the hardliners, exemplified by the increase in the number of formal market access agreements after 1985. More specifically, the second Reagan and Bush Administrations pursued a selective, results-

oriented Japan policy, with a bilateral agreement including a foreign market share target for semiconductor sales in Japan as the most dramatic example. A process of learning about the Japan problem across the American trade policy community strengthened the hardliners' position in the second half of the 1980s. This saw the development of a more codified hardline paradigm (revisionism) and new credibility within the ranks of the free traders for the idea that Japan was different from other industrialised economies, at least in terms of its international openness.

The Bush Administration's Structural Impediments Initiative incorporated elements of this policy learning in a process-oriented framework. The first Clinton Administration heralded the culmination of the hardliners' ascendancy, placing demands for quantitative indicators in agreements with Japan at the centre of US trade policy. But by the mid 1990s momentum behind a high-profile results-oriented approach had waned due largely to strong opposition from the Japanese government and the changing economic fortunes of the United States and Japan.

Contents

| | | |
|----------|--|------------|
| 1 | America's "Japan Problem" and the search for results | 1 |
| | A state-society framework | 4 |
| | The argument in brief | 6 |
| | Organisation of the thesis | 10 |
| 2 | Explaining US trade policy: A state-society framework | 13 |
| | The limits of systemic theories of trade policy | 14 |
| | The trade policy regime as domestic structure | 27 |
| | Advocacy coalitions, ideas and policy-oriented learning | 34 |
| | Conclusion | 39 |
| 3 | An American trade policy regime crisis | 40 |
| | Domestic regime crisis as a conditioning variable | 41 |
| | America's relative economic decline and the Japanese challenge | 50 |
| | Reaganomics and the domestic sources of regime crisis | 64 |
| | The rise of aggressive bilateralism | 70 |
| | Conclusion | 80 |
| 4 | Hardliners versus Free Traders | 81 |
| | NTT and high-tech targeting: Focal points behind-the-border | 82 |
| | "Peeling the onion" and debating industrial policy | 97 |
| | The free traders: Keeping the hardliners in check | 103 |
| | Regime crisis, MOSS and new policy thresholds | 115 |
| | Conclusion | 119 |
| 5 | The Semiconductor Agreement: A Hardline Landmark | 120 |
| | Japan's DRAM dominance and the High Technology Working Group | 121 |
| | Saving a "strategic" industry in crisis | 126 |
| | Dumping actions strengthen US leverage | 135 |
| | The (ambiguous) deal, the 20 per cent target, and the drive to retaliation | 138 |
| | The first semiconductor agreement in perspective | 144 |
| | Conclusion | 147 |
| 6 | Reagan, Bush and <i>Selective</i> Demands for Results | 148 |
| | Auto parts: Domestic content with a VIE component | 148 |
| | Results for Motorola and Cray | 158 |
| | Renewing the semiconductor agreement and securing 20 per cent | 168 |
| | The Reagan-Bush legacy | 178 |
| | Conclusion | 180 |

| | | |
|-----------|---|------------|
| 7 | The Hardliners Advance | 181 |
| | Congress, Japan and Super 301 | 182 |
| | American Business and the Japan Problem | 188 |
| | Revisionism: Hardliners learn to paradigm | 191 |
| | Fertile soil and the “latent” hardliners | 203 |
| | Conclusion | 208 |
| 8 | Free Traders and Japan’s “structural impediments” | 209 |
| | Economists and the Japan Problem | 210 |
| | The Structural Impediments Initiative | 221 |
| | Conclusion | 230 |
| 9 | The Revisionist Moment with a Hardliner-in-Chief | 232 |
| | The Clintonites take charge | 234 |
| | “You get as much as you can”: A Framework for confrontation | 245 |
| | Modest results: the first Framework agreements | 257 |
| | To the brink on autos | 263 |
| | The hardliners scale back | 271 |
| | Conclusion | 277 |
| 10 | The Eclipse of the Japan Problem? | 279 |
| | The second Clinton Administration | 279 |
| | Theoretical perspectives | 282 |
| | Some questions for the future | 289 |
| | References | 293 |

List of Figures

| | | |
|------------|---|-----|
| Figure 2.1 | United States Merchandise Trade Shares (1965-95) | 20 |
| Figure 3.1 | US Trade Balance in Manufactures (1970-85) | 58 |
| Figure 3.2 | US-Japan Trade Balance in Manufactures (1970-85) | 58 |
| Figure 3.3 | Gross Savings and Investment Ratios – US and Japan (1980-88) | 62 |
| Figure 3.4 | International Investment Position of the US and Japan (1982-90) | 63 |
| Figure 3.5 | Foreign Direct Investment – US and Japan (1980-90) | 64 |
| Figure 3.6 | US Current Account and Real Effective Exchange Rate (1979-85) | 66 |
| Figure 3.7 | US Export and Import Volumes (1979-85) | 67 |
| Figure 3.8 | US-Japan Merchandise Trade Imbalance (1970-85) | 73 |
| Figure 4.1 | US-Japan Bilateral Market Access Agreements (1980-1996) | 116 |
| Figure 5.1 | Shares in World Merchant DRAM Market (1978-90) | 122 |
| Figure 5.2 | Average Selling Prices (US\$ per chip, Mar 84-Dec 86) | 127 |
| Figure 6.1 | Automotive Sector's Share in US-Japan Trade Imbalance (1985-94) | 150 |
| Figure 6.2 | Share in North American Vehicle Production of Japanese-owned Vehicle Manufactures (1982-1996) | 150 |
| Figure 6.3 | Foreign Share of Japanese Semiconductor Market (Sept 86-Sept 92) | 176 |

List of Tables

| | | |
|-----------|---|-----|
| Table 2.1 | Sectoral Protection in the United States (1993) | 22 |
| Table 2.2 | Special Protection in the United States (1990) | 23 |
| Table 3.1 | Manufacturing Productivity Growth in Major Industrialised Countries (1950-73 and 1973-79) | 51 |
| Table 3.2 | US Automobile Industry (select statistics, 1970-85) | 53 |
| Table 3.3 | US Steel Industry (select statistics, 1970-85) | 53 |
| Table 3.4 | US Textile Industry (select statistics, 1970-85) | 54 |
| Table 3.5 | US Apparel Industry (select statistics, 1970-85) | 54 |
| Table 3.6 | Export Growth Rates and Relationship to Output Growth (1950-52 to 1967-69) | 56 |
| Table 3.7 | Shares of Select Products in Total Japanese Exports | 57 |
| Table 3.8 | The “twin deficits” of Reaganomics | 69 |
| Table 4.1 | External Balances of US and Japan (1970-80) | 83 |
| Table 5.1 | Semiconductor Capital Spending in North America and Japan (1980-85) | 131 |

Abbreviations

| | |
|---------|---|
| ACTPN | Advisory Committee on Trade Policy and Negotiations |
| AEA | American Electronics Association |
| AFL-CIO | American Federation of Labor and Congress of Industrial Organizations |
| APAC | Auto Parts Advisory Committee |
| APPA | Automotive Parts and Accessories Association |
| AT&T | American Telephone and Telegraph |
| CEA | Council of Economic Advisers |
| CIA | Central Intelligence Agency |
| COMECON | Council for Mutual Economic Aid |
| CSPP | Computer Systems Policy Project |
| DDI | Diani Denden Corporation |
| DIA | Defense Intelligence Agency |
| DRAMs | Dynamic Random Access Memory devices |
| EC | European Community |
| EEC | European Economic Community |
| EIAJ | Electronic Industries Association of Japan |
| EPC | Economic Policy Council |
| EPROMs | Erasable Programmable Read Only Memory devices |
| EU | European Union |
| FDI | Foreign Direct Investment |
| FTA | Free Trade Agreement |
| GAO | General Accounting Office |
| GATT | General Agreement on Tariffs and Trade |
| GDP | Gross Domestic Product |
| GNP | Gross National Product |
| HST | Hegemonic Stability Theory |
| HTWG | High Technology Working Group |
| IC | Integrated Circuit |
| IDO | Idou Tsushin Corporation |
| IIE | Institute for International Economics |
| IMF | International Monetary Fund |
| INSEC | International Semiconductor Cooperation Center |
| IPE | International Political Economy |
| ITC | International Trade Commission |
| JAMA | Japan Automobile Manufacturers' Association |
| JFTC | Japan Fair Trade Commission |
| JFY | Japanese Fiscal Year |
| JSBB | Japan Softball League |
| JSMR | Japan Shared Mobile Radio |
| LDP | Liberal Democratic Party |
| LSI | Large-Scale Integration |
| MAPs | Market Access Plans |
| MFA | Multi-Fibre Arrangement |
| MFN | Most Favoured Nation |
| MITI | Ministry of International Trade and Industry |
| MOCP | Market-Oriented Cooperation Plan |
| MOSS | Market-Oriented, Sector Selective |

| | |
|-------|---|
| MPT | Ministry of Posts and Telecommunications |
| MRC | Mobile Radio Center |
| NAFTA | North American Free Trade Agreement |
| NAM | National Association of Manufacturers |
| NEC | Nippon Electric Company |
| NIEs | Newly Industrialising Economies |
| NSC | National Security Council |
| NTB | Non-Tariff Barrier |
| NTE | National Trade Estimates |
| NTT | Nippon Telegraph and Telephone |
| OE | Original Equipment |
| OECD | Organisation for Economic Cooperation and Development |
| OMA | Orderly Marketing Arrangement |
| OMB | Office of Management and Budget |
| R&D | Research and Development |
| RTAA | Reciprocal Trade Agreements Act |
| SCSG | Semiconductor Congressional Support Group |
| SIA | Semiconductor Industry Association |
| SII | Structural Impediments Initiative |
| SRAMs | Static Random Access Memory devices |
| STR | Special Trade Representative |
| TACS | Total Access Communications System |
| TFC | Trade Facilitation Committee |
| TPRG | Trade Policy Review Group |
| TQIs | Temporary Quantitative Indicators |
| UAW | United Auto Workers |
| USTR | United States Trade Representative |
| VANs | Value-added Networks |
| VERs | Voluntary Export Restraints |
| VIEs | Voluntary Import Expansions |
| VLSI | Very Large-Scale Integration |
| WSTS | World Semiconductor Trade Statistics |
| WTO | World Trade Organization |

1 America's "Japan Problem" and the search for results

Introduction

On 15 April 1998, United States Trade Representative (USTR) Charlene Barshefsky used a forum marking the 50th anniversary of the General Agreement on Tariffs and Trade (GATT) to praise the historical achievements of the rules-based multilateral trading system. At the same time, she singled out for criticism countries that had changed the letter of laws reducing trade barriers through successive rounds of the GATT, but 'did not meet the spirit of their goals. Markets remain largely closed, opaque and driven more by informal cliques than by laws, rules and contracts. Japan is a classic case in point'.¹

Unmet American expectations about market access marked the "Japan problem" as the most salient bilateral issue consuming the time and energies of American and Japanese policy-makers in the closing decades of the 20th century. The prevailing air of crisis in US-Japan trade relations through this period generated a steady stream of claims and counter-claims about which country's trade policies posed the bigger affront to the international trading system. Particular controversy surrounded America's shift towards a "results-oriented" Japan policy — demanding quantitative indicators in bilateral market access agreements rather than relying on more traditional, "process-oriented" negotiations over 'laws, rules and contracts'. This thesis examines the sources of change in US market access policy towards Japan, tracing the rise of a results-oriented Japan policy.

After World War II, the United States was instrumental in establishing the GATT-based trading system centred on process-oriented, multilateral trade negotiations and reciprocal, non-discriminatory reductions in trade barriers; albeit with qualifications and exceptions. The progressive reduction of industrial tariffs was the crowning achievement of this system which international relations scholar John Ruggie has identified with an ordering principle of 'embedded liberalism' — a heterodox replacement of *laissez-faire*

¹ Ambassador Charlene Barshefsky, Speech to the Institute for International Economics, 15 April 1998.

liberalism in which the goal of liberalisation was tempered by a common (Keynesian) social purpose among states for external and internal economic stability (Ruggie 1982, 1986, 1996). Even by his relatively elastic standard, Ruggie has scored America's results-oriented Japan policy as recent history's most serious deviation from the embedded-liberalism compromise — a violation of 'both the spirit and letter of postwar norms' (Ruggie 1996: 133).² How did America's policy approach of process-oriented multilateralism and non-discrimination evolve into demands for affirmative action in market access negotiations with Japan?

In contrast with the extensive theoretical and empirical work on the politics of trade protection, the politics of export market access have received much less attention, even though 'the importance of the second seems to be growing relative to the first' (Baldwin, Nelson and Richardson 1992: 679).³ A somewhat messy dependent variable, without clean lines of policy change, complicates the analytical task for this study. The lack of an obvious metric for market access policy — unlike, say, tariff rates or non-tariff barrier (NTB) coverage ratios — places a heavy reliance on inferences drawn from the historical record of US-Japan negotiations. The result is a patchwork ranging from purely process-oriented US demands through to explicit demands for specific market access outcomes. Even so, that record is suggestive of both a quantitative and qualitative change in US market access policy towards Japan through the 1980s and into the 1990s. This is evident in a sharp increase in the number of formal agreements between the two countries after 1985 and a general trend towards more specific American market access demands vis-à-vis Japan.

A 1986 bilateral agreement identifying a market share target for sales of foreign semiconductors in Japan (renegotiated in 1991) stands out as the most radical departure from traditional, process-oriented market access agreements between the United States and Japan. It marks one end of a spectrum of sectoral negotiations under the second Reagan and Bush Administrations that amounted to a *selective*, results-oriented Japan policy. The election of the Clinton Administration in November 1992 saw the United

² The elasticity of Ruggie's embedded liberalism idea is illustrated by his characterisation of such import restricting trade interventions as "voluntary" export restraints (VERs) and the Multi-Fibre Arrangement (MFA) as examples of 'norm-governed' change (Ruggie 1982: 384).

³ For empirically-oriented contributions on US market access policy, see Mastanduno (1992a), Bayard and Elliott (1994), and Noland (1997).

States elevate demands for quantitative indicators of results from Japan to a more high-profile status at the centre of US trade policy objectives. This study is designed as a multi-causal analysis of this evolutionary profile of policy change in an analytical framework where change in the policy environment and policy choice are both given their proper due.

An important premise for the thesis is that case studies of policy change over time need not involve mere “storytelling” but can, if done carefully, contribute theoretical insights (Lijphart 1971, Eckstein 1975, Skocpol and Somers 1980). This tradition of research combines comparison with an appreciation of historical context and a close analysis of the unfolding of events over time within the case (George and McKeown 1985, Collier 1993). While scope for theoretical generalisation is constrained, in recent years a number of political-economy scholars have made the case for research agendas less enamoured with the search for a single, grand theory of foreign economic policy behaviour (Cohen 1990, Dillon, Odell and Willett 1990, Odell 1990, Haggard 1991, Ikenberry 1996). The call is for more contingent analysis looking to identify the conditions under which particular variables are causally significant. This provides an opening for a synthesis of existing theories and approaches, integrating variables often treated as mutually exclusive sources of explanation. A detailed case study of policy change over time provides one route for taking up this challenge.

This study’s point of departure is that variables at the interface of state-society relations warrant theoretical priority in explaining the content and timing of change in US market access policy towards Japan. This *state-society approach* is in the tradition of scholarship that emphasises variation in unit or domestic-level variables (across nation-states and over time) as causally significant for explaining policy variation. The dual demands for parsimony and explanatory leverage are met most efficiently with theoretical attention to the institutions, norms and groups which cross-cut the state-society distinction.

While the *primary* constraining and enabling factors explaining policy behaviour reside at this domestic “level-of-analysis”, a state-society approach accommodates international, systemic change as part of a multi-causal chain. The insight that systemic factors can shape domestic politics has been a distinctive strand in the political-economy literature seeking to integrate sources of explanation from different levels-of-analysis

(Gourevitch 1978, 1986; Katzenstein 1978, 1985; Milner 1988; Rogowski 1989). A state-society approach remains open to change at the international level helping to set the broad contours for policy change. But domestic politics are the primary focus of theoretical attention, due in part to policy indeterminacy arising from international forces. As Jacobsen (1996: 100) observes:

International forces require states to respond in indeterminate ways, but the specifics are the stuff of domestic politics. Few international messages enter the domestic arena unprocessed and unmediated, and fewer still can avoid further mediation in the domestic crucible. ... When we refer to an international realm we actually refer to politicized interpretations of aspects of it, a politicization constructed domestically. Most policies are not fashioned by systemic determinants because multiple routes to any single objective exist and because incentives operate more potently domestically than internationally.

A state-society framework

The state-society approach to explaining change in US market access policy towards Japan relies on three core assumptions: (1) the analytical priority of exploring the sources of state *preferences*; (2) that a domestic policy *regime* (the formal and informal “rules of the game” in a policy issue-area) is the most appropriate prism for exploring domestic preference formation; and (3) that domestic *advocacy coalitions* comprising both state and non-state actors are important agents for explaining the substantive content and timing of policy innovations.

The starting point for a state-society approach is the assumption that state preferences – that is, an ordering among fundamental social purposes underlying the strategic calculations of governments – are causally significant. This boils down to an assumption that what states want is the primary determinant of what they do, with preferences determining the nature and intensity of the game states are playing.⁴ The theoretical significance of this assumption is most obvious when the state-society approach is contrasted with international, systemic theories that some scholars maintain should be the first-cut for analysis in international and comparative political economy (Keohane 1984: 16). Both realist and international institutionalist theories have states maximising a

⁴ Preferences comprise a set of fundamental interests (material or ideational) defined across “states of the world” and are distinct from “strategies”, “tactics” and “policies”. By definition, they are causally independent of the strategies of other states and, therefore, prior to specific interstate political interactions (Moravcsik 1997: 519).

fixed, homogeneous utility function — unit or domestic-level factors are, at best, secondary sources of explanation. The realist paradigm, for example, maintains that the configuration of state capabilities in the international system is the primary determinant of what states do. By contrast, the state-society approach focuses on the differentiated interpretations of state preferences forged out of domestically-grounded institutions, norms and groups. It makes theorising about the process of domestic preference formation of first-order significance. This does not mean that states get what they want due to the reality of international constraints imposed by the preferences of other states. Indeed, the state-society approach is open to international-level factors shaping the broad contours of policy change, but the primary theoretical focus is on domestic politics.

The second assumption of this approach is that the enduring institutions, laws and shared norms mediating state-society relations in a given issue-area (the policy regime) should be at the centre of analysis of domestic preference formation. The state-society model of the policy process relies on a conception of domestic structure that includes the positional attributes of state and societal actors *and* the policy regime. For these actors, the regime's institutions, laws and norms are, in essence, concrete features of structure, not interaction. Rationality in the identification of actor preferences means knowing the rules of the game. From this vantage-point, a state-society approach stands in contrast to models of the policy process that ignore or downplay the structuring and enabling role of institutions, laws and norms. This has particular relevance for the conceptual and theoretical treatment of the state. Where, for example, interest group pluralism assumes that the state is merely a filter for societal actor demands, a state-society approach takes account of the unique structural position of the state linking the international and domestic political economies. The measure of independent causal weight this affords state institutions and state actors points to the significance of domestic policy regimes in shaping not only which domestic groups gain access to the policy process, but even the way such groups define their goals.

The third assumption concerns the issue of agency and the realm of choice in the policy-making process. Explaining the substantive content and timing of policy innovations draws attention to the political contests between domestic advocacy coalitions — sub-regime groups that cross-cut the state-society distinction. The shared beliefs of key advocacy coalitions and their representation in central decision-making positions are

important arbiters of state preferences and their translation into policy. In this context, the state-society approach permits a (limited) role for ideas in explaining policy change.⁵ Non-cognitive factors are assumed the primary drivers of policy, but a more complete explanatory picture brings into focus the way in which actors with scope for choice interpret policy problems, identify cause-effect relationships and propose policy responses. Exploring the fit between ideas and politics – why some ideas win out over others, and why ideas catch on at the time they do – allows for a fuller understanding of how the boundaries for policy innovation are delimited. This in turn permits a role for “learning” whereby changing beliefs in a policy community about a policy problem leave an imprint on outcomes in a way that cannot be tied simply to changing external circumstances or the superior resources of one advocacy coalition over another.

Running through this state-society approach and the assumptions that preferences, rules and ideas matter is the overarching theme that history matters. Actions taken at one point in time result in opportunities for and constraints on future action. In one sense, this observation is trivial given a research task aimed at shedding light on historically-grounded policy outcomes. But it encapsulates the need to problematise state preference formation, the importance of institutions, the contingent nature of politics, and a role for political agency and choice. This makes room for an element of “path dependency” within this state-society framework. It embodies a view of politics where decisions ‘at one point in time can restrict future possibilities by sending policy off on particular tracks, along which ideas and interests develop and institutions and strategies adapt’ (Weir 1992: 192).⁶

The argument in brief

The central argument of this thesis is that the rise of a results-oriented Japan policy was conditioned by a “crisis” in the US trade policy regime in the first half of the 1980s. This arose from the interaction of long-term, systemic change in the international position of the American economy and more concentrated macroeconomic shocks and domestic

⁵ The terms “beliefs” and “ideas” are used interchangeably in this study.

⁶ This highlights the commonalities between the state-society framework developed here and the “historical institutionalist” school with its distinctive emphasis on historical contingency and path dependency as part of the “new institutionalism” (Thelen and Steinmo 1992: 2).

policy decisions in the early 1980s. Japan was the principal target of a more aggressive bilateral market opening strategy initiated in 1985 by the second Reagan Administration. The regime crisis enabled “hardliners” in the American trade policy community to exert more influence over US market access policy towards Japan through the second Reagan and Bush Administrations. This ascendancy of the hardliners over “free traders” was bound up with a process of learning across the American trade policy community that Japan was “different” economically from other advanced industrialised economies in terms of its international openness and responsiveness to process-oriented trade negotiations. The coupling of fertile political soil with these shared beliefs about the Japan problem culminated in the results-oriented Japan policy of the first Clinton Administration.

Attention to the critical mediating role of institutional variables helps in uncovering both the broad determinants of change in US market access policy towards Japan and, ultimately, whose preferences are represented as state preferences. Following the passage of the Reciprocal Trade Agreements Act (RTAA) of 1934, the American trade policy regime rested on a set of institutions, laws and norms which saw the US Congress cede primacy in trade policy to the executive branch. Under this “1934 regime”, the executive branch used this authority to play the game of multilateral “export politics” – negotiating reciprocal liberalisation of trade barriers through the GATT with Congress largely shielded from the sort of log-rolling demands for protection which led to the sharp rise in US protection in the early 1930s (Destler 1995). Executive branch primacy in trade policy after World War II saw American policy preferences defined for the most part in terms of process-oriented, multilateral trade negotiations.

A combination of international and domestic shocks resulted in a crisis of legitimacy of the 1934 trade regime in the first half of the 1980s. An important systemic source of these pressures was the erosion of the (artificial) dominance of the American economy in the postwar period. Expansion of Japanese production, export and technological capabilities was at the leading edge of these international pressures. New patterns of policy interdependence also followed from the emergence of new sources of surplus capital in the world economy with Japan again at the forefront. Change in America’s relative position in the international economy, especially vis-à-vis Japan, provides an

important but permissive international setting when it comes to explaining the rise of a results-oriented Japan policy.

Critical to the nature, timing and intensity of the regime crisis were domestic factors, in particular the macroeconomic policy decisions of the first Reagan Administration. A sharp fall in American national savings and a sustained rise in the US dollar followed a marked loosening in fiscal policy in the early years of the Reagan Administration. The impact on the competitive position of America's traded goods sector was apparent in sharply higher US trade deficits following the global recession of 1982. Acute pressure on the American traded goods sector underpinned both increased US protection and the shift by the second Reagan Administration in September 1985 towards a more aggressive bilateral market opening policy under the rubric of "fair trade". The proximate cause of this shift in trade strategy was the credible threat by the Congress to enact restrictive trade legislation and to limit substantially the trade policy discretion of the executive branch. After 1985, Congress moved to reclaim a more central policy role and demands for fair trade and sectoral reciprocity became more dominant orienting norms for US policy behaviour (Destler 1995, Mucciaroni 1995). The scale of its competitive challenge to US industry and the size of the bilateral trade imbalance helped ensure that Japan would be the primary target of the new "aggressive bilateralism".

Change in the political fortunes of two broad advocacy coalitions sheds light on the content and timing of US policy reactions to the Japan problem. The postwar US trade strategy of process-oriented multilateralism embodied the power and preferences of a "Free Trade-Good Relations" coalition (free traders). The trade regime crisis would leave this coalition fragmented and reactive to an emergent "Hardline-Japan is Different" coalition (hardliners). The rise of a results-oriented Japan policy and the timing of policy innovations reflected the progressive dominance of hardliners over free traders in the American trade policy community. The idea that Japan was significantly different from other advanced industrial economies in terms of its structural (behind-the-border) trade barriers constituted a binding force for the hardline challenge to the free traders. For the most part, free traders (concentrated at high levels of the executive branch, the national security policy community and among the ranks of professional economists) tended to view the stakes surrounding the Japan problem as relatively low. By contrast, hardliners (especially in Congress, the US traded goods sector and among manufacturing-oriented

policy analysts) saw the stakes as high and requiring significant policy change by the United States.

The September 1985 shift by the second Reagan Administration towards the “self-initiation” of Section 301 actions signified the crisis of legitimacy in the 1934 trade regime and a new policy setting favourable to hardline grievances about Japan. The Market-Oriented, Sector Selective (MOSS) talks begun in 1985 illustrated the transition by the second Reagan Administration towards a more structured and aggressive approach to the Japan problem with a wider network of US government actors claiming a stake in securing market access results. With frustration over Japan market access growing across the American trade policy community, hardliners achieved their most dramatic policy breakthrough in 1986 with a bilateral agreement over semiconductor trade, including a 20 per cent market share target for foreign sales in the Japanese market. The semiconductor agreement (renegotiated in 1991) was part of a selective, results-oriented policy under the second Reagan and Bush Administrations that highlighted the weakened position of the free traders in the wake of the regime crisis.

The second half of the 1980s saw the political base of the hardliners strengthened by a Congress intent on reclaiming an action-forcing role in US trade policy and more concerted demands by internationally-oriented American firms for a results-oriented Japan policy. It also was marked by a new phase in the American policy community’s learning about the Japan problem. The emergence of the so-called “revisionists” saw the development of a more codified paradigm surrounding Japan’s allegedly different form of capitalism. The idea that Japan was different (at least in terms of its international openness) also gained new credibility from within the ranks of professional economists — traditional bastions of free trade advocacy. By the end of the 1980s, learning across the US trade policy community about Japan was a notable element weakening opposition to a results-oriented Japan policy. The Bush Administration incorporated aspects of this learning experience in a process-oriented policy innovation — the Structural Impediments Initiative (SII). The election of Bill Clinton to the presidency in November 1992 saw demands for quantitative indicators in bilateral agreements with Japan assume a higher policy priority in line with hardline trade preferences. The results-oriented approach of the Clinton Administration carried the mantle of a policy whose time had come.

Organisation of the thesis

This study provides a layered analysis of the factors that explain the rise of a results-oriented Japan policy. Chapter 2 sets out the case for a state-society approach to explaining policy change, locating it in the political-economy literature on the determinants of national trade policies. The theoretical assumptions of the state-society approach distinguish it from system- or society-centred theories and approaches that maintain that a single level-of-analysis holds the key to explaining policy behaviour. The primary theoretical focus of this approach is on American state-society relations — specifically, the institutions, norms and groups that cross-cut the state-society distinction and that act as critical constraining and enabling policy variables.

Chapter 3 focuses on the central conditioning variable explaining change in US market access policy towards Japan — a crisis in the American trade policy regime in the first half of the 1980s. Putting the policy regime at the centre of the analysis emphasises how individuals and groups make choices in an environment that has established institutions and norms of action. The policy regime serves as a vantage-point for identifying the broad determinants of policy change. This chapter focuses on the interaction of international and domestic variables that restructured the American policy regime to the benefit of domestic actors advocating more aggressive market access demands on Japan.

Chapter 4 directs attention to the political contest between key advocacy coalitions whose belief systems guide understandings of policy problems and appropriate responses. It explores the emergence of a coalition of Japan hardliners, challenging the dominant free trade coalition's process-oriented multilateral trade strategies. In the late 1970s and early 1980s, heightened exposure by both state and non-state actors in the American trade policy community to behind-the-border market access problems in Japan helped to crystallise the core hardline idea that Japan was different from other industrial countries in terms of its structural barriers to imports. The trade regime crisis relaxed the institutional checks on the hardliners and paved the way for a more structured and aggressive approach to market access problems.

Chapter 5 examines in detail the single most important precedent in the rise of a results-oriented Japan policy — the 1986 US-Japan semiconductor agreement and the retaliatory trade action by the United States in its immediate aftermath. The market share target set for foreign semiconductor sales in Japan was a dramatic departure from traditional, process-oriented negotiations. This breakthrough by the hardliners, while not heralding a wholesale change in policy, was a landmark in the somewhat haphazard shift towards a results-oriented Japan policy.

Chapter 6 examines a series of bilateral negotiations through the second Reagan Administration and the Bush Administration to support the argument that the trend towards a results-oriented policy went beyond the semiconductor case. Grey-area market access negotiations in such sectors as auto parts, telecommunications, supercomputer and computer procurement, glass and paper products suggested a more general trend towards a selective, results-oriented Japan policy.

Chapter 7 looks at the second phase of the ascendancy of the hardliners in the American trade policy community after 1985. Hardliners in Congress and the business community moved decisively into the role of advocates for a results-oriented Japan policy in this period. This chapter also focuses on the emergence of the revisionists as a knowledge-based network directly challenging the free traders' view of the Japan problem, and the fertile political soil these ideas found in the second half of the 1980s.

Chapter 8 traces how a process of puzzling about the Japan problem by professional economists in the American trade policy community lent greater credibility to the notion that the way Japan worked challenged free trade orthodoxy. It also looks at how the Bush Administration's Structural Impediments Initiative embodied elements of this policy learning about Japan in a process-oriented framework.

Chapter 9 examines the culmination of the hardline ascendancy with the election of the Clinton Administration and subsequent moves to put a results-oriented Japan policy at the centre of American trade strategy. While the agreements secured by the Clinton Administration established some new benchmarks, the Japanese government was successful in blunting demands for explicit quantitative indicators in market access agreements. A combination of factors, in particular strong Japanese resistance to US

demands and diverging performances of the US and Japanese economies, help to explain the reduced impetus for an aggressive results-oriented policy by the mid 1990s.

Chapter 10 looks briefly at the experience of the second Clinton Administration, draws out some theoretical perspectives from the study, and suggests how its insights might apply to future research on American trade policy.

2 Explaining US trade policy: A state-society framework

Introduction

The key question confronting theories of foreign economic policy is whether state preferences matter and, if so, how to examine them in a theoretically useful way. A state-society approach focuses on the consequences for US trade policy of shifts in state preferences grounded in the institutions, norms and groups at the interface of state-society relations. The rise of a results-oriented Japan policy is traced through the twin state-societal lenses of the American trade policy *regime* and the key *advocacy coalitions* contesting America's Japan policy. This chapter develops an analytical framework for explaining change in US market access policy towards Japan, contrasting it with alternative perspectives on the sources of foreign economic policy.

Although grounded in domestic politics, a state-society framework eschews any prior assumption that a single level-of-analysis can satisfactorily explain national trade policies. State-centred realist and game theoretic models focused on the international system are, at best, theoretically permissive with a high level of policy indeterminacy. These systemic approaches to US trade policy are not compelling without information about the preferences of such a major economic power. A state-society framework is open to international-level change reshaping policy constraints and incentives. But ignoring the domestic process linking state preferences and policy outcomes obscures when and how change in the international environment matters.

A state-society approach also stands in contrast to models of the policy process which ignore or down-play the role of institutions, laws and norms. Society-centred models focusing on domestic interest group activity view American trade policy as an essentially demand-driven process. This narrow focus, however, neglects the transformative capacity of state institutions and actors in the determination of state policy preferences. A state-society framework offers a more plausible treatment of the supply-side of the policy-making process (that is, the state) by focusing conceptually on the American trade policy regime — the institutional and normative rules of the game structuring state-society relations in the trade policy arena. Putting the regime at the centre of analysis of

domestic preference formation highlights how institutional factors shape not only which domestic groups gain access to the policy process, but even the way such groups define their goals.

The policy regime provides the most appropriate vantage-point for identifying the broad determinants of policy change. An advocacy coalition approach complements this analysis by focusing on the shared beliefs of group actors with scope for policy choice. Comprised of state and non-state actors, advocacy coalitions are the basic units of analysis engaged in interpreting policy problems and proposing policy responses. Exploring the political contest between free traders and hardliners in the American trade policy community opens the way for ideas to help explain the content and timing of changes in US market access policy towards Japan. While non-cognitive factors are seen as the critical drivers of policy change, scope also exists for learning within a policy community to leave an imprint on political outcomes.

The limits of systemic theories of trade policy

A diverse theoretical literature on the determinants of national trade policies locates the primary sources of policy at different levels-of-analysis.⁷ Systemic or international-level approaches grant theoretical primacy to such factors as the distribution of global political-military power, the international economic structure, or shared systemic norms and information embodied in international institutions. Unit or domestic-level approaches emphasise such variables as the economic interests of societal actors, domestic political structures and coalitions, and/or the prevailing ideologies, beliefs and ideas of central decision-makers. Parsimonious, systemic models have a privileged status in the eyes of many international relations scholars. Keohane (1984: 16), for example, argues that systemic analysis should be the first-cut on research questions because ‘without a conception of the common external problems, pressures and challenges [facing states] we lack an analytical basis for identifying the role played by domestic interests’.

⁷ Waltz (1959) pioneered this way of understanding international relations by organising the literature on the causes of war around three levels-of-analysis (or “images”): systems, states and individuals. See also Singer (1961) and Jervis (1976).

This “top-down”, system-first proposition is unconvincing, however, in isolation from the particular object of research. Traditionally, systemic theories of international relations have taken as their main research program broad patterns of inter-state interaction and such large-scale questions as the scope for peaceful change in world politics. The dominant realist school has emphasised enduring threats to state survival, and the capacity of the international power structure to mould state behaviour and to limit the scope for international cooperation (Waltz 1979, Gilpin 1981). While accepting many of the core assumptions of realism, international institutionalist theories focus on the way in which multilateral institutions and norms can create opportunities for more cooperative political outcomes (Krasner (ed.) 1983, Keohane 1984). System-centred theories may be a logical starting point for high-level studies of inter-state relations, but their capacity to explain foreign economic policy content is more contentious. Indeed, the more careful systemic theorists have drawn a distinction between structural “theories of international relations” (the behaviour of aggregations of states) and “theories of foreign policy” (the behaviour of individual states) (Waltz 1979: 72, 77). By implication, variation in research questions recommends differentiated bodies of theory rather than a grand theoretical template fitting all international politics.

The qualified virtue of theoretical parsimony also cautions against making the international system the necessary starting point for explaining national trade policy. As Nye (1988: 243) has stated, ‘parsimony is not the only way by which one judges good theory. Good theory also requires a good explanatory fit’. This reinforces the case for theoretical pluralism with sensitivity to the scope and domain of research questions (Wolfers 1962, Baldwin 1989). As Haggard (1991: 417) has observed:

the claim for the superiority of a theory on the basis of its parsimony cannot stand alone. What use is a parsimonious theory that is wrong or that explains only a small portion of the variance? The issue, therefore, is not one of parsimony per se but of the trade-off between parsimony and explanatory power. The general point ... is that there is no need to grant priority to systemic theory on the basis of its parsimony alone, unless it can be proved also to have at least equal explanatory power.

The weak explanatory power of system-centred, state-as-actor models of US trade policy recommends a more “bottom-up” approach. This study focuses on state-society relations and on the domestic process linking trade policy preferences (what states want) with policy outcomes. Starting at the level of preferences reverses ‘the nearly universal

presumption among contemporary international relations theorists that “systemic” theories like realism and [international] institutionalism should be employed as an analytical “first cut”, with theories of “domestic” preference formation brought in only to explain anomalies’ (Moravcsik 1997: 516). Systemic approaches lack a theory of preferences over outcomes (Powell 1994). The goals of unitary, rational states are assumed fixed or exogenous with variations in the geo-political environment seen as the key to explaining policy. By contrast, a state-society framework focuses on the consequences for US trade policy of shifts in state preferences grounded in the institutions, norms and group actors in American state-society relations.⁸

Assuming that preferences matter is not to assume that states can do what they want regardless of other actors. Actual strategies and policies pursued reflect not simply a state’s own preferences, but rather the configuration of preferences of all states (Moravcsik 1997: 523). Nor does the state-society framework seek to locate the sources of policy action solely in domestic politics. For example, the preferences of domestic economic actors do not derive simply from “domestic” economic assets and endowments. The relative position of those assets and endowments in the global economy clearly matters. Hence, a state-society framework is open empirically to international-level change reshaping the trade policy environment. But it rejects a top-down, systemic perspective that assumes that state preferences are fixed or that they can be imputed exogenously from the international geo-political environment. The point is not to deny the significance of international factors as part of a multi-causal analysis of policy change. It is to argue that the most useful theoretical vantage-point for analysing when and how international-level change matters for policy lies at the intersection of state-society relations.

The realist literature on postwar US trade policy illustrates the limitations of systemic, state-as-actor approaches. Realists view the unitary, rational state as the dominant actor in international politics with states distinguished solely by their relative power in the international system. Threats to state survival are deemed pervasive given the ordering

⁸ Conceptually, this state-society framework borrows heavily from Moravcsik’s (1997) ‘nonideological and nonutopian’ liberal theory of international politics. While sharing Moravcsik’s core assumption of the centrality of state-society relations in world politics, the approach advanced here places greater emphasis on the independent capacity of state institutions and state actors and less on the ‘capture’ of the state by societal groups.

principle of “anarchy” in international politics. Realism highlights the constraints on international cooperation and the importance of the relative gains motive (how states fare relative to other states) over mutual interest in absolute gains (how states fare in and of itself). Realist scholars see states structuring international economic relations in pursuit of power, wealth and security. Such variables as the distribution of world output, trade and foreign direct investment (FDI), relative per capita income and relative productivity are assumed the primary determinants of state trade interests and hence policy outcomes. For realists, departures from free trade represent rational state behaviour because of the state’s non-economic objectives and/or because of economic gains from protection. As such, realism embodies distinct elements of the mercantilist tradition.

Two problems, both related to the inadequate treatment of state preferences, highlight the weakness of systemic realism as explanatory theory of US trade policy. First, even at its most plausible, realism is theoretically permissive and under-determining. Any given configuration of international structural variables can appear consistent with markedly different policy outcomes. In part, this policy indeterminacy problem reflects disagreement among scholars on such fundamental issues as the nature of the international power structure, the goals of states, the way states pursue their goals and distributional consequences across states. Similar problems arise with state-as-actor game theoretic approaches. Second, notable empirical anomalies have confronted realist scholars who have sought to draw strong inferences about the systemic determinants of US trade policy. The works of Robert Gilpin, Stephen Krasner and David Lake underscore the pitfalls of imputing state trade interests from the international environment and ignoring the domestic process of trade preference formation. The result is a body of literature where the trade-off between parsimony and explanatory power is poor. The case for making realism the theoretical starting point for a fine-grained analysis of change in US market access policy towards Japan is correspondingly weak.

Robert Gilpin (1971, 1975, 1977, 1981, 1987) and Stephen Krasner (1976, 1978, 1979) were among the founders of modern International Political Economy (IPE) with propositions about the international structural determinants of openness/closure of the international economy. Along with Kindleberger (1973), they are synonymous with hegemonic stability theory (HST), the argument that a powerful hegemon is necessary for the maintenance of an open and stable international economic order. Although the

trade policy of the hegemon was not their main focus, Gilpin and Krasner drew explicit links between relative American economic decline and the expectation of significantly greater US trade closure. Both maintained that relative US decline would, and indeed should, see the rational, realist American state move away from openness, though they recognised obstacles to such a policy shift.

Gilpin's (1975: 40) argument that 'a liberal international economy requires a power to manage and stabilize the system' provided the core of hegemonic stability theory. From the vantage-point of the mid 1970s, Gilpin saw American hegemony as short-lived, linking increasing instability in the world economy to US decline in the face of increasing Soviet military power and the rise of Western Europe and Japan as economic competitors. Sketching a range of scenarios for the international economy, he suggested that the 'most likely' saw the American-led economic order 'break down and fragment into conflicting imperial systems or regional blocks' (Gilpin 1975: 72). By the 1980s, 'the Pax Americana was in a state of disarray' (Gilpin 1981: 231). According to Gilpin (1987: 230), this new era of economic nationalism and protection demanded that the United States overcome its free trade ideology which had 'become unrealistic under the present circumstances'.⁹

Like Gilpin, Krasner focused primarily on international openness and stability rather than national policy, but his realist, state-power model drew clear links between international structure and state trade interests.¹⁰ Krasner (1976: 323) maintained that 'openness is most likely to occur during periods when a hegemonic state is in its ascendancy'. He dated American ascendancy from 1945 to 1960 and the state power explanation of international openness was seen as persuasive through this period — tariffs fell, trade flows recovered above interwar levels, and regionalisation of trade began to decline. Krasner conceded that his realist theory of trade policy had difficulty explaining the continuation of trends towards openness from 1960 to the mid 1970s. He attributed this to the influence of 'particular societal groups whose power had been enhanced by earlier state policies' to the point where they prevented the United States

⁹ To be sure, Gilpin's brand of realist theory is eclectic, drawing on aspects of liberal and Marxist thought.

¹⁰ Keohane (1997: 151) describes Krasner's important 1976 paper, 'State Power and the Structure of International Trade', as having 'crystallized issues and set the terms for more than a decade of work in the field of international political economy'.

‘from making policy amendments *in line with state interests*’ (Krasner 1976: 318) (emphasis added).

The major empirical anomaly for HST is that America’s trade policy has remained considerably more open and accommodating to imports than Gilpin and Krasner would have expected. By a range of indicators cited by both scholars, America’s relative position in the international economic system has eroded since World War II, although the experience has been an uneven one.¹¹ In terms of output shares, trade shares, per capita GDP and productivity convergence, most of the relative decline in America’s international economic ascendancy occurred between 1950 and 1970 (Kunkel 1998).¹² Change in the international financial position of the United States has been more pronounced since 1970.¹³

This relative change in the position of the United States in the international economy has not resulted in the sort of generalised, state-sanctioned movement away from openness conjured up by HST realists. The dependent variable, trade openness, is usually seen as encompassing both actual trade flows and the policy instruments designed to influence imports (Krasner 1976, Webb and Krasner 1989, McKeown 1991). As to the former, Figure 2.1 shows the continued trade integration of the United States into the international economy. Total merchandise trade (exports plus imports), total imports and manufactured imports have continued to rise as a share of US Gross Domestic Product (GDP). Import volumes rose at an annual growth rate of 6.2 per cent between 1965 and 1995 and there is evidence of increasing import elasticity in the United States economy in the 1990s (Kunkel 1998: 15).

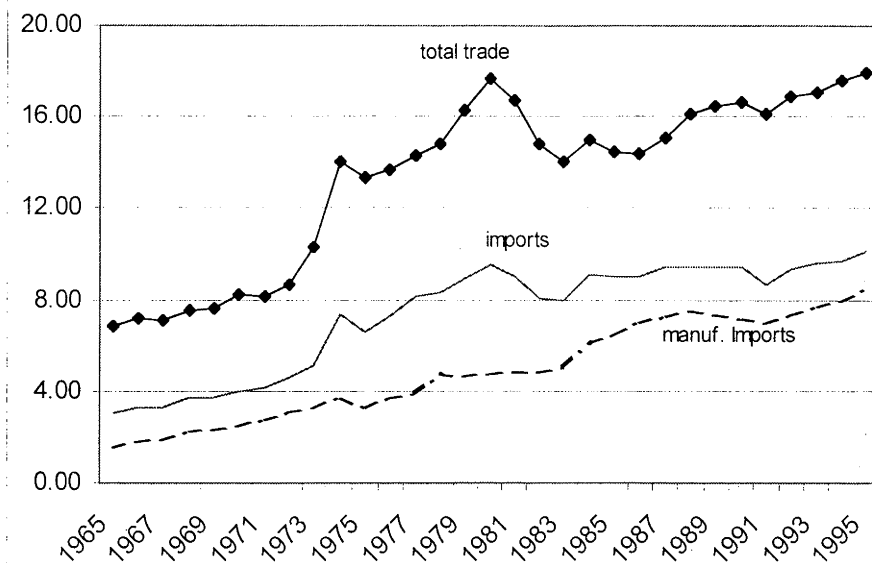
In terms of policy instruments, the general picture is one of low tariffs and pockets of high protection due to NTBs, but no generalised move towards trade closure by the

¹¹ Indicators included: (1) the relative size of the US economy (Gilpin 1975, Krasner 1976); (2) relative economic growth rates (Gilpin 1975, Krasner 1976); (3) relative per capita income (Krasner 1976); (4) relative productivity performance (Gilpin 1977); (5) the relative US share of world trade (Krasner 1976); and (6) the relative US share of FDI (Gilpin 1975, Krasner 1976).

¹² On these measures, the US international economic position has been broadly stable from the early 1970s to the mid 1990s. Japan’s position continued to advance up to the early 1990s, while in some areas the major industrial nations of Western Europe have fallen from postwar peaks achieved before 1970.

¹³ The US share of the global stock of FDI fell significantly between 1970 and 1990, partly due to large capital inflows into the United States from other industrialised countries (Kunkel 1998, UNCTAD 1998).

Figure 2.1 United States Merchandise Trade Shares (%GDP)



Source: World Bank data, International Economic Databank, Australian National University.

United States. The process of reciprocal tariff bargaining over the last 50 years has seen the trade-weighted tariff average of the United States fall to 3.5 per cent by the mid 1990s following the Uruguay Round (Hoda 1994: 47).¹⁴ The major long-term departures from this general postwar trend towards increasing openness have been in textiles and apparel and parts of agriculture.¹⁵ In addition, since the late 1960s, a number of standardised-technology manufacturing industries with long-term structural adjustment problems have gained varying levels of protection. Measurement problems mean that accurate data on long-term trends in NTB protection, and especially the intensity of such measures, are not readily available. One estimate is that the share of US imports affected by some form of NTB increased from 36 per cent in 1966 to 45 per cent in 1986 (Laird and Yeats 1990).¹⁶ Simultaneous moves towards greater openness in some areas and increased closure in others (such as in the administration of anti-dumping laws) make neat conclusions about trends in US protection difficult to draw. But Uruguay Round

¹⁴ All tariff rates are bound and 40 per cent of US imports are duty free (Hoda 1994: 47-49).

¹⁵ Maritime services have also been heavily protected dating back to the earliest years of the Republic.

¹⁶ Data compiled by the OECD (1996) suggest that over the late 1980s and early 1990s approximately 20 per cent of US tariff lines were subject to NTBs.

commitments and continued strong import growth in the 1990s point broadly to the maintenance of American trade openness.¹⁷

The weak empirical record of “first generation” realism embodied in HST spawned a range of alternative perspectives.¹⁸ One strand invoked the role of international institutions in maintaining an open international economic order (Krasner (ed.) 1983, Keohane 1984). For other scholars, the main problem with hegemonic stability theory was not that it neglected the role of international institutions, but that it mispecified the international economic power structure. David Lake (1984, 1988) sought to reassert the primacy of the international economic structure and of realist explanations of US trade policy. Lake (1988: 64) hypothesised that ‘nation-states will normally give priority to the constraints and opportunities of the international economic structure’ in determining trade strategy given ‘the anarchic nature of the international system and the consequent need to ensure national survival in a competitive environment’.

Lake proposed a system-centred explanation of continued US openness in contrast with HST’s pessimism about the consequences of relative economic decline. He defined seven categories of nation states across two dimensions (relative size, and relative labour productivity) with economic structures distinguished by the number of middle-sized and large states in the international economy. The trade interests of two categories of state are relevant to understanding postwar US trade strategy: a ‘hegemonic leader’ (large and above average productivity), and an ‘opportunist’ (middle-sized and above average productivity). Lake identified three different structures since 1945: US hegemony (1945-65), US-West German bilateral opportunism (1965-75), and US-West German-French multilateral opportunism (1975-).¹⁹ The United States was deemed a ‘hegemonic leader’ from 1945 with a trade preference for free trade at home and free trade abroad, and the capacity to move the latter goal towards realisation. In the mid 1960s, the position of the United States changed to one of ‘opportunism’ with a first preference for strategic trade protection at home and free trade abroad. Lake maintains that because other opportunist

¹⁷ This finding remains robust in the second half of the 1990s (including post-Asia crisis), even though some sectoral pressures for protection in relation to steel and certain agricultural products have been accommodated (OECD 1999: 207-221).

¹⁸ See Kunkel (1998: 18-19) on some of the second thoughts of Gilpin and Krasner in light of the empirical weakness of simple HST.

¹⁹ Based on his calculation of labour productivity, Lake foresaw Japan emerging into the multilateral opportunist structure only in the late 1980s/early 1990s.

states have stood ready to retaliate, and while there are still residual benefits to the United States from international openness, it has not been in the US national interest to move towards trade closure.

Lake's systemic approach is logically consistent with continued US trade openness, but the emphasis on the strategic trade protection motive suggests it too is a weak predictor of policy content. While stopping short of ascribing all protection to strategic trade logic, he does assert that such motives 'may explain the widespread patterns of protection observed historically' (Lake 1993: 475). States are assumed to implement strategic trade protection to shift industrial structures towards capital-intensive industries that in turn create large technological spin-offs and a virtuous cycle of rising economic progress. Lake (1993: 475) concedes this is no more than an 'intuition' and that he is unable to 'measure or demonstrate these basic linkages'.²⁰ More importantly, Lake leaves unexplored the dominant empirical evidence on the sectoral pattern of US protection. Tables 2.1 and 2.2 present data on the sectoral distribution of US protection in the early 1990s to illustrate the types of industries that the US state has sought to protect.

Table 2.1 Sectoral Protection in the United States – 1993

| ISIC description | av. MFN tariff rates (prod'n weighted) | core NTB Freq. Ratio |
|------------------------------------|---|-------------------------|
| 1 Agriculture | n.a. | 3.6 |
| 2 Mining, quarrying | n.a. | 2.3 |
| 3 Manufacturing | 4.9 | 24.7 |
| 31 – food, bev. & tobacco | 7.4 | 12.1 |
| 32 – textiles & apparel | 11.5 | 69.9 |
| 33 – wood & wood prod. | 4.1 | 0.6 |
| 34 – paper & paper prod. | 2.1 | 1.3 |
| 35 – chemicals, petroleum prod. | 5.2 | 5.8 |
| 36 – non-metallic mineral products | 4.9 | 5.3 |
| 37 – basic metal industries | 4.2 | 57.1 |
| 38 – fabricated metal products | 3.7 | 13.8 |
| 39 – other manufacturing | 5.9 | 1.1 |

Source: OECD (1996)

²⁰ Lake's argues that detailed analysis of the policy-making process and the terms of political discourse offers a way of assessing the theory's validity.

Table 2.2 Special Protection in the United States – 1990

| Protected by high tariffs | Tariff or equivalent as % world price | Hourly wages relative to manuf. average |
|--|--|--|
| ball bearings | 11 | 1.2 |
| benzenoid chemicals | 9 | 1.55 |
| canned tuna | 12.5 | 0.44 |
| ceramic articles | 11 | 0.88 |
| ceramic tiles | 19 | 0.85 |
| costume jewelry | 9 | 0.61 |
| frozen conc. orange juice ^a | 30 | 0.74 |
| glassware | 11 | 1.07 |
| luggage | 16.5 | 0.63 |
| polyethylene resins | 12 | 1.36 |
| rubber footwear | 20 | 0.61 |
| softwood lumber | 6.5 | 1 |
| women's footwear (exc. athletic) | 10 | 0.57 |
| women's handbags | 13.5 | 0.56 |
| Protected by import quotas | | |
| Agriculture | | |
| - dairy products ^b | 50 | 0.97 |
| - peanuts ^c | 50 | 0.62 |
| - sugar | 66 | 1.08 |
| Maritime | 85 | 1.28 |
| Protected by VERs | | |
| apparel | 48 | 0.6 |
| textiles | 23.4 | 0.74 |
| machine tools ^d | 46.6 | 1.13 |
| Total | 35.2 | 0.71 |

Notes: a (av. 1988-91); b (av. 1989-91); c (av. 1988-89); d (av. 1989-90)

Source: Hufbauer and Elliott (1994)

While short of a systematic examination of the issue, the data suggest that motives other than capturing the commanding heights of the international economy have dominated state-sanctioned protection in the United States. The OECD data suggest that the highest protection in 1993 was afforded textiles and apparel and basic steel products, industries facing long-term structural decline in the US economy. The 21 sectors receiving special protection which Hufbauer and Elliott (1994) investigate also suggest a pattern of protection flowing to industries which are either politically influential and/or which employ large numbers of low wage, low skill workers. Indeed, the weighted-average relative wage across these high protection sectors is some 30 per cent *below* the manufacturing average. Analysis of the sectoral spread of US protection can not be

considered decisive evidence against the strategic trade motivation. But it does underline that Lake's "second generation" realism is based largely on assertion and intuition about trade policy in the absence of empirical investigation as to what actually determines policy.²¹

It can be argued that empirical anomalies in the works of Gilpin, Krasner and Lake do not constitute a complete indictment of realist approaches to US trade policy. Plausible arguments can be constructed about broad constraints imposed by the international environment on the choice-setting of US policy-makers. The correlation between relative American economic ascendancy and the high tide of American process-oriented multilateralism in trade policy from the late 1940s through the 1960s is suggestive of the sort of margin of dominance that accommodates such policy strategies. But a more general problem of policy indeterminacy highlights the theoretical permissiveness of realism and other system-centred approaches.

In the case of the United States, for example, how much power is enough for *hegemony*? When did the United States become a hegemon? Has it ceased to be one? (Russett 1985, Strange 1987, Nau 1990, Nye 1990) Lake's approach illustrates how these (arbitrary) lines of demarcation can be forced to carry heavy causal burdens when it comes to variation in a state's trade policy behaviour. By a range of measures, the United States had already reached hegemonic status by the time of the Smoot-Hawley Tariff Act of 1930 and its structural parameters at that time were roughly equivalent to those in the 1950s era of GATT-based liberalisation (Frieden 1986). For Lake's approach to account equally well for US policy behaviour in 1930 and in the 1950s virtually demands a high level of policy indeterminacy and a weak link between international structure and policy outcome. As one sceptic has noted, 'it is difficult to agree that the future of world trade hinges on whether the US share is 14 per cent or 17 per cent' (Odell 1990: 159).

Why a dominant international position shapes the state's trade interest in one direction and not another remains a puzzle for system-centred theory. Why, for example, should a

²¹ It is instructive that in Lake's original version of his realist theory of US trade policy he noted that the recipients of US protection in the early 1980s were the 'least competitive industries' (Lake 1984: 165). A similar statement does not appear in his 1988 book. For detailed empirical work on the determinants of US protection, see Lavergne (1983) and Baldwin (1985).

hegemonic power necessarily pursue open trade policies? Reliance by dominant powers on illiberal commercial policies appears at least as prevalent as liberal hegemony as the cases of the former Soviet Union in Eastern Europe and Germany before World War II seem to attest. Large structural power is likely to lead dominant states to seek access to weaker states, but power does not appear to determine the content of the resultant economic order (Hirschman 1945, Ruggie 1982, Nau 1990). Moreover, international trade theory identifies incentives for a hegemon to exploit its market power with optimal tariffs rather than maintain openness (Conybeare 1984). Some realists counter that a rational hegemon might forgo an optimal tariff and instead promote trade liberalisation if this could prevent the development of economic challengers (Gowa 1989a, Lake 1988). But in any case, the scope for hegemonic choice and policy indeterminacy appears substantial.

The fact that states usually have multiple goals introduces a further source of indeterminacy proportional to the complexity of states' utility functions. Given multiple state goals, a fully specified theory requires analysis of factors which affect the trade-offs between state goals when they conflict, including the weights which states attach to different decision criteria — in other words, the circumstances under which states are interested in relative gains versus absolute gains. At a minimum, realists would argue that states simultaneously seek security and wealth. Gowa (1989b) develops a model which identifies tension between these two potentially conflicting objectives as the main source of variation in national trade policy preferences. She suggests that in a bipolar security context, a rational hegemon may forgo optimal tariffs vis-à-vis allies because free trade has security externalities. Thus, the hegemon has conflicting security and economic incentives, but it is effectively constrained to facilitate free trade between friends for security reasons, even if allies enjoy relative economic gains. For some realists, however, relative economic gains by allies remain central obstacles to cooperative behaviour by the hegemon (Grieco 1990). More fundamentally, there seems to be no systematic link between bipolarity and trade policy if one contrasts the trade relations within the liberal postwar Western alliance with those within the interwar German-led authoritarian alliance and the Cold War Soviet bloc. Rather, 'the relationship between bipolar systems and free trade appears to be subject to the domestic political and economic organization of the major alliance partners' (Simmons 1994: 6).

Despite realism's reification of power politics and the relative gains motive, both the instruments of power and the distribution of gains remain surprisingly under-specified in explanations of American postwar economic hegemony (Snidal 1985). Was the United States a *benevolent* hegemon — accepting the burdens of leadership as implied by Kindleberger's (1973) collective action approach to international economic relations — or was it *coercive* — forcing weaker states to make contributions for the maintenance of the postwar liberal economic order? At various points, Gilpin, Krasner and Lake imply elements of both in the case of postwar US trade policy. The United States is cast variously as taking the lead on trade liberalisation, actively using leverage to change other states' policy preferences, but also gaining relatively less than weaker states. The finding that the United States was a coercive hegemon but that other states secured relative economic gains poses a particular puzzle for approaches which focus on the international *economic* structure as the *deus ex machina* for policy behaviour. Lake concludes that the United States was necessarily coercive because in his theory not all states gain from free trade. The hegemon must change the policies of others to satisfy its own goals. But identification of the instruments of power and how the hegemon alters others' behaviour — in other words, policy — is deemed merely a 'second-order question'. It may take the form of 'negative sanctions (threats), positive sanctions (rewards), the restructuring of market incentives, ideological leadership, or simply success worthy of emulation' (Lake 1993: 469). With such wide policy discretion, it is hardly surprising that the capacity to predict actual policy outcomes is low.

As Simmons (1994: 6) observes, systemic theories of foreign economic policy choice are 'based on the *supposition* that the strongest incentives facing states in the system are indeed external and can be deduced from systemic variables'. But the high level of indeterminacy in structural theory weakens the logic that the preferences of states, especially dominant economic powers, will be tightly constrained by the external environment. Simmons underlines this point with her analysis of the domestic sources of foreign economic policy during the interwar years — the period which spawned modern structural theories of IPE with the work of Charles Kindleberger (1973). She notes that:

Kindleberger himself was not *puzzled* by the United States' unwillingness to open its markets, maintain a stable currency, and maintain countercyclical capital flows during the Depression. He understood the domestic political incentives facing American policymakers (and deplored these actions nonetheless). The point is quite general: without some information about the preferences of the dominant economic power and

the other states in the system, the logic of systemic hegemonic theory is less than compelling (Simmons 1994: 6).

Game theory offers an alternative parsimonious, state-as-actor approach, but it can not resolve the problems of indeterminacy in structural analysis. Game theory defines preference orderings exogenously and the logic of game theory is unassailable 'as long as we make the correct assumptions about the nature of the game, which in turn rests on correctly identifying state preferences' (Simmons 1994: 6). The most important of the various elements that describe a game is the payoff structure which illuminates not only why players are interested in playing, but tells us *what* they are playing. Nelson (1991: 133) states correctly that given the importance of the payoff structure:

it is somewhat surprising to note that in most applications of game theory to specific strategic situations like trade policy, payoffs are (often implicitly) assumed as "given". ... If our game theoretic account of the political economy of trade policy is to be at all compelling, we need to be considerably more concrete about the structure of the political space in which the game is played, the nature of outcomes in that space, and the mappings from political to economic outcomes and from economic outcomes to utilities.

Game *theory* cannot tell us where the payoffs come from, hence the importance of correctly identifying state preferences.²²

The trade policy regime as domestic structure

The most common bottom-up perspective on US trade policy formulation focuses on the political activity of societal interest groups. In keeping with the strong pluralist tradition in American political science, this approach sees politics as an essentially demand-side phenomenon with the interests of ascendant societal groups translated into political outcomes.²³ Schattschneider's (1935) account of pressure group activity and the Smoot-Hawley tariff remains an exemplar of this school. More contemporary scholars have traced American policy outcomes to the impact of international market conditions on shifting coalitions of sectors, industries and firms in the US economy (Gourevitch 1986,

²² The limits of the game-theoretic approach to trade policy choice have become more rather than less obvious over time. As one survey has noted, 'At times, the relationship between particular issues (e.g., trade), game structures (e.g., prisoners' dilemma), institutional forms (e.g., regimes), and outcomes (e.g., cooperation, allocative results) is very confused' (Caporaso 1993: 456).

²³ Notable works in the American pluralist tradition include Bentley (1949), Truman (1951), Latham (1952) and McConnell (1967).

Friedan 1988, Milner 1988).²⁴ Models of endogenous protection, developed by economists drawing on the public choice school of politics, represent a more formal strand of this society-centred literature. Trade intervention (usually an import tariff or quota) is conceptualised as a public or collective good, demanded by economic groups in society and supplied by politicians seeking to maximise political support. Which groups organise to demand political intervention depends on the concentration of benefits and the costs of collective action in the presence of the free-rider problem (Olson 1965).²⁵

At the core of this approach is a simple, powerful insight: trade intervention is because politically-influential groups in society can be made better off economically. Yet the narrow focus on interest group demands is problematic on both theoretical and empirical grounds. The risk of tautological reasoning hangs over the political science literature where a group's influence is assessed solely from the outcome of group struggle. The lack of an independent measure of group power results in a strong post hoc character to many society-centred studies (Ikenberry, Lake and Mastanduno 1988: 8). Endogenous trade policy models display greater theoretical coherence, but at the cost of a sizeable gap between theoretical abstraction and trade policies observed in practice. In his survey of this literature, Nelson (1988) attributes this gap to fundamental assumptions about the nature of politics being made on the grounds of theoretical convenience so as to minimise the need to alter standard microeconomic techniques. Notwithstanding the formal rigour of the endogenous trade policy literature, 'the link between the theoretical concepts and their empirical referents is so weak as to undermine general interest in its results' (Nelson 1988: 830).²⁶

Undermining the theoretical and empirical claims of a society-centred approach to US trade policy is the neglect of the supply-side of the policy process. Rather than playing an active, transformative role in the policy process, the state is conceptualised as a more-or-less passive register of interest group demands, captured by a dominant societal group or coalition. State actors and institutions filter pressure group activity, but exert no

²⁴ Linkages to the international level-of-analysis embody Gourevitch's (1978) 'second-image reversed' approach, but with policy outcomes determined in a domestic pluralist framework.

²⁵ For surveys of endogenous protection theory, see Magee (1984), Nelson (1988), Hillman (1989) and Rodrik (1994). See Baldwin (1984a), Hughes (1986) and Marks and McArthur (1990) for surveys of the econometric literature related loosely to this theoretical work.

²⁶ In a similar vein, Rodrik's (1994:1) critique of this literature concludes that it 'has lost sight of the very questions that have motivated it'.

independent causal weight in the determination of state trade preferences. The unique structural position of the state at the intersection of the international and domestic political economies is subsumed by societal reductionism. To be sure, the empirical record of US trade policy affirms that societal pressures establish incentives and constraints on policy action. But rarely do such pressures appear sufficiently binding as to justify “black-boxing” the state. Major redirections of US trade policy, as well as more specific episodes in US-Japan trade relations, highlight the need to go beyond a focus on demands of societal interests.

A society-centred perspective has particular problems explaining the sustained tariff liberalisation by the United States in the second half of the 20th century. Such an approach obscures the fundamental transformation in the institutional power and purpose of the US executive branch which conditioned this policy outcome. With the RTAA of 1934, the Roosevelt Administration sought and obtained from the Congress a hitherto unprecedented role in US trade policy.²⁷ This institutional bargain struck during the Great Depression allowed the executive branch to implement an internationalist trade policy centred on the reciprocal reduction of trade barriers. After World War II, the United States (in particular the US State Department) played the lead role in establishing the GATT — a new multilateral system of trade rules. The capacity of President Roosevelt’s successors to link a relatively liberal, multilateralist trade policy with such wider foreign policy interests as alliance building/maintenance and Cold War anti-communism helped to cement a central role for the executive branch in US trade policy.

The critical role of state actors and institutional reform in this historical policy realignment begun only four years after the Smoot-Hawley Tariff Act has been documented extensively (Destler 1995, Haggard 1988, Nelson 1989, Goldstein 1993). Haggard (1988: 96, 99) argues persuasively that while societal pressures reinforced the passage of the RTAA in 1934:

explaining the institutional innovations themselves demands attention to the initiatives, interests, and motivations of state actors.

... Without allies in industry and agriculture who were capable of benefiting from a new trade policy, the administration could not have acted. But executive initiatives and

²⁷ Article 1, section 8 of the US Constitution grants Congress power over the regulation of international commerce.

interests were crucial in defining the trade policy agenda, and even in shaping the “dominant coalition”.

The economic crisis of the Great Depression both created an environment conducive to institutional innovation and weakened the intellectual credentials of protectionism within the state policy-making apparatus (Destler 1995, Goldstein 1993). The RTAA is widely credited as a triumph of US Secretary of State Cordell Hull, the most vigorous free trade advocate in the Roosevelt Administration. The institutional emergence of what Schlesinger (1973) termed the “Imperial Presidency” provided the capacity for an emergent cross-party elite consensus to sustain liberal, multilateralist policy preferences. Although Congress would remain divided on trade policy and would continue to set limits of scope and duration on the president’s tariff cutting mandate, the executive branch used its newly-acquired policy authority to mobilise group interests in line with its policy preferences, offsetting to some extent opposing political and economic interests (Bauer, Pool and Dexter 1963). The capacity of state actors to exploit cross-cutting societal pressures, to actively build coalitions of support for particular policy preferences, and to act as the ultimate source of policy authority weakens the claims of a society-centred approach.

The significance of institutional variables can be illustrated via effects on the configuration of group interests and the incentives for group action. Lowi’s (1964) more general inference that the institutional definition of a given policy strongly influences the form of politics surrounding that policy was drawn directly from the contrasting politics of Smoot-Hawley and the RTAA (and its legislative successors).²⁸ Prior to the RTAA, trade was defined politically as a ‘distributive issue’. A universal norm of ‘reciprocal non-interference’ ensured that virtually all requests for protection by group interests were accommodated through generalised log-rolling. The periodic transfer of tariff cutting authority to the president after 1934 helped to alter the political definition of trade policy by weakening this general right to protection. The institutional definition of trade shifted more towards that of a ‘regulatory issue’ characterised by conflictive patterns of behaviour. Consistent with this new normative dynamic, the rise of anti-protection groups moderated the dominance of protectionist interests (Destler and Odell 1987). In this way, changes in the institutional structure can be seen as influencing not only which

²⁸ The following draws on Nelson’s (1989) analysis of Schattschneider (1935) and Lowi (1964).

societal groups have access to the policy arena, but also the way such groups define their goals.

The location in the executive branch of more technocratic decision-making processes relating to administered protection also altered the incentives for group action. Institutionally, Congress has a more domestic and sectional orientation to trade policy compared with the presidency by virtue of their different electoral constituencies (Mayhew 1974, Baldwin 1985). Under the new rules for administered protection, expected beneficiaries found themselves having to lobby the executive for something approaching a public good, reducing incentives through the logic of collective action. In short, while Congress remained responsive to constituent pressure for protection, its responsiveness under the post-1934 institutional arrangements was systematically reduced compared with the period prior to the RTAA.²⁹

Particular cases in the evolution of US market access policy towards Japan also highlight the capacity of state-centred variables to channel societal pressures away from certain policy outcomes. For example, the Reagan Administration's initiation of a more aggressive market opening strategy in the mid 1980s was geared critically towards countering acute societal pressures at that time for a more protectionist policy towards Japan. By the first half of 1985, a significant cross-section of US manufacturing industry, including internationally-oriented firms traditionally supportive of freer trade, was lobbying actively for a Japan-specific import surcharge. Legislation mandating such a policy was initiated by elements in Congress that hitherto had resisted such directly restrictive action. Despite these pressures, Reagan Administration officials were able to channel demands for an import surcharge towards a more activist market access policy using Section 301 of the Trade Act of 1974. Societal trade activity can provide an indication of pressure on the policy process to "do something", but still fall decidedly short of explaining actual policy outcomes.³⁰

A second example of the imprint of state-centred variables was the Bush Administration's decision in 1989 to resist societal pressure for an aggressive, results-oriented market access policy towards Japan. Soon after assuming office, the Bush

²⁹ Destler (1995) characterises the post 1934 era as one based on 'protection for Congress'.

³⁰ This episode is dealt with in more detail in chapters 3 and 4.

Administration was presented with a clear recommendation from its high-level private sector advisory body to move towards a policy of numerical market access indicators. Congress had also sent a strong signal in support of such an approach in the form of the 1988 Omnibus Trade and Competitiveness Act, including the Japan-focused Super 301 provision. The Bush Administration resisted these pressures, embracing instead the less prescriptive, process-oriented Structural Impediments Initiative. A simple focus on societal pressures offers little help in explaining how SII became the US government's key innovation in market access policy towards Japan between 1989 and 1992. A perspective that fails to accommodate the role of institutional variables and the preferences of state actors leaves critical aspects of policy decision-making unexplored.³¹

A state-society framework recognises the political capacity and causal significance that follows from the unique structural position of the state at the intersection of the international and domestic political economies. Variation in institutions linking state and society, and in state actor choice settings and motivations, are important sources of variation in state policy preferences. In this framework, the state is conceptualised as a *relational* variable rather than an autonomous actor. Importantly, this contrasts with state-centred approaches which conceptualise the state as a unitary, rational actor promoting ends and values separate from those in society (Krasner 1978, 1984; Evans, Reuschemeyer and Skocpol (eds.) 1985). As Lowi (1988: 891) has noted, the state-as-actor model is problematic as there are 'too many characteristics of states, and too many of these characteristics are really continua, with every state placed at a different point on each continuum'. For the purposes of this study, the state is defined in terms of concrete institutions and actors rather than in terms of its autonomy. First, it is a set of representative institutions structuring state-society relations that is the focus of domestic and international political activity. Second, these institutions are staffed and directed by (boundedly) rational state actors whose roles and preferences have their own causal significance.

This relational concept of the state commends a focus on the policy regime – the enduring institutions, laws and norms mediating state-society relations in a policy issue-area. Again, the contrast with a society-centred approach is worth highlighting. The

³¹ Chapters 6-8 explore the Bush Administration's Japan policy more fully.

policy regime is conceptualised as a concrete feature of domestic policy structure, rather than simply the product of interest group struggle. Knowing the institutional and normative rules of the game is bound up analytically with actor rationality. All social action depends on the pre-existence of rules. Hence, domestic structure encompasses actors and rules (materials for action) rather than actors and the arrangement of actors as in a purely “positional” ontology of structure (Dessler 1989).³²

Putting the regime at the centre of the analysis emphasises how individuals and groups make choices in an environment that has established institutions and norms of action. Policy regimes shape and constrain political strategies in important ways. By shaping not just actors’ strategies (as in pure rational choice analysis), but their goals as well, regimes structure political interactions and leave their own imprint on the domestic process of preference formation (Thelen and Steinmo 1992: 9). Policy regimes temper the influence of changes in market conditions and in international and domestic politics. International forces are interpreted through institutional lenses that describe what changes are progressive, which do or do not affect national or particularistic interests, and what mechanisms government officials may use in response (Goldstein 1993: 18). Within domestic politics, institutions structure the incentives to political action and influence the relative standing and power of different groups.

Chapter 3 hinges the identification of key sources of change in US market access policy around the 1934 regime — the rules of the game established by the RTAA of 1934 which restructured fundamentally American trade relations between the executive, Congress and societal groups. Centring attention on the structuring and enabling role of institutions, laws and norms reflects the grounding of a state-society approach in domestic trade preference formation. The policy regime provides the most appropriate vantage-point for analysing the interaction of international and domestic forces as part of a multi-causal analysis of change in US trade policy. The following chapter identifies the external sources of a crisis in the American trade policy regime in the 1980s which, it is argued, was the critical conditioning variable behind the rise of a results-oriented market access policy towards Japan.

³² This conception of domestic structure draws on assumptions about rules/institutions embedded in the philosophy of scientific realism (Dessler 1989, Grafstein 1992).

Advocacy coalitions, ideas and policy-oriented learning

A focus on advocacy coalitions complements the regime-centred analysis and takes the state-society framework into the realm of human agency and political choice. While the regime structures domestic trade politics, actors constantly seek to control or reformulate the rules of the game, to claim the authority and resources of institutions, and to persuade centres of policy-making of the merits of their ideas and policies. Tracing the political contest between key advocacy coalitions provides for a more detailed analysis of change in US market access policy towards Japan. Change in US trade policy is understood as a product of political-economic circumstance *and* the political choices of actors in a policy community (Hecló 1974). Advocacy coalitions include both state and non-state actors. The important role of state actors within advocacy coalitions, and the extent to which legal and institutional authority are critical resources in the policy process, reinforces the contrast with society-centred pluralism. At the same time, the diverse array of non-state actors in the American trade policy community (from societal interest groups to policy experts and journalists) makes for a more open and fluid perspective of the policy process than implied by state-centred approaches or tightly-structured “iron triangle” models (Hecló 1978, Kingdon 1984, Hall 1993).

An advocacy coalition is defined as a group of actors from a variety of public and private institutions who ‘share a set of basic beliefs (policy goals plus causal and other perceptions) and who seek to manipulate the rules, budgets, and personnel of governmental institutions in order to achieve these goals over time’ (Jenkins-Smith and Sabatier 1993:5). The conceptual elevation of shared beliefs as the glue for group formation and concerted action is a central feature of this approach. It draws on a strand of the public policy literature which views policies themselves in the same manner as belief systems: that is, as sets of value priorities, perceptions of important causal relationships, perceptions of the seriousness of a problem, and perceptions of the efficacy of policy instruments as means of attaining those value priorities (Pressman and Wildavsky 1973, Majone 1980). In this state-society framework, two or more advocacy coalitions are the basic units of analysis engaged in framing debate on policy problems and, ultimately, determining the content of state policy preferences: identifying

important relative to less important information, identifying cause-effect relationships, and proposing policy responses.³³

An advocacy coalition approach opens the way for ideas to contribute to a more fine-grained explanation of the content and timing of American trade policy innovations. The causal significance of ideas (*vis-à-vis* interests) remains a topic of intense controversy in the study of politics. The basic premise of this analysis is that the distinction should not be exaggerated as ideas and interests are usually intertwined; a view supported by distinguished scholars in both the rational choice and constructivist traditions (Fiorina 1995: 114, Smith 1995: 137). Interests must be represented and aligned with those of other actors and may be ambiguous, unclear, or internally contradictory. Ideas are interesting at the stage of preference formation because of the difficulties in identifying structurally-determined interests and because they help to give content to “objective” interests. Rationalist, interest-based models of actor behaviour must still identify a set of parameters (goals, means, perceived causal relationships, and performance indicators) which constitute a belief system (Sabatier 1987: 663). An advocacy coalition approach also makes a case for attention to groups formed around shared beliefs on operational grounds. Belief system models have the capacity to be more inclusive by incorporating self-interest and organisational interests, while also allowing actors to establish goals in quite different ways; for example, as a result of socialisation. This inclusiveness carries with it operational benefits when it comes to aggregating state and non-state actors into a limited number of advocacy coalitions (Sabatier 1993: 28).

To be sure, ideas will rarely be the major drivers of change in policy. Non-cognitive factors — the “real world” of international political-economic conditions, macroeconomic cycles, or broad governing coalitions in a political system — will dictate the dominance of one coalition over others in a policy community, and hence core aspects of a policy. Belief systems may determine the *direction* in which an advocacy coalition will seek to move governmental policies, but *its ability to do so* will be dependent critically upon the distribution of such resources as money, number of supporters, expertise, and legal authority (Sabatier 1993: 29). Also, not everyone active in a policy community will belong to an advocacy coalition or share one of the major

³³ The advocacy coalition framework has been applied in an American political context to such policy areas as crime, unemployment and air pollution (Sabatier and Jenkins-Smith (eds.) 1993).

belief systems. A potentially important role may be filled by ‘policy brokers’ concerned predominantly with finding some reasonable compromise to keep the level of conflict in a policy area within certain limits.³⁴

But ideas are more than epiphenomenal. Neglecting ideas underestimates the scope for human agency and choice resulting in an incomplete picture of the dynamics of policy change. Exploring the fit between ideas and politics – why some ideas win out over others, and why ideas catch on at the time that they do – allows for a fuller understanding of how the boundaries for policy innovation are delimited. Yee (1996: 97) argues cogently that as the basis for inter-subjective understandings, ideas ‘quasi-causally affect’ actions ‘not by directly or inevitably determining them but rather by rendering these actions plausible or implausible, acceptable or unacceptable, conceivable or inconceivable, respectable or disreputable, etc.’ How social phenomena become “policy problems”, and how particular understandings of problems emerge over time to guide policy-making, are important questions in a state-society framework.

This intertemporal dimension suggests a role for policy-oriented learning — relatively enduring alterations of thought or behavioural intentions that result from experience and are concerned with the attainment (or revision) of policy objectives (Hecllo 1974: 306).³⁵ A substantial literature on learning and its role in the policy process has developed from different social scientific perspectives.³⁶ While only individuals learn, the distribution of attitudes within, and positions of, groups clearly change over time.³⁷ The advocacy coalition approach assumes that for the most part learning is instrumental. The *core* beliefs of an advocacy coalition are quite resistant to change over time and coalitions

³⁴ The distinction between ‘advocate’ and ‘broker’ rests on a continuum. As Sabatier (1993: 27) points out, many brokers ‘will have some policy bent, while advocates may show some serious concern with system maintenance’.

³⁵ The concept of policy-oriented learning is not meant to convey improved policy effectiveness. Nor does it carry normative implications regarding approval of the content and ends of policy. What Nye (1987: 379) terms ‘negative learning’ can occur where new information is misleading or wrongly applied.

³⁶ For surveys of the politics and foreign policy literature, see Bennett and Howlett (1992) and Levy (1994).

³⁷ Sabatier (1987: 672) cites in this regard: (1) individual learning and attitudinal change; (2) the diffusion of new beliefs/attitudes among individuals; (3) turnover in individuals within a collectivity; (4) group dynamics, such as polarisation of homogeneous groups; and (5) rules for aggregating preferences and for promoting (or impeding) communication among members. In general, a time frame of a decade or more appears necessary to allow for the cumulative impact of policy learning from past successes or failures.

will resist information suggesting that their basic beliefs may be invalid or unattainable.³⁸ Hence, they will use policy analysis primarily to buttress and elaborate those beliefs (or attack their opponents' views). While exogenous events or opponents' activities may force a re-examination of core beliefs (cognitive learning), the pain of doing so (ego-defense, peer-group and organisational forces) tends to limit such activity.

Even so, learning can lead to changes in *secondary* aspects of a belief system; for example, the search for improved mechanisms to attain core values internal to a belief system. Often termed tactical learning, this implies a focus on learning *within* advocacy coalitions. A central argument of this study, however, is that policy-oriented learning will be more "credible" the more it embodies an element of learning *across* coalitions in a policy community and the less it relies on the superior resources or institutional position of one coalition over another. Drawing attention to policy-oriented learning points to a fluid dimension of the US trade policy process in which certain belief systems strengthen over time, binding one coalition of actors together, whereas alternative belief systems fragment, loosening ties within the rival coalition. Subsequent chapters argue that over time particular ideas about the Japan problem left an imprint on US trade policy in a way that cannot be tied simply to changing external circumstances or the superior resources of one coalition. The result was a deepening penetration across the American trade policy community of the view that Japan was different from other advanced industrial economies in terms of the openness of its economy to international commerce and its responsiveness to traditional, process-oriented trade negotiations.

To explain more fully the content and timing of change in US market access policy towards Japan, this study emphasises the contest between two broad advocacy coalitions in the American trade policy community – the Free Trade-Good Relations coalition (free traders) and the Hardline-Japan is Different coalition (hardliners). The free traders are synonymous with US foreign policy internationalism and the ascendancy of the United States as a global superpower. Their expansive definition of American foreign policy

³⁸ Proponents of an advocacy coalition approach have divided the structure of elite belief systems into three categories: (1) a deep core of fundamental normative and ontological axioms that define a person's personal philosophies; (2) a near (policy) core of basic strategies and policy positions for achieving deep core beliefs in a policy area; and (3) a set of secondary aspects comprising a multitude of instrumental decisions and information searches necessary to implement the policy core in the specific policy area. The three categories are arranged in order of decreasing resistance to change (Sabatier 1993: 30).

interests has entailed far-reaching political-economic engagement and power projection and drawn strength from America's global corporate and financial reach. The burst of American-led alliance and institution building in the years immediately following World War II established the structures that have supported this continuity (Gardner 1980, Pollard 1985, Ikenberry 1993). The emergence of the bipolar struggle of the Cold War saw containment of the Soviet Union provide an ordering doctrine of American foreign policy to which was welded the economic arms of American diplomacy (Gaddis 1982, Kunz 1997). If not free trade in an absolute sense, freer trade emerged as one element of a shared belief system increasingly identified with an American foreign policy elite. The capacity of this free trade coalition to command and staff key policy institutions in the US executive branch has been a hallmark of continuity in US foreign policy.

A core American trade policy strategy of process-oriented multilateralism through the GATT defined the policy ascendancy of the free traders from the second half of the 1940s through the 1960s. Periodic rounds of trade negotiations under the GATT saw tariffs significantly reduced by the end of the 1960s. By the 1970s, the relative decline in the margin of American economic ascendancy, the emergence of a substantial balance of payments deficit and heightened domestic economic problems associated with stagflation weakened the political base of support for free trade. But the maintenance of strong Cold War alliances and support for an open international trading system remained core concerns of high-level American policy makers. By the 1980s, the strains on this policy framework emerged more acutely in the form of pressures on the US executive branch to adopt a less cooperative, less multilateralist trade policy. In time, the emergence of the Japan problem at the centre of American foreign policy debate would challenge fundamentally the dominant belief system associated with the free trade coalition.

The hardliners' conception of the Japan problem drew on the longer American policy tradition characterised by suspicion of internationalism and free trade ideas and committed to defending sectoral interests under the rubric of fair trade.³⁹ While the experience of the 1930s made trade protection a difficult argument to justify intellectually, it did not remove the political pressures on the American political system

³⁹ As Gardner (1980: 1) notes, prior to the 1940s the 'dominant tradition of US international economic policy was a 'compound of economic isolation and economic nationalism'. Similarly, Goldstein (1993: 176) remarks that 'fair-trade ideas have a far longer and more entrenched history than free-trade ideas'.

to constrain import competition. Neither did the institutional structures created after World War II to bind Japan into a US-centred international alliance network supplant a history of bilateral economic and military conflict which had marked the earlier century of US-Japan relations. The hardliners, institutionally represented most forcefully by parts of Congress, shared a general antipathy towards what they saw as a foreign policy elite all too willing to trade-off American commercial interests for the sake of good international relations. The same forces that eroded the political ascendancy of the free traders in the 1970s brought to the fore stronger demands for fair trade and for more specific reciprocity in the conduct of US trade policy (Cline 1983b).

Heightened exposure to Japanese behind-the-border institutions and practices, in conjunction with an increasing bilateral trade imbalance and intense Japanese import competition in the US market, led to increased American policy attention to bilateral market access problems in Japan in the 1970s. The idea that Japan played by different rules economically, while not new, gained wider intellectual support by the 1980s. Over time, the hardliners successfully focused attention on the Japan problem as an issue of high political and economic salience. In the wake of a crisis in the American trade policy regime, hardline ideas helped to alter the boundaries of American market access policy towards Japan.

Conclusion

A state-society approach focuses on the domestic institutions, norms and groups that cross-cut the state-society distinction. Although it is open to international-level factors shaping the broad contours of policy change, the primary theoretical focus is on the domestic process of preference formation. A state-society approach puts the domestic trade policy regime at the centre of the analysis, highlighting how institutional variables shape and constrain political strategies. An advocacy coalition approach complements this regime focus by examining the political contest between groups engaged in guiding understandings of policy problems, identifying cause-effect relationships, and proposing policy responses. The following chapter explores the critical variable underpinning the ascendancy of the hardliners over the free traders in the American trade policy community and the rise of a results-oriented Japan policy – a crisis in the American trade policy regime in the first half of the 1980s.

3 An American trade policy regime crisis

Introduction

The first half of the 1980s was marked by a crisis in the institutions, laws and norms that had oriented US trade policy since 1934 – a crisis in the 1934 regime. The US trade deficit ballooned, a sharp rise in US protection threatened to undermine 50 years of trade liberalisation, Congress took on a more activist policy role, and America's postwar commitment to process-oriented multilateralism in its trade relations was significantly weakened. Japan would be the primary target of a more aggressive bilateralism after 1985. This chapter argues that explaining the evolution of US market access policy towards Japan requires an understanding of this broader crisis in the American trade policy regime.⁴⁰

Within a state-society framework, a regime focus highlights how institutional factors structure political situations as part of the architecture defining the policy environment. But just as a regime acts as a source of order, so can incongruities and frictions in different institutional politics act as sources of change. Such frictions tend to be most acute at times of economic stress, testing the *legitimacy* of established policy regimes. The economic crisis of the Great Depression paved the way for a major restructuring of the American trade policy regime via the Reciprocal Trade Agreements Act of 1934. The 1934 regime would in turn face a crisis of legitimacy in the 1980s and the resultant erosion of the key regime norm of executive branch primacy would have long-lasting consequences for US policy.

The regime crisis connects external shocks to the policy regime with the second Reagan Administration's initiation of a more aggressive bilateral market access policy in 1985. The fundamental sources of this crisis lay in the interaction of international and domestic variables. The internationalisation of US manufacturing industry and the emergence of new sources of surplus capital in the global economy eroded the postwar dominance of the American economy. Japan emerged as the broadest and deepest economic challenger

⁴⁰ Destler's (1995) seminal book on American trade politics is a reference point for any institution-centred analysis of US trade policy.

to American economic supremacy on both these fronts. Systemic change is nonetheless an insufficient source of explanatory leverage over the nature, intensity and timing of the policy regime crisis. Domestic decisions pushed the American trade policy process to crisis point in the mid 1980s – most notably, the macroeconomic policies of the Reagan Administration.

The rising tide of regime stress in the first half of the 1980s was marked by a reassertion of congressional activism and rising US protection across a range of sectors. By September 1985, a credible threat by Congress to enact veto-proof restrictive trade legislation and to further limit executive branch policy discretion forced the Reagan Administration to adopt a more aggressive approach to bilateral export politics using Section 301 of the Trade Act of 1974. The scale of its competitive challenge and the size of the bilateral trade imbalance went a long way to ensuring that Japan was the primary target of this shift in US policy.

Domestic regime crisis as a conditioning variable

This study's state-society framework fits most comfortably within the historical institutionalist school of politics that, together with the rational choice school of institutionalists, has advanced the case for a "rediscovery" of institutions in political analysis.⁴¹ Historical institutionalists maintain that by shaping not just actors' strategies (as in rational choice), but their goals as well, and by mediating their relations of cooperation and conflict, institutions structure political situations and leave their own imprint on political outcomes. The historical institutionalist school has a particular interest in constructing analytic bridges between state-centred and society-centred analyses by looking at the institutional arrangements that structure relations between the two (Thelen and Steinmo 1992: 10).

A regime focus highlights the importance of institutional context in mediating the formulation of actor goals and in determining whose preferences are represented as state preferences. Regimes tend to be "sticky" as institutions are slow to change and rules and norms endure. They often outlive the constellation of interests that created them. Policy

⁴¹ See, for example, March and Olsen (1989), North (1990), Weaver and Rockman (1993) and Hall and Taylor (1996).

choices are long-lasting, not only because their institutionalisation influences future constellations of interests, but also because actors come to value the policy's rules and norms themselves (Goldstein 1993: 9). Regimes, while ultimately changeable, 'confront choosing agents as historical givens, as part of the architecture defining the choice situation rather than as something to be chosen' (Caporaso and Levine 1992: 156).

The persistence or stickiness of policy regimes is governed critically by perceptions of their legitimacy. Focusing on political institutions, Skowronek (1995: 92) notes that:

the distinctive criteria of institutional action are official duty and legitimate authority. Called on to account for their actions or to explain their decisions, incumbents have no recourse but to repair to their job descriptions. Thus, institutions do not simply constrain or channel the actions of self-interested individuals, they prescribe actions, construct motives, and assert legitimacy.

Definitions of actor interest and actor behaviour are forged in an environment of legitimate and authoritative norms. Of course, in any political system there are likely to be contending sources of legitimate action. Indeed, many different rules and norms of legitimate action will be operative in a political system at any given time. This gives institutional politics not only its patterns of order, but also patterns of conflict. 'Institutional politics is most significant, in other words, as the arena in which different rules of legitimate order converge, collide, and fold back on one another' (Skowronek 1995: 95). Perceptions of regime legitimacy take on particular significance in this context, as do issues of historical contingency.

The historical institutionalist approach seeks to integrate an understanding of general patterns of political history with an explanation of the contingent nature of political and economic development (Thelen and Steinmo 1992). It is interested in conjunctures of separately located processes or conflicts and how earlier outcomes change the parameters for subsequent developments. Emphasising the role of institutions, contingent variables and political agency, historical institutionalism avoids the sort of structural determinism that characterises more abstract, deductive theories. Space for historical and institutional arguments has come also from notions of multiple equilibria and path dependence drawn from economics. As Evans (1995: 7) notes:

These new theoretical approaches are saying that, even in principle, formal theoretical models cannot provide determinative answers without knowing something about

individual sequences of events. There has to be an element of path dependence, which is to say history.

Using historical-inductive approaches, a number of scholars have explored the role of economic crises as a source of “extraordinary politics”, regime delegitimation and long-lasting policy reorientation (Olson 1982, Gourevitch 1986, Nelson (ed.) 1990, Haggard and Kaufman (eds.) 1992, Williamson and Haggard 1994).⁴² During crises, interests tend to be fluid, existing coalitions can fracture and opportunities are created for actors who were previously prevented from taking the initiative. Crises open the door to policy reform by breaking the normal, incremental mode of decision-making. This economic crisis hypothesis has found a place in the study of American trade policy with Goldstein (1993: 13) arguing that, ‘Just about all significant changes in American trade policy have been prefaced by hard economic times’. Most notably, the crisis of the Great Depression paved the way for a fundamental restructuring of the American trade policy regime with the Reciprocal Trade Agreements Act of 1934. The RTAA transformed the American trade policy process by reordering the institutional relationship between the executive, Congress and societal groups. In particular, *executive primacy* replaced *congressional primacy* as the central norm of the American trade policy regime. The Depression was important not simply because of the export-oriented interests it served to mobilise, but also because state actors were empowered by crisis conditions to justify an ‘extraordinary’ delegation of power from Congress to the executive (Haggard 1988: 100). This regime change in the United States would provide the foundation for a more liberal international trading system under US leadership.⁴³

The contrast with the pre-1934 regime highlights the significance of this institutional change. Under the US Constitution, America’s Founding Fathers created a system of ‘separated institutions sharing powers’ (Neustadt 1960: 33). The separation of powers in the Constitution and its system of checks and balances built institutional conflict and contending sources of legitimate action into the making of public policy. Compared with parliamentary systems of government, the most striking feature of the American system is the weakness of the executive. The US president exercises very few powers alone outside of ensuring that laws are ‘faithfully executed’. The president can veto a bill

⁴² The term “extraordinary politics” has been borrowed from Balcerowicz (1994).

⁴³ Winham (1992: 19) argues that the RTAA was ‘a signal event and it produced what could be reasonably called a revolution in international trade policy’.

passed by Congress, but has little formal power to ensure that desired legislative measures will be enacted (Wilson and DiIulio 1995). Under the US Constitution, Congress has exclusive power to 'regulate commerce with foreign nations'. While it has sole authority to negotiate agreements with foreign countries, the executive has no direct trade policy powers. As Destler (1995: 14) notes, 'The Constitution grants the president no trade-specific authority whatsoever. Thus, in no sphere of government policy can the primacy of the legislative branch be clearer: Congress reigns supreme on trade, unless and until it decides otherwise'.⁴⁴

Prior to 1934, the institutional dominance of Congress was largely unchallenged. The result was a domestically-oriented tariff setting process sensitive to particularistic economic interests. Following a brief period in which the revenue needs of the Republic prevailed (1789-1816), the politics of the tariff revolved primarily around firm and industry-level returns to protection – especially following the Civil War which saw the development of many new industries in the North and the military defeat of the traditionally low-tariff South (Nelson 1989: 87). The Smoot-Hawley Tariff Act of 1930, which increased ad valorem rates on dutiable imports to around 60 per cent, symbolised the ascendancy of narrowly-based commercial interests in a policy regime where the dominant norm of reciprocal non-interference meant that commercial interests expecting to be harmed found their only available recourse to be additional protection for themselves. Smoot-Hawley was followed by a wave of retaliation by America's trading partners and the resultant steep fall in world trade deepened the economic crisis of the Great Depression (Kindleberger 1973).

This crisis of the pre-1934 policy regime provided the critical opening for supporters of institutional reform under the leadership of US Secretary of State, Cordell Hull. Hull's advocacy of free trade reflected a combination of economic and political motivations. He attacked the assumption that the United States could export without importing, but more important was the connection he drew between protectionism, nationalism and international conflict (Hull 1948). The move within the international trading system towards bilateralism and preferential trading schemes that accompanied the Depression

⁴⁴ From a comparative perspective, as Cohen, Paul and Blecker (1996: 106) argue, 'When it comes to trade policy, no other legislative body has as much influence and authority relative to the executive branch as does the US Congress'.

put a premium on executive branch ability to negotiate credibly and flexibly. Under Hull, the State Department criticised the incoherence of US policy, using historical precedent to justify a centralisation of policy through the RTAA of 1934 (Haggard 1988: 100). Indeed, as Goldstein (1993: 143) suggests, ‘Hull was successful at trade liberalization only because his ideas were consonant with the new institutional structures. In retrospect, his support of executive delegation was probably more critical to the history of the trade reform program than was his commitment to liberalism’.

The Smoot-Hawley Tariff Act was the last general tariff law enacted by the US Congress. Under the RTAA, the president was authorised to negotiate tariff reductions of up to 50 per cent within a specified period of three years. As Goldstein (1993: 146) points out, this congressional delegation of tariff setting to the executive branch was ‘an unusual moment in congressional history’ in that:

Congress could have mandated that it ratify all treaties negotiated by the president. Instead, its members specifically denied themselves even this authority. After 1934, treaties that were within the reductions specified, *ex ante*, by Congress were enacted and implemented through executive order.

Presidential authority to negotiate and implement reciprocal tariff reductions with other nations was renewed in 1937, 1940, 1943 and 1945. After the war, the US executive took the lead in multilateralising its trade negotiating objectives through the GATT.⁴⁵ The GATT established the framework for an American trade strategy of process-oriented multilateralism designed to promote reciprocal reductions in trade barriers through trade negotiating rounds.⁴⁶ Six rounds of GATT negotiations were completed by the end of the 1960s. Especially important were the first, the Geneva Round of 1947, and the last, the Kennedy Round (1963-1967). During the former, the United States reduced its tariffs by an average of 20 per cent on all dutiable imports.⁴⁷ During the latter, major participants reduced tariffs by about 35 per cent on their non-agricultural imports that accounted for about 80 per cent of industrial countries’ dutiable imports (Pastor 1980: 118-19).

⁴⁵ Finalised in October 1947 after seven months of negotiation, the GATT contained ‘most of the provisions on commercial policy supported in the 1940s by US diplomats’ (Dam 1970: 12).

⁴⁶ From the outset, there were important exceptions in efforts to establish a comprehensive, multilateral trading system, including US-instigated waivers to allow for the continuation of New Deal farm programs. In addition, moves to launch a more ambitious International Trade Organization could not gain US congressional endorsement (Diebold 1952).

⁴⁷ The United States engaged in the most meaningful tariff reductions in the early years of the GATT largely due to the maintenance of quantitative restrictions in other countries (Curzon 1965: 70).

Beyond the crisis phase of depression and war, a number of factors helped to reinforce and secure executive primacy at the heart of the 1934 policy regime. First, as will be explored further below, America's global economic dominance was conducive to an executive-defined agenda of reductions in trade barriers. Second, trade policy was interwoven with a national security policy centred on the Cold War and the construction of an American-led alliance system in opposition to the spread of communism. In the immediate postwar years, key policy makers in the Truman Administration (e.g., Marshall, Acheson and Kennan) saw the instruments of international economic policy (including trade policy) as fundamental instruments of national security policy (Gaddis 1982, Pollard 1985, Kunz 1997).⁴⁸ And third, the 1934 regime was secured by the decline of trade as a major source of conflict between the Republican and Democratic parties. Critical in this regard was the gradual shift by the Republican Party towards support for a more liberal trade policy. This was vital to the norm of executive primacy as presidents, regardless of party, could champion liberal trade for both foreign and domestic policy reasons.⁴⁹ Increased support for international economic liberalism among government and business elites was a significant factor in this cross-party support for executive primacy. This elite coalition in turn drew strength through the 1950s and 1960s as the pursuit of freer trade coincided with a period of growing global economic prosperity. Success confirmed the liberal ideology, just as the Great Depression discredited protectionism.

The 1934 regime was characterised by a centralisation and insulation of the policy-making process. At the same time, Congress took on a balancing and brokering role, continuing to place limits on the autonomy of the executive branch. Especially important were devices for managing protectionist pressures and diverting them from Congress to the executive branch. First, the GATT-based system of multilateral trade rounds provided the key mechanism for export politics, shifting the balance of trade interests by

⁴⁸ A major aim of US policy was to integrate Japan into the "free world" economic system, underpinning its role as a key US strategic ally in Asia. The United States took the lead in sponsoring Japan's entry into the GATT and, along with Canada, was one of two GATT members not to invoke Article XXXV authorising non-application of the GATT to a new contracting party (Curzon 1965).

⁴⁹ A key test of executive primacy came with the election of the Eisenhower Republican Administration in 1952. In their analysis of the Reciprocal Trade Agreements Act of 1954-55, Bauer, Pool and Dexter (1963: 466) point out that the Republican Party (normally most susceptible to the pressure of business interests for protection from foreign competition) 'felt free to adopt as the most cherished item of its legislative program a Roosevelt measure which transferred tariff making from the legislative to the executive branch'.

engaging exporters in the opening up of new markets overseas and, in the process, deferring protectionist claims. Still, Congress continued to set guidelines, regulating how much tariff levels should be changed, by what procedures, and with what exceptions. Second, Congress established the terms of access to administered protection, designed to offer recourse to interests seriously injured by imports, and to combat alleged unfair foreign practices. With the retention in US trade law of procedural safeguards such as the peril point and escape clause provisions, Congress sought to ensure that industries disadvantaged by the trade liberalisation program of the executive could gain relief.⁵⁰ Third, Congress required an agent in the policy-making process to ensure that congressional and constituency concerns were not easily ignored even while trade expansion was pursued. As a price for providing President Kennedy with new negotiating authority in 1962, Congress proposed the establishment, within the Executive Office of the President, of the Special Trade Representative (STR).⁵¹ Later recast as USTR with the Trade Representative given cabinet rank, this agency would serve as the focal point for US trade policy management allowing Congress to more systematically shift responsibility on to the executive branch.

Clearly the shift towards executive primacy under the 1934 regime did not equate with free trade and demands for protection from politically-sensitive industries still had to be addressed. But equally, Congress gave executive officials leeway to find the specific form of protection that would minimise potential retaliation, and to ensure that less compelling pressures were diverted to a depoliticised administrative process that was for the most part unfriendly to granting relief (Mucciaroni 1995: 105).⁵² By the 1970s, however, signs were emerging of a more fragmented and politicised policy regime as key economic interests abandoned support for liberal trade.⁵³ Structural economic problems of high inflation and unemployment preoccupied American policy-makers, as they did

⁵⁰ See Destler (1995: 21) for a discussion of the peril point and escape clause provisions and their pre-1934 precedents. Goldstein (1993) deals at length with how postwar moves towards liberalisation incorporated many vestiges from the earlier protectionist period.

⁵¹ In the immediate postwar years, the US State Department played the lead role in trade negotiations. But over time the State Department became subject to increasing domestic criticism for trading away American commercial advantages for diplomatic goals.

⁵² The percentage of industries for which the US International Trade Commission (ITC) found import-induced injury was 35 per cent in 1951-62 and fell to 20 per cent in 1963-74 (Lawrence and Litan 1986: 44).

⁵³ Most notably, rising import penetration in many manufacturing industries saw the peak body of US organised labour, the American Federation of Labour and Congress of Industrial Organizations (AFL-CIO), move out of the open trade coalition. This change in labour's position was reflected in the trade policy stance among an increased number of Democratic Party members of Congress.

those in most other industrialised economies. The emergence of persistent balance of payments problems saw trade issues become more salient politically in the United States. Also, the success of the process of tariff reductions shifted attention towards NTBs to trade, not only because they were more obvious as tariff rates declined but also because they were increasingly the outlet of protectionist pressures.

In the Trade Act of 1974, Congress authorised the Nixon Administration to begin a new round of negotiations – the Tokyo Round – with a particular focus on reducing NTBs. But in order to preserve greater oversight, Congress now stipulated that any agreements must be approved by a majority vote in both the House of Representatives and the Senate – the so-called “fast-track” procedure. The 1974 Trade Act also eased the conditions regulating access to relief under anti-dumping and countervailing duty mechanisms. In addition, Congress established a process whereby domestic interests could petition the executive to act against unfair foreign import restrictions. Building on an earlier provision in the Trade Expansion Act of 1962, the new Section 301 provision granted the president authority to take retaliatory action against a country that maintained ‘unjustifiable’, ‘unreasonable’, or ‘discriminatory’ restrictions on US exports. In time, Section 301 would form the legal instrument for a rebalancing of US trade policy focus away from multilateralism and towards aggressive bilateralism.

In 1979, the Carter Administration won overwhelming congressional approval for the Tokyo Round agreements. The Tokyo Round reduced tariff rates on manufactured products by an average of one-third and put in place new codes on NTBs in such areas as government procurement, subsidies and countervailing duties (Winham 1986). While Congress again moved to ease the standards by which administered protection could be granted in the Trade Act of 1979, the central norm of executive primacy was largely maintained. Congress’ main objective was limited to giving more power to the bureaucracy by easing aid requirements, not to subvert executive branch primacy. It was this presidential authority and leadership, used astutely to tip the balance in favour of freer trade, that underpinned the 1934 regime. It allowed Congress to avoid blame and continue to deflect pressures for it to assume a more dominant role in the trade policy process. As a result of successive rounds of multilateral negotiations initiated by the executive, the average US tariff level on dutiable imports was reduced from 60 per cent in 1931 to 5.7 per cent in 1980 (Laverne 1983). With their larger constituency, capacity

to control appointments, to set agendas and to define the nature of an issue, postwar presidents were able to use their position to support a generally liberal, multilateralist trade strategy. As Destler (1995: 32) notes:

There were variations in their degrees of personal commitment: on balance, Gerald R. Ford's was greater than Richard M. Nixon's, and Lyndon B. Johnson and Jimmy Carter were more devoted free traders than John F. Kennedy. But all proved willing to play the role of tilting in the liberal direction – in the decisions they made themselves and in the appointments they made to key trade positions.

The 1980s crisis in the US trade policy regime would signify an unprecedented test of the legitimacy of the 1934 regime, its central norm of executive primacy and the process-oriented multilateralism that had been at the centre of American trade strategy for around 40 years. It saw the most avowedly free trade-oriented US President of the modern era preside over what even supporters would term a 'strategic retreat' on trade policy (Niskanen 1988: 137). The Reagan Administration's first formal "Statement on US Trade Policy" in July 1981 set as its goal the promotion of 'free trade, based on mutually acceptable trading relations' while pledging to 'strongly oppose trade distorting interventions by government'.⁵⁴ In time, senior Reagan Administration officials would acknowledge that the President had imposed more protectionist measures than any predecessor since Herbert Hoover whose signature approved the Smoot Hawley tariff.⁵⁵ By the second half of 1985, Congress had moved to reclaim a more central role in US trade policy, wielding the threat of veto-proof protectionist legislation and embarking on the first omnibus trade bill to be drafted by the Congress in over 50 years. President Reagan was forced to unveil a new strategy of 'free and fair' trade on 23 September 1985. The centrepiece was the self-initiation by the US government of bilateral Section 301 actions to combat unfair foreign trade practices.

The regime crisis acts as a conditioning variable and vantage-point for exploring change in US policy towards Japan. It illuminates the role of path dependency and how actions taken at one point in time result in opportunities for and constraints on future action by sending policy off on particular tracks. It would have long-lasting consequences as Congress moved to reclaim a more central role in US trade policy and the executive

⁵⁴ US Congress, Senate Committee on Finance (1981).

⁵⁵ In 1987, then US Treasury Secretary James Baker remarked that President Reagan had granted 'more import relief' than any predecessor 'in more than half a century' (Finger 1992: 89). Similarly, Niskanen (1988: 137) states that 'the administration imposed more new restraints on trade than any administration since Hoover'.

branch embraced a more structured and aggressive bilateral market access policy. As Haggard (1988: 119) notes, 'If institutions matter in explaining policy outcomes, political scientists should spend more effort unraveling those historical conjunctures or "turning points" when the context of policymaking changes fundamentally'. But in so doing it becomes clear that while institutional factors are important, they are never the sole "cause" of outcomes. The underlying sources of the regime crisis lay in the interaction of international and domestic factors external to the policy regime.

America's relative economic decline and the Japanese challenge

Stresses in the American trade policy regime by the 1980s can be traced in part to change in America's relative position in the world economy, especially vis-à-vis Japan. Relative decline in American economic power and increasing interdependence with the world economy provide an important, but permissive, systemic factor explaining a general US shift towards a more aggressive bilateral market opening policy in the 1980s. Two factors restructured the international environment facing American institutions and actors: (1) the erosion of the artificial postwar dominance of American manufacturing industry; and (2) the emergence of new sources of surplus capital in the international economy. With the United States increasingly dependent on international trade and financial flows, Japan would emerge as the major economic challenger to American economic supremacy. In the real economy, Japan's challenge was first apparent via pressure on basic US manufacturing industries, and later manifest in the area of high technology. By the 1980s, Japan's financial resources saw it eclipse the United States as the world's largest creditor nation.

At the end of World War II, the United States emerged with its economic base greatly expanded, while the industrial capacity of both its enemies and its allies was either destroyed or obsolete. Output in the United States had roughly doubled in real terms during the war, and by 1945 the US produced around half of the world's industrial output (Gardner 1980: 178). The United States was often the only source of products incorporating the technologies that emerged after the war. Trade patterns in the early postwar years confirmed its economic dominance. The United States accounted for over one-third of world trade in the war's aftermath, but its economy remained largely self-

sufficient.⁵⁶ As late as 1952, the US share of manufactures exports of the ten largest industrial economies stood at 35 per cent, compared with only 21 per cent in both 1938 and 1928. Export surpluses were recorded at that time in every major industrial group except metals – for example, machinery, vehicles, chemicals, textiles, and miscellaneous manufactures (Baldwin 1984b: 8). One senior figure in postwar US economic diplomacy would write subsequently that the position of the United States after World War II was ‘entirely abnormal and unsustainable’ (Volcker 1992: xv).

Two decades of rapid economic growth in Europe and Japan meant that the postwar dominance of the US economy had diminished significantly by the early 1970s. On a purchasing power parity basis, the US share of world output fell from around a third in the late 1940s to approximately 22 per cent in 1970 (Maddison 1995a). America’s share of the ten major industrial countries’ total manufacturing output fell from 62 per cent in 1950 to 44 per cent in 1970 (Branson 1980: 191). Low- and medium-technology manufacturing industries in the United States experienced eroding comparative advantage, first relative to European and Japanese competitors, and later relative to the newly industrialising economies (NIEs) of Asia and Latin America. In the 1950s, productivity in Japan and Europe was very low compared with the United States. Subsequently output per worker in these countries converged to the US level, though at a steadily diminishing pace. Table 3.1 shows the differences in manufacturing productivity growth rates that delivered the postwar “catch-up” with the United States by other industrial countries, as well as the general productivity slow-down in the 1970s.

Table 3.1 Manufacturing Productivity Growth in Major Industrialised Countries
(average annual growth, %)

| | United States | Japan | Germany | France | United Kingdom |
|---------|---------------|-------|---------|--------|----------------|
| 1950-73 | 2.62 | 9.48 | 6.31 | 5.63 | 3.25 |
| 1973-79 | 1.37 | 5.39 | 4.22 | 4.9 | 0.83 |

Source: Bailey and Blair (1988: 180)

⁵⁶ In 1946-47, exports were about 6 per cent of national income while imports were 2.5 per cent (Pollard 1985: 281).

The US share of world manufactures exports fell from 29 per cent in 1953 to 13 per cent in 1971 (Branson 1980: 196). Summarising the changing international position of America's manufacturing sector, Branson (1980: 183) noted that:

in the immediate postwar years, the pattern of United States trade was distorted by a relative strength in manufacturing that was transitory. The recovery of the European and Japanese economies in the 1950s and 1960s, and the growth of manufacturing capacity in the developing countries in the 1960s and 1970s inevitably reduced the United States share of world output and of world exports. ... By the 1970s, trade patterns reflecting underlying comparative advantage had been restored, and the United States was once again an importer of consumer goods.

Total manufacturing output in the United States grew at about the same rate as the average of all industrialised countries between 1973 and 1980, and total employment in manufacturing increased in absolute terms (Lawrence 1984: 34). At the same time, a real depreciation of the US dollar after 1971 worked to sustain overall US manufacturing competitiveness through the decade. The US share of manufactured exports of 13 major OECD countries was roughly 20 per cent both at the beginning and end of the 1970s (OECD 1994: 87). The long-term structural adjustment problems of American manufacturing were concentrated overwhelmingly in a few large, medium and low-technology industries — in particular automobiles, steel, textiles and apparel. Special protection had been a feature of the textile and apparel industries since the mid 1950s, and of steel since the late 1960s.⁵⁷ Sluggish domestic demand, declining comparative advantage and weak productivity growth continued to afflict these industries in the 1970s in the context of the more general slowdown in productivity growth in the industrialised world after 1973.

Tables 3.2-3.5 show in most cases weak output growth, absolute declines in employment and rising import penetration across these basic manufacturing industries through the 1970s and into the 1980s. In 1979, automobile output and employment were 12.8 per cent and 5.5 per cent respectively below peak levels in 1973. Steel production fell 8.3 per cent between 1973 and 1979, while employment was down 6.0 per cent from the 1974 peak. Textile output reached a new peak in 1979, but with 13.1 per cent less labour than

⁵⁷ Hufbauer, Berliner and Elliott (1986) provide a short history and analysis of the major cases of special protection in the United States.

Table 3.2 US Automobile Industry (select statistics)

| | output (1973=100) | employment (000s) | import penetration (%) |
|------|-------------------|-------------------|------------------------|
| 1970 | 67.8 | 245.3 | 14.7 |
| 1971 | 88.8 | 283 | 13.1 |
| 1972 | 91.3 | 284 | 14.6 |
| 1973 | 100.0 | 309.1 | 15.2 |
| 1974 | 75.8 | 262.2 | 15.8 |
| 1975 | 69.5 | 235.1 | 18.2 |
| 1976 | 87.9 | 273.8 | 14.9 |
| 1977 | 95.3 | 289.9 | 18.3 |
| 1978 | 94.9 | 303.5 | 17.8 |
| 1979 | 87.2 | 292 | 22.7 |
| 1980 | 66.0 | 220.6 | 28.2 |
| 1981 | 64.7 | 223.4 | 28.8 |
| 1982 | 52.5 | 193.5 | 29.3 |
| 1983 | 70.1 | 216.5 | 27.6 |
| 1984 | 80.4 | 247.6 | 24.9 |
| 1985 | 83.9 | 249.7 | 25.2 |

Sources: World Bank and United Nations data, International Economic Databank, Australian National University, Fuss and Waverman (1992), Crandall et al. (1986) and Nelson (1996).

Table 3.3 US Steel Industry (select statistics)

| | output (1973=100) | employment (000s) | import penetration (%) |
|------|-------------------|-------------------|------------------------|
| 1970 | 84.8 | 862 | 13.8 |
| 1971 | 77.9 | 798 | 17.9 |
| 1972 | 86.2 | 800 | 16.6 |
| 1973 | 100.0 | 860 | 12.4 |
| 1974 | 96.6 | 881 | 13.4 |
| 1975 | 77.2 | 783 | 13.5 |
| 1976 | 84.1 | 778 | 14.1 |
| 1977 | 83.4 | 785 | 17.8 |
| 1978 | 91.7 | 808 | 18.1 |
| 1979 | 91.7 | 828 | 15.2 |
| 1980 | 75.2 | 749 | 16.3 |
| 1981 | 80.0 | 724 | 18.9 |
| 1982 | 49.7 | 558 | 21.8 |
| 1983 | 57.9 | 480 | 20.8 |
| 1984 | 64.1 | 505 | 26.6 |
| 1985 | 62.1 | 449 | 25.9 |

Sources: World Bank and United Nations data, International Economic Databank, Australian National University, OECD (1995), Gray, Pugel and Walter (1986).

Table 3.4 US Textile Industry (select statistics)

| | output (1973=100) | employment (000s) | import penetration (%) |
|------|-------------------|-------------------|------------------------|
| 1970 | 77.9 | 1113 | 4.89 |
| 1971 | 81.1 | 1094 | 5.47 |
| 1972 | 92.6 | 1145 | 5.46 |
| 1973 | 100.0 | 1178 | 5.38 |
| 1974 | 92.6 | 1107 | 5.22 |
| 1975 | 85.3 | 996 | 4.56 |
| 1976 | 93.7 | 1042 | 4.99 |
| 1977 | 93.7 | 1067 | 4.81 |
| 1978 | 95.8 | 1062 | 5.83 |
| 1979 | 101.1 | 1024 | 5.58 |
| 1980 | 96.8 | 986 | 5.99 |
| 1981 | 94.7 | 951 | 6.51 |
| 1982 | 87.4 | 897 | 6.39 |
| 1983 | 98.9 | 905 | 6.47 |
| 1984 | 96.8 | 895 | 8.50 |
| 1985 | 95.8 | 839 | 9.84 |

Source: World Bank and United Nations data, International Economic Databank, Australian National University.

Table 3.5 US Apparel Industry (select statistics)

| | output (1973=100) | employment (000s) | import penetration (%) |
|------|-------------------|-------------------|------------------------|
| 1970 | 86.6 | 1164 | 5.56 |
| 1971 | 88.7 | 1142 | 5.94 |
| 1972 | 93.8 | 1187 | 6.51 |
| 1973 | 100.0 | 1213 | 7.12 |
| 1974 | 99.0 | 1155 | 7.77 |
| 1975 | 91.8 | 1065 | 8.55 |
| 1976 | 107.2 | 1117 | 10.87 |
| 1977 | 115.5 | 1155 | 10.76 |
| 1978 | 115.5 | 1146 | 14.27 |
| 1979 | 115.5 | 1137 | 14.79 |
| 1980 | 108.2 | 1150 | 15.04 |
| 1981 | 103.1 | 1097 | 16.04 |
| 1982 | 91.8 | 1019 | 16.33 |
| 1983 | 99.0 | 1036 | 18.20 |
| 1984 | 107.2 | 978 | 23.25 |
| 1985 | 104.1 | 887 | 25.57 |

Source: World Bank and United Nations data, International Economic Databank, Australian National University.

in 1973. Apparel output performed strongly, increasing by 15.5 per cent between 1973 and 1979, but with 6.3 per cent less employment.

Despite already receiving in some cases very high protection, these industries figured prominently in the trade-related adjustment problems of the United States in the early 1980s. Their predicament was widely portrayed as synonymous with the “de-industrialisation” of America due to foreign trade. In the cases of steel and automobiles, industries where wage levels were significantly higher than the US manufacturing average, declining employment raised the spectre of well-paid manufacturing jobs migrating overseas leaving US workers with low-paid employment in the services sector.⁵⁸

Japan’s remarkable economic recovery from wartime devastation was both a vindication of American postwar foreign economic policy and the source of significant adjustment pressure on American manufacturing industry. The rapid growth of export-oriented Japanese manufacturing industry was a hallmark of postwar growth. Japanese manufacturing output grew at an extraordinary annual rate of 14 per cent between 1953 and 1971, even faster than the 8.8 per cent annual growth in national output (Denison and Chung 1976: 73).⁵⁹ Growth in export volumes provided a critical spur to productivity growth and investment in Japan. Table 3.6 shows average growth of Japanese export volumes in the 1950s and 1960s of 16.5 per cent, almost double that of Western Europe and three times that of the United States. The elasticity of exports with respect to output over this period was a remarkable 6.6 per cent in Japan, significantly higher than in the United States and Europe. Barely a decade after Japan commenced its rapid postwar growth, a leading scholar would argue that ‘no other country has ever put so great a strain on American tolerance of competitive manufactures’ (Hunsberger 1964: vii).

Through the 1960s and 1970s, Japan successfully realigned the sectoral composition of output, employment, investment and exports away from low-technology sectors such as

⁵⁸ See, for example, Bluestone and Harrison (1982). For a more careful analysis of the impact of trade on American manufacturing employment, see Lawrence (1984).

⁵⁹ Within manufacturing, the growth rate was highest in machinery (19.6 per cent), comprising electrical and nonelectrical machinery, transportation equipment (including automobiles), and precision instruments (Denison and Chung 1976: 74).

**Table 3.6 Export Growth Rates and Relationship to Output Growth
(1950-52 to 1967-69, %)**

| | Growth rates of merchandise exports | Growth elasticities of exports to GNP ¹ |
|----------------|--|---|
| United States | 5.3 | 1.5 |
| Japan | 16.5 | 6.6 |
| Western Europe | 8.4 | 1.8 |

¹ Export growth rate divided by the corresponding GNP growth rate at constant prices.

Source: Eichengreen and Kenen (1994: 24).

textiles, wood and food and into medium- and high-technology sectors such as automobiles, computers and telecommunications equipment. Table 3.7 identifies export shares of select commodities over time to illustrate the changing composition of Japanese exports. The growth of Japanese manufacturing capability and its changing composition was a source of dislocation in the US economy and a target of Japan-specific protection since the 1950s. The Eisenhower Administration first engineered VERs on Japanese cotton textiles in 1957. This was followed by the Short-Term and later Long-Term Cotton Textile Arrangements during the Kennedy Administration, and by the first MFA during the Nixon Administration (Saxonhouse 1972, Destler, Fukui and Sato 1979, Friman 1990). From 1969, the United States negotiated VERs on steel imports from Japan and in the 1970s Japanese consumer products were singled out for special protection. VERs on steel imports from Japan would remain in place from 1969 to 1974. The Ford Administration negotiated an orderly marketing arrangement (OMA) on specialty steel imports from Japan in 1976, while carbon steel imports were restricted again under the “trigger price mechanism” put in place by the Carter Administration in 1978 (Crandall 1981, Sato and Hodin 1982). Carter Administration trade officials also negotiated an OMA on colour television receivers from Japan in 1977.

By the 1970s, Japan had become a global economic power, the world’s second largest market economy, and the major challenger to American industrial and technological supremacy. Though well down on the rates recorded in the 1950s and 1960s, Japanese

Table 3.7 Shares of Select Products in Total Japanese Exports (%)

| | 1957 | 1970 | 1980 |
|-----------------------------|------|------|------|
| Textiles | 34.8 | 9.7 | 3.9 |
| Iron and Steel | 7.6 | 15.7 | 12.5 |
| Electrical machinery | 2.1 | 14.5 | 16.4 |
| Motor vehicles | 1.1 | 8.5 | 21.4 |

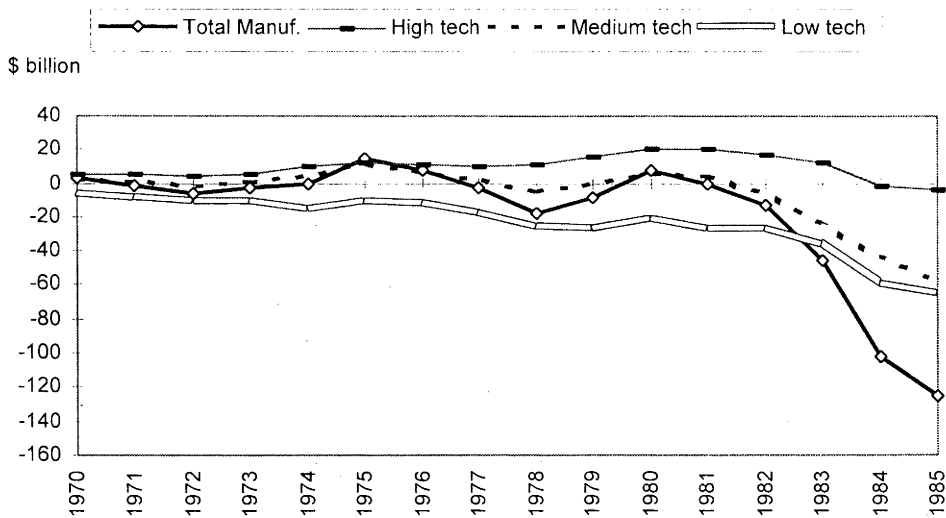
Sources: World Bank data, International Economic Databank, Australian National University, Japan Times (1960)

growth continued to exceed that of other industrialised countries in the 1970s. Japanese shares of global output and trade continued to rise in the face of two oil shocks, weaker domestic demand and a less favourable external environment. Rapid capital accumulation remained the key driving force behind Japanese economic expansion with the stock of invested capital as a ratio to GDP surpassing the US level in the 1970s (Maddison 1995b). By the end of the 1970s, the broad technological ascendancy of the United States was being challenged in a range of export-oriented sectors of Japanese industry. Jorgenson, Kuroda and Nishimizu (1987) concluded that by 1979 Japan had closed the productivity gap in nine of 28 industries, including automobiles, transportation and communication, electrical machinery and precision instruments.

Figures 3.1 and 3.2 suggest why Japan's technological advance came to represent a particular problem for the US trade policy process in the first half of the 1980s. Figure 3.1 shows that through the 1970s the overall US trade position in manufactures remained roughly in balance with an increasing surplus in high-technology products cancelling out a growing deficit in low-technology products. Figure 3.2 shows bilateral manufacturing trade balances between the United States and Japan with US deficits across all three categories, but increasing significantly in medium-technology products from the mid 1970s and in high-technology products from the start of the 1980s.⁶⁰

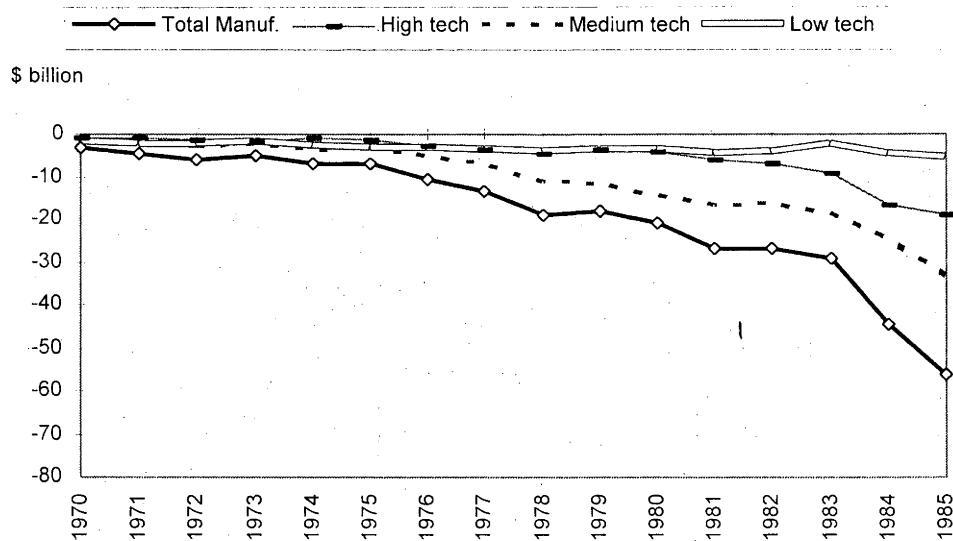
⁶⁰ See Zysman and Tyson (1983: 33) for a discussion of the perceived adverse implications of the US trade deficit with Japan in technology-intensive products.

Figure 3.1 US Trade Balance in Manufactures



Source: IMF, *International Financial Statistics*, International Economic Databank, Australian National University.

Figure 3.2 US-Japan Trade Balance in Manufactures



Source: IMF, *International Financial Statistics*, International Economic Databank, Australian National University.

With the internationalisation of American manufacturing, trade became more important to America's domestic and international politics. The continued erosion of US comparative advantage in low- and medium-technology industries, an adjustment problem made more acute by the post 1973 slowdown in demand and productivity growth, increased demands for new and more restrictive trade measures. The rapid advance of Japanese manufacturing export capacity challenged the ascendancy of American firms across a range of higher technology products. With a broader range of American commercial interests pursuing direct trade remedies against Japanese imports, Japanese market access negotiations not surprisingly became a more important part of the export politics of the executive branch.

Along with adjustment pressures in the real economy, a loss of financial hegemony by the 1980s reinforced the new pressures of interdependence and America's relatively diminished position in the international economy. The growth of alternative sources of surplus capital in the world economy arose with the enormous expansion in private capital flows. The emergence of a large pool of excess savings in Japan compared with a low and declining savings rate in the United States was a key factor underlying record capital flows and a transformation of US-Japan financial relations. In the space of a few years in the 1980s, Japan became the world's largest creditor nation while the United States became the world's largest net debtor. In the process, Japan became a major investor in the United States creating new sources of friction surrounding asymmetries in the bilateral investment relationship.

As the world's strongest economic power, the United States assumed primary responsibility for the reconstruction and management of international monetary relations after the war. The US dollar was at the centre of the Bretton Woods monetary system based on the strength of the US economy, America's role as provider of global liquidity, and the commitment of the US government to convert dollars into gold at \$35 per ounce. The system of fixed exchange rates put in place under Bretton Woods greatly constrained international capital flows in the world economy. Since large international capital flows could create pressures on exchange rates, governments tended to adjust internal, macroeconomic policies to keep current account imbalances small in order to preserve currency values. Under the Bretton Woods system, currency pegs could be adjusted in cases of "fundamental disequilibrium", but only as a last resort. Exchange controls

restricting capital flows were still quite severe in most industrial countries in the 1950s and 1960s. But the postwar reconstruction of the international economy and the development of new markets and trading technologies eroded the effectiveness of controls over time. The growth of highly liquid international financial markets in which the scale of transactions greatly exceeded official international reserves made it increasingly difficult to carry out orderly adjustments of currency pegs.

The underlying tensions in the Bretton Woods system became more apparent during the late 1960s. This reflected a number of factors, including expansionary US macroeconomic policy, a dramatic increase in private capital markets relative to official reserve holdings, and divergences in policy objectives among some of the major participants in the system (Solomon 1977). Despite attempts to maintain the system in the early 1970s, speculative capital flows and concerns about the US dollar's overvaluation led the Nixon Administration to break the link between the US dollar and gold in August 1971 and to finally abandon the fixed exchange rate system in 1973 (Gowa 1983). Well into the 1970s, however, net capital transfers remained small, resulting in a close correlation between national domestic investment and national savings.⁶¹

This correlation began to break down in the early 1980s (Frankel 1991, Feldstein and Bacchetta 1991): A combination of domestic policy decisions and secular shifts in national savings and investment patterns gave impetus to financial integration and large capital flows. The pace of financial reform intensified in industrial countries in the late 1970s, making substantial funds from high-saving countries such as Japan and (West) Germany available in the international capital markets. And even though all major industrial countries experienced a decline in their national savings rates after the mid 1970s, there were marked differences among industrial countries in terms of the proportion of national income that was saved. This was nowhere more apparent than in the world's two largest economies with the US savings rate ranking consistently among the lowest in the industrialised world and Japan's consistently among the highest.

⁶¹ In a widely-cited study, Feldstein and Horioka (1980) found that the development of more open international financial markets in the 1970s did not lead to a reduction in the very high correlation between domestic saving and investment rates in industrial countries. One explanation for this pattern, not inconsistent with a high degree of capital mobility, is that governments in the 1970s may have to some extent aimed fiscal policy at limiting the magnitude of current account imbalances (Summers 1988).

Record capital flows and Japan's eclipse of the United States as the world's largest creditor nation in the 1980s were a direct result of the high Japanese savings rate. In the period of rapid growth from 1960 through to the early 1970s, the high Japanese savings rate was absorbed by an equally high rate of investment, and the balance between savings and investment was maintained. But in the 1970s, notably in the wake of the first oil crisis, Japan's annual economic growth rate fell from around 10 per cent to roughly half that figure. With the savings rate showing little if any decline, Japan began to accumulate large savings surpluses.⁶²

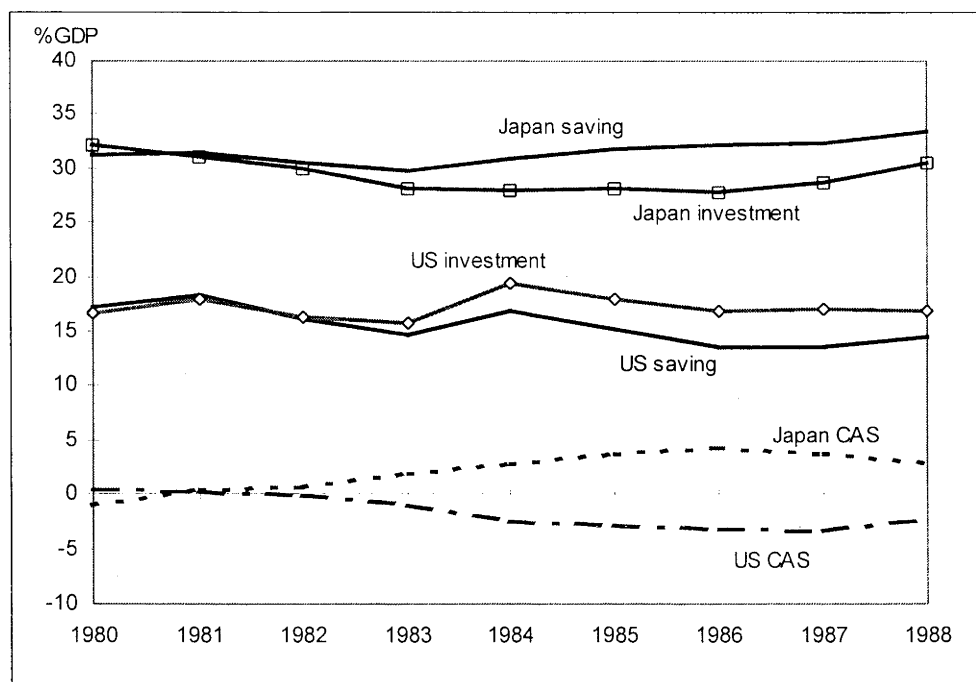
The deregulation of Japanese financial markets helped to make these substantial excess savings available in international capital markets. Japanese restrictions on foreign exchange and private capital flows remained tight until the late 1970s. Towards the end of the decade, these policies came under pressure from the domestic financial sector, as well as from American government negotiators.⁶³ Financial reform in Japan was undertaken progressively with the revision in 1980 of the Foreign Exchange and Trade Control Law. This reform changed the earlier policy that all international transactions would be prohibited unless specifically authorised by the government to one in which transactions would be free of control unless specifically targeted by the government (Komiya and Suda 1991).

As Figure 3.3 shows, savings and investment moved in opposite directions in the world's two largest economies in the early 1980s. These shifts were reflected in current account balances. The 1980s saw a historic swing by the US toward massive borrowing from abroad as a widening of the US budget deficit created excess demand for saving and attracted foreign saving through higher interest rates. This net capital inflow reversed the pattern of the preceding 90 years. During World War I, the United States had passed from being a net debtor vis-à-vis the rest of the world to being a net creditor. By 1982 the United States had attained a recorded net investment position in excess of \$350 billion, with net foreign assets more than 10 times as large as Japan's. It took only a few years of

⁶² Japan's especially high rate of household savings has been attributed to, among other things, a prosaving tax and financial system, a shortage of housing, leisure, and consumption goods on which to spend income, and a rapidly aging population (Horioka 1990).

⁶³ According to Alexander (1995: 5), 'Outside pressure likely had less impact than the declining domestic demand for loans plus growing opportunities evident overseas as other countries liberalized their broadly defined financial policies; that proved a strong impetus for Japanese investors to seek changes in domestic regulations'.

Figure 3.3 Gross Savings and Investment Ratios – United States and Japan



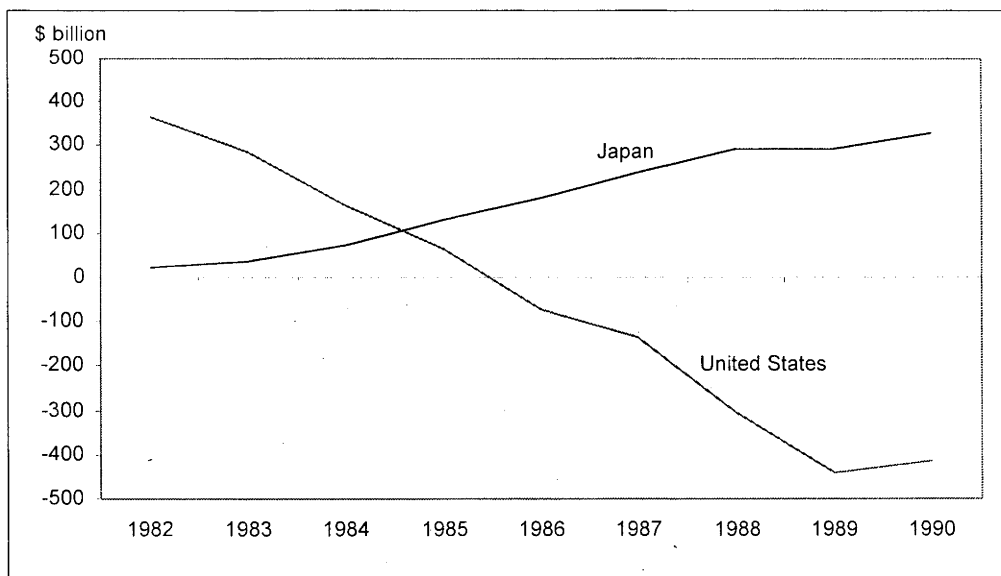
Note: CAS = Current Account Surplus

Source: Bergsten and Noland (1993: 37)

large external imbalances to undo a century of net accumulation of foreign assets by the United States and to dramatically change the relative financial positions of the US and Japan (Figure 3.4).

Japan's high savings rate combined with financial market liberalisation provided the impetus to its purchases of foreign assets. The most striking feature was the surge in cross-border portfolio investment flows. An average annual inflow of \$1 billion of portfolio investment in 1970-82 into Japan changed to an average annual outflow of \$52 billion in 1983-88. Meanwhile, the average portfolio capital inflow into the United States increased from \$0.1 billion in 1970-82 to an average of \$40 billion in 1983-88 (IMF 1991: 16). Japan's net asset position in the United States increased from -\$2 billion in 1980 to \$129 billion in 1988. By the end of the 1980s, the US accounted for nearly half of Japan's net foreign assets and Japan had become the largest foreign holder of US Federal debt securities and the second largest investor in US businesses and real estate (Jackson 1990). Financial interdependence added a new dimension to bilateral economic

Figure 3.4 International Investment Position of the United States and Japan
 (\$billion, historical-cost basis)



Source: Bank of Japan, *Balance of Payments Monthly*, various issues. US Department of Commerce, *Survey of Current Business*, various issues.⁶⁴

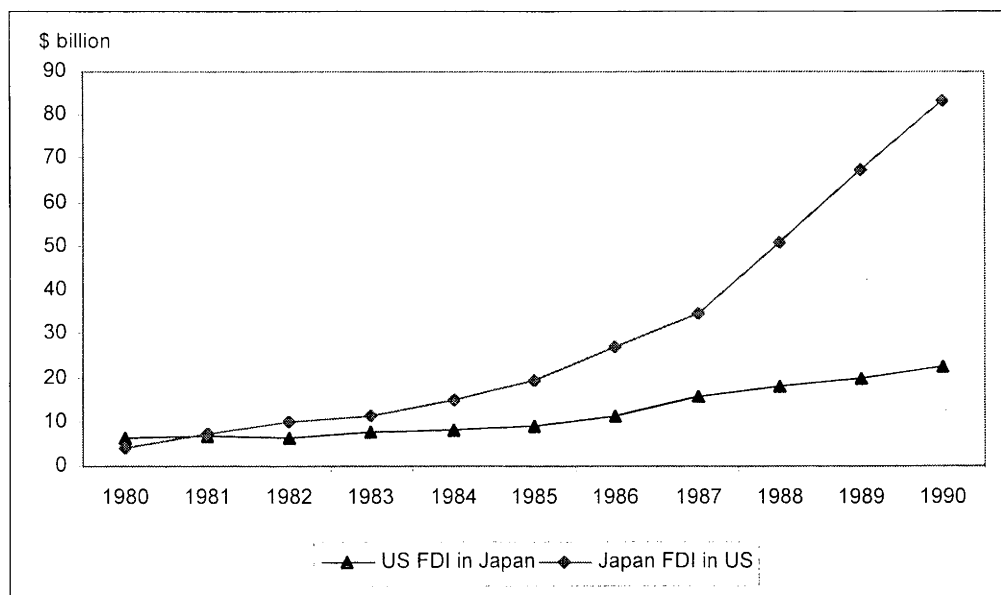
friction. The degree to which Japanese firms began acquiring American companies through foreign direct investment became a focal point of political concern about the increasing presence of foreign firms in the United States.⁶⁵ Concerns also surrounded the rise in Japanese holdings of US Federal securities and fears that Japanese investors could spark a financial crisis in the United States by withdrawing their funds (Bergsten 1987).

The rise in Japanese FDI in the United States in the second half of the 1980s was a particular focal point for attention (Yamamura (ed.) 1989). Figure 3.5 shows this increase relative to US FDI in Japan. While the sharp appreciation of the yen after 1985 was a key factor behind increased Japanese FDI, the political spotlight focused on the extent to which Japan was an outlier both in terms of the penetration of its economy by foreign firms and the behaviour of Japanese-based firms in the United States (Graham

⁶⁴ Revisions in the US Department of Commerce data incorporate the concept of current replacement cost rather than the traditional historical cost measure. This method narrows the extent to which the United States appears as a net debtor but does not change the overall trend.

⁶⁵ The most notable political response was the passage by Congress of the Exon-Florio amendment as part of the Omnibus Trade and Competitiveness Act of 1988. This established for the first time a mechanism to screen certain direct investments in the United States. Although Japanese FDI was of growing importance as the 1980s wore on, European (and especially British) firms continued to account for the majority of FDI in the United States (Graham and Krugman 1995).

Figure 3.5 Foreign Direct Investment – United States and Japan



Source: US Department of Commerce, *Survey of Current Business*, various issues.

and Krugman 1995: 174).⁶⁶ Japanese firms were criticised for destroying jobs and worsening the trade deficit, eroding America's technology base, and potentially compromising national security (Burstein 1988, Prestowitz 1988). Especially prominent were claims that Japanese firms had a higher propensity to import rather than source in the US domestic market.⁶⁷ Japanese companies in the United States were also singled out as exerting undue influence in American political processes (Choate 1990). The rise of Japan as a financial superpower in the 1980s contributed to American perceptions of a unique Japan investment problem that amplified tensions in the trade relationship.

Reaganomics and the domestic sources of regime crisis

So far, the American trade regime crisis has been analysed in terms of pressures arising from relative change in the economic positions of the United States and Japan in the international economy. But systemic changes do not affect the policy environment in an unambiguous way. The nature, intensity and timing of the American trade regime crisis

⁶⁶ For analyses stressing the importance of past restrictive investment policies in Japan, see Mason (1992) and Encarnation (1992).

⁶⁷ Graham and Krugman (1995: 78) found that in 1990 Japanese affiliates imported 2.2 times as much per worker as did the average foreign-controlled affiliate. They suggested that the main reason for the disparity related to mismeasurement and selection bias as Japanese FDI were newer and less mature.

cannot be explained adequately without taking account of domestic policy actions. This is especially the case where policy developments outside the trade policy process can have profound implications for US trade policy. A central lesson of the 1980s concerned the degree to which macroeconomic factors can have large, unintended consequences for US trade policy. The trade regime crisis cannot be understood independently of the sharp deterioration of the US external deficits associated with the budgetary policies implemented in the first term of the Reagan Administration. The impact of Reaganomics suggests that a balanced macroeconomic policy mix underpinned, at least implicitly, the stability and legitimacy of the 1934 regime.

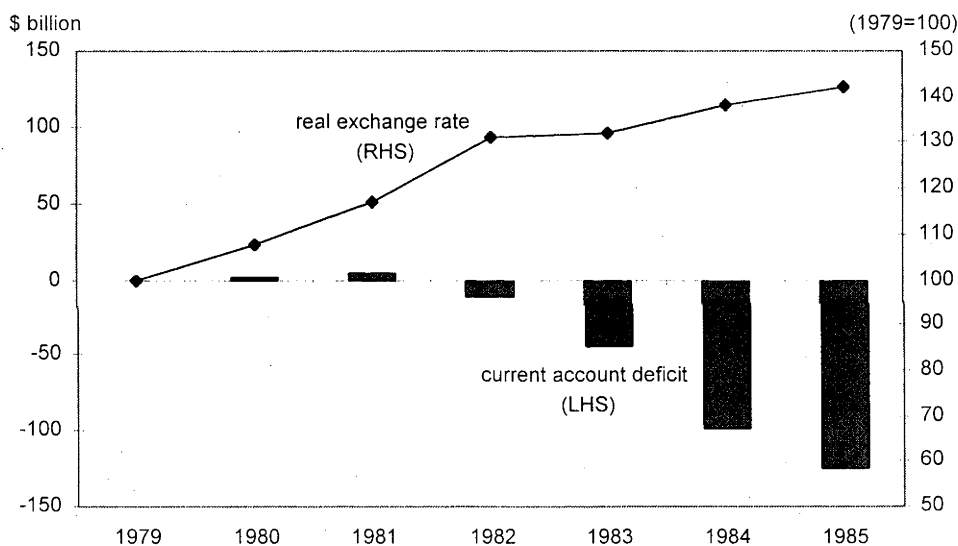
Despite rising import competition, external developments still played a relatively small role in the performance of the US economy at the start of the 1980s. Imports and exports each accounted for less than 10 per cent of GDP, trade was roughly in balance and international capital flows financed a very small part of the net investment of the United States. But by 1985, the United States was running a current account deficit of over \$120 billion (around 3 per cent of GDP) and was well advanced towards becoming the world's largest net debtor. A 40 per cent real appreciation of the US dollar against the currencies of its trading partners between 1979 and the first quarter of 1985 undermined even the most competitive traded goods industries.

The steep deterioration in the US trade balance in the early 1980s reflected the macroeconomic policy mix of fiscal expansion and monetary contraction in the United States in combination with the opposite mix in other industrialised countries. Beginning in October 1979, the US Federal Reserve tightened monetary policy determined to squeeze double-digit inflation out of the US economy. The federal funds rate rose from 12 per cent in October 1979 to 18 per cent in March 1980, while the prime rate peaked at 21.5 per cent in the last quarter of 1980. This monetary tightening resulted in a sharp rise in the real interest rate differential and appreciation of the US dollar at the same time that the US economy slumped into a deep recession in 1981-82. Unemployment reached 10.5 per cent in 1982 while US manufacturing production and employment fell 8.3 per cent and 10.7 per cent respectively from their 1979 peaks (CEA 1986).

In the face of a deteriorating economy, the newly-elected Reagan Administration's budget program of March 1981 featured major reductions in income tax rates over three

years and a large real increase in defense outlays.⁶⁸ In the absence of reduced spending on domestic programs, the budget deficit climbed from 2.1 per cent of GNP in 1981 to 4.6 per cent in 1982 and 5.2 per cent in 1983. The reduction in tax revenue from 20.8 per cent of GNP in 1981 to 18.6 per cent in 1983 accounted for most of the budgetary shortfall, but the Reagan Administration also increased real federal spending by 3.7 per cent per annum in its first term. As the fiscal stimulus took hold in 1982 and 1983, the US economy recovered strongly from recession contributing to a further rise in the interest differential and the exchange rate. The current account fell substantially into deficit in 1983, when the recovery in growth was under way and the lagged effects of the earlier appreciation of the dollar were beginning to have strong effects (Figure 3.6).

Figure 3.6 The US Current Account and Real Effective Exchange Rate



Source: IMF, *International Financial Statistics*, International Economic Databank, Australian National University.

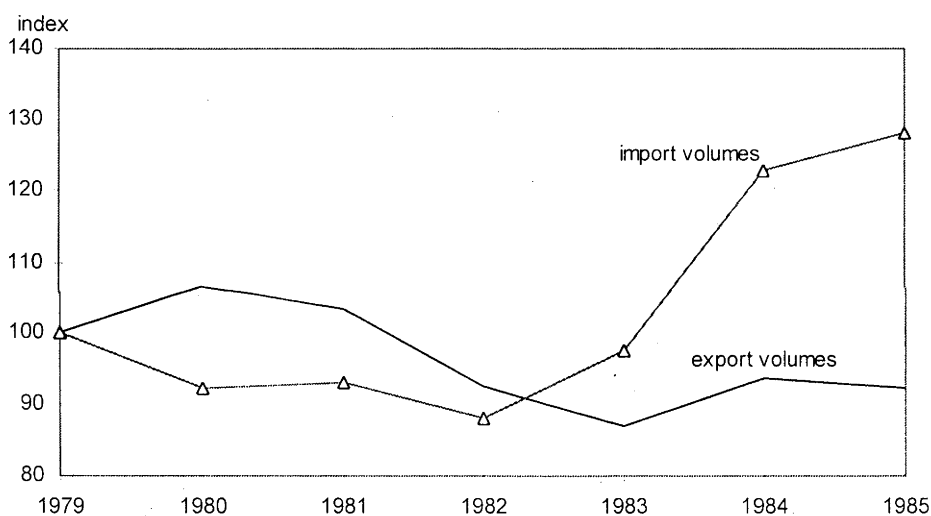
Compounding the impact of the Reagan Administration's macroeconomic policies on external balances was the move by other countries towards fiscal consolidation. As the United States was increasing its structural budget deficit, Japan took substantial steps to

⁶⁸ In August 1981, President Reagan signed into law an across-the-board 25 per cent cut in personal income tax rates to be phased in over three years. The 1981 bill also substantially reduced taxation of business income (Niskanen 1988).

reduce its deficit, accentuating the differential in real interest rates and providing a further incentive for capital flows out of Japan and into the United States.⁶⁹

Figure 3.7 shows the slump in US export volumes and the surge in import volumes that accompanied the Reagan Administration's high dollar recovery. A fall in real net exports more than accounts for the fall in the nominal current account given the improvement in the US terms of trade over the period. Export prices rose moderately on average while import prices fell due to lower oil prices and to the dampening effect of the rise in the US dollar on nonoil imports (Hooper and Mann 1987: 21). The sharp deterioration in the US manufactures trade deficit ignited fears that the United States was falling victim to the industrial targeting policies of foreign governments, especially Japan.

Figure 3.7 US Export and Import Volumes (1979=100)



Source: IMF, *International Financial Statistics*, International Economic Databank, Australian National University.

But as Lawrence (1984: 50) noted at the time, the manufactures deficit and the strength of the exchange rate reflected:

⁶⁹ Estimated structural changes in the central government budget deficit between 1980 and 1986 were +2.7 per cent of GNP for the United States and -1.8 per cent of GNP for Japan (IMF 1986).

the need to channel foreign goods into the United States to meet the rise in domestic consumption. In this sense, the growth in the manufactured goods trade deficit is a response to a change in economic structure. But it is not a change that has resulted from shifts in US or foreign industrial policies or prowess; it is rather a change that reflects the budgetary decisions of the US government.

How did President Reagan's economic advisers envisage the international implications of the president's macroeconomic policies? William Niskanen (1988: 231) notes that, 'the rapid increase in imports and the trade deficit were the major unanticipated economic effects of the initial Reagan program'.⁷⁰ Indeed, he argues:

the initial program barely acknowledged the international dimensions of economic policy. One paragraph described how the proposed policies were expected to improve the international economic environment, but there was no mention of the principles that would guide our economic relations with other nations. The implicit assumption was that international conditions were not an important consideration affecting the proposed policies (Niskanen 1988: 6).

This neglect of the foreign economic policy implications of Reaganomics found expression in the official view that the steep rise in the US dollar in the first half of the 1980s simply reflected foreign investors' endorsement of the administration's policies rather than being a symptom of macroeconomic policy imbalance.⁷¹ A number of analysts have explored the relationship in the US context between macroeconomic developments and trade policy response, and in particular the impact of an overvalued exchange rate on import protection. Bergsten and Williamson (1983: 102) concluded that 'overvaluation of the dollar has proved to be an accurate "leading indicator" of trade policy in the United States — perhaps the most accurate of all in the postwar period'. As of the early 1980s, they identified the three postwar periods of most severe protectionist pressures in the United States — the early 1970s, 1976-77, and 1981-82 — as following promptly on periods of overvaluation of the dollar (Bergsten and Williamson 1983: 111). Bergsten (1982a) considered the impact of a misaligned exchange rate on trade policy to be even more pronounced in the bilateral economic relationship between the United States and Japan. Dornbusch and Frankel (1987) were more cautious about dismissing alternative, microeconomic hypotheses on the determinants of US protection in the first

⁷⁰ Niskanen was a member of the President Reagan's Council of Economic Advisers from April 1981 to March 1985.

⁷¹ See Williamson (1985), Marris (1987) and Destler and Henning (1989) for critiques of the Reagan Administration's exchange rate policies.

half of the 1980s, but concluded that an overvalued exchange rate was the most important macroeconomic factor.

The link between macroeconomic factors and the sharp increase in US protectionism in the first half of the 1980s points to the significance of Reaganomics as a domestic shock to the American trade policy regime. Table 3.8 shows how the move by the United States towards a substantial federal budget deficit in the early 1980s was correlated with large net capital inflows and hence a marked increase in the current account deficit. It also highlights how the growth of the “twin deficits” through this period was in marked contrast with the relative internal and external balance from 1950 to 1980. This suggests the historical importance of orthodox budgetary policy as an implicit norm of the American trade policy regime.

Table 3.8 The “twin deficits” of Reaganomics

| Period or year | Net private domestic savings (1) | State and local surplus (2) | Federal deficit (3) | Net domestic savings (1)+(2)-(3) (4) | Net private domestic investment (5) | Net domestic savings shortfalls (5)-(4)= net capital inflows (6) |
|----------------|----------------------------------|-----------------------------|---------------------|--------------------------------------|-------------------------------------|--|
| 1950-59 | 7.5 | -0.2 | -0.1 | 7.8 | 7.5 | -0.3 |
| 1960-69 | 8.1 | 0 | 0.3 | 7.8 | 7.1 | -0.7 |
| 1970-79 | 8.1 | 0.8 | 1.7 | 7.2 | 6.9 | -0.3 |
| 1980 | 6.4 | 1 | 2.2 | 5.2 | 4.9 | -0.3 |
| 1981 | 6.6 | 1.1 | 2.1 | 5.6 | 5.5 | -0.1 |
| 1982 | 5.5 | 1.1 | 4.6 | 2 | 2 | 0 |
| 1983 | 5.7 | 1.4 | 5.2 | 1.9 | 3.1 | 1.2 |
| 1984 | 6.8 | 1.7 | 4.5 | 4 | 6.6 | 2.6 |
| 1985 | 5.7 | 1.6 | 4.9 | 2.4 | 5.1 | 2.7 |
| 1986 | 5.3 | 1.3 | 4.8 | 1.8 | 5.1 | 3.3 |
| 1987 | 4.1 | 1.2 | 3.5 | 1.8 | 5.1 | 3.3 |

Source: Lawrence (1988: 51)

Richardson (1991: 8) has noted how ‘US trade policy in the 1980s ended up a weak and unwilling handmaiden to macroeconomics. It was forced into trying to do what macroeconomic policy could or would not do’. The impact of Reaganomics underscores how notionally separate policy developments can have major spillover effects in other policy domains with long-lasting consequences. The trade regime crisis saw the collision of domestic macroeconomic decisions with longer term structural forces changing the

institutional dynamic of American trade policy and favouring certain groups and ideas over others. Consistent with the historical institutionalist approach, Weir (1992: 192) points to the need for ‘casting a broad eye over politics to understand how developments in different domains of politics and policy collide to create outcomes that cannot be readily anticipated or easily controlled by individual actors. Such collisions can become turning points in a sequence by creating opportunities for political actors seeking to promote new ideas and different visions of politics’. The regime crisis which led in 1985 to highly conflictual relations between the executive and Congress would be one such turning point, rendering some interpretations of US trade problems more persuasive than others.

The rise of aggressive bilateralism

Ballooning US trade and current account deficits, sharply higher protection, a Congress intent on reclaiming an action-forcing role in US trade policy and a move away from multilateralism towards more narrowly-based market opening policies would be among the key legacies of the American trade policy regime crisis. With institutional conflict between Congress and the executive branch at a level not seen for 50 years, the Reagan Administration was forced to embrace a more aggressive bilateral approach to export politics. Specifically, it moved from a stance of relative neglect of Section 301 towards its high-profile and aggressive use. Prior to 1985, Section 301 was not a major part of US trade law armoury and provided little more than a mechanism for US business to register a market access complaint. The most comprehensive study of the provision found that of the 21 investigations under Section 301 during the first Reagan term, ‘only two were even partially resolved to US satisfaction’ (Bayard and Elliott 1994: 15). After 1985, Section 301 would become a major tool of American trade policy, one that other countries would condemn as contrary to the norms of the multilateral trading system.

In the early part of the Reagan Administration, recession and the rising dollar ensured that American industries’ demands for import relief remained the most politically-sensitive trade issues. Executive officials justified new import protection on the basis that, were it not to act, Congress would impose even more restrictive measures. The most striking departure from the Reagan Administration’s free trade credentials came in its first months in office when it secured a VER to restrict annual Japanese automobile

exports to the United States to 1.68 million units (Winham and Kabashima 1982). The auto VER was followed in December 1981 by the renewal of a more restrictive MFA. And in October 1982, after US steel producers filed multiple anti-dumping and countervailing duty petitions, Commerce Secretary Malcolm Baldrige announced VERs restricting carbon steel exports from the EC.⁷² Successful campaigns by the automobile, steel, textile and apparel industries pointed to the influence of these politically powerful industries, but also to the pragmatic calculus of an administration keen to preserve political capital in Congress for President Reagan's domestic agenda.⁷³

Early in its first term, the Reagan Administration held back from pressing for specific market access concessions from Japan, merely warning that it needed to take actions to support the international trading system (Japan Economic Institute of America 1983: 45). The 97th Congress (1981-1982) initiated the main instrument of export politics directed at Japan in the form of "reciprocity" legislation. In December 1981, the Senate Finance Committee (the committee with trade jurisdiction in that chamber) passed a 'sense of the committee' resolution embodying the idea of equivalent or reciprocal market access between Japan and the United States.⁷⁴ This new 'strict reciprocity' was described at the time as 'aggressive rather than passive as in the past: it would impose new trade barriers as a threat, rather than merely refraining from extending new liberalization to nonreciprocating countries' (Cline 1983a: 16).⁷⁵

More than 30 reciprocity bills were introduced in the 97th Congress (Cline 1983b: 121). The focal point for legislative activity was the reciprocity bill (S. 2094) introduced by Senator John Danforth (R, MO), chairman of the trade subcommittee of the Senate Finance Committee. The bill sought to establish the principle that US access to foreign markets be 'substantially equivalent' to the access accorded by the United States. In so

⁷² Japan had limited its carbon steel shipments to between 5 per cent and 6.5 per cent of the total US market in understandings with successive US administrations (Hufbauer, Berliner and Elliott 1986: 171).

⁷³ In the case of the automobile VER, former USTR William E. Brock maintains that the Reagan Administration could have blocked any congressional trade restrictions, 'but we thought the price we would pay in some other areas of real consequence like the tax reductions that we were wedded to might be higher than we wanted to pay'. William E. Brock, interview with author, 24 June 1996, Washington DC.

⁷⁴ The resolution called on the US Trade Representative to 'take such actions as are necessary and appropriate to bring the denial of equivalent market access specifically and directly to the attention of the Government of Japan ... [and] achieve expeditiously reciprocal trading opportunities for all American producers in the Japanese market' (Japan Economic Institute of America 1982: 35).

⁷⁵ Keohane (1986) popularised the terms 'strict' and 'diffuse' reciprocity to differentiate the more narrowly defined 1980s version from the less calibrated reciprocity practised in the earlier rounds of the GATT.

doing, it sought to amend Section 301 of the Trade Act of 1974 to make lack of substantially equivalent market access grounds for a complaint by an injured party or by the president or Congress.⁷⁶ But in the midst of a deep recession, congressional interest in export politics waned and the Danforth reciprocity bill failed to reach the Senate floor in 1982. Congressional trade energies shifted towards a more pointedly trade-restrictive piece of legislation in the House of Representatives targeted at Japanese automobile manufacturers.⁷⁷ November 1982 saw the trough of recession in the United States and while the Reagan Administration avoided greater restrictions in the automobile industry, rising import penetration continued to drive other basic manufacturing industries to seek import relief. Despite a strong economic recovery through 1983 and 1984, the Reagan Administration acquiesced to further protection for the steel, textile and apparel industries (Pearson 1989).

The focus of US market access pressure on Japan in the early years of the Reagan Administration remained very much on cases where clear Japanese government restrictions could be targeted. In 1983, talks focused on beef and citrus products and the procurement practices of Japan's state-owned telephone monopoly, the Nippon Telephone and Telegraph Company (NTT) — all cases of existing agreements coming due for renewal. A new area for discussions was trade in high-technology products with both governments looking to reduce bilateral trade conflict, especially in the semiconductor industry. Despite a strong rhetorical pitch, then USTR William Brock recalls that, 'I don't think we were that tough on Japan. The public posturing was more than the private one'.

There were the non-governmental barriers, but they were still more buried under the surface. We would take those examples that were more egregious in the first place and document the case and we made usually a pretty good amount of progress.

... Everyone could figure out what it would take to satisfy the politicians on both sides. And it was contentious, but in the final analysis it was not that difficult a negotiating procedure. What it was not doing was dealing with the problem; and we began to realise that.⁷⁸

⁷⁶ Believing the legislation would violate the GATT and invite foreign retaliation, the Reagan Administration proposed a compromise bill which included a limited strengthening of Section 301, but which replaced any reference to 'substantially equivalent' market access with 'fair and equitable' market opportunities.

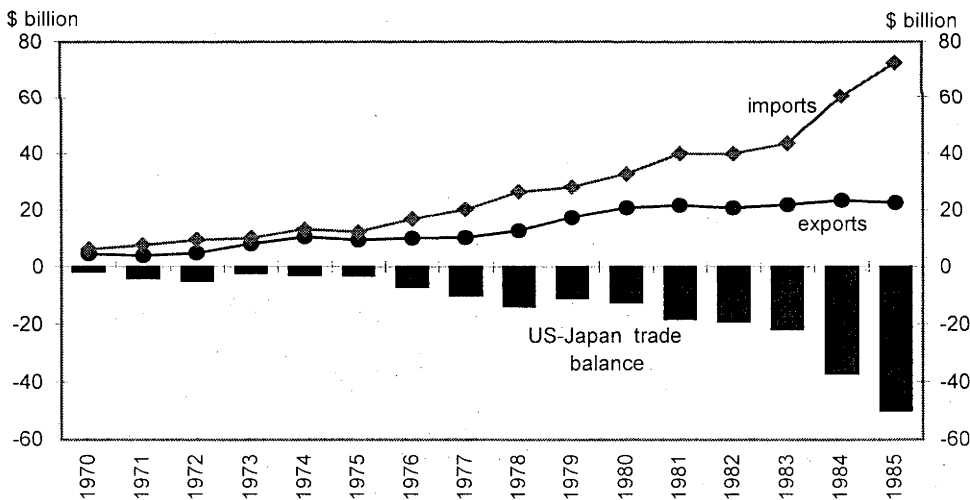
Congressional Quarterly, 19 June 1982, p. 1486.

⁷⁷ A highly restrictive domestic content bill on automotive manufacturers passed the House of Representatives in 1982 and 1983, but failed to reach the floor of the Senate.

⁷⁸ Brock, interview, 1996.

In 1984, US-Japan talks continued on the renewal of the beef and citrus and NTT procurement agreements as well as on US complaints concerning Japanese barriers in wood products, legal services and Japan's inadequate copyright protection laws. By this time, the sharp rise in the US trade deficit with Japan was creating its own momentum behind bilateral trade friction (Figure 3.8). As it mirrored the broader deterioration in the US external position, the bilateral imbalance provided an important transmission belt from Reaganomics to a more aggressive Japan policy. Between 1981 and 1984, the US trade deficit with Japan doubled from \$18 billion to almost \$37 billion. The trade gap had 'an important indirect impact by creating, in US trade politics, something of a presumption of Japanese guilt' which in turn made it 'more difficult for US officials to accommodate Japanese arguments and interests without undermining their credibility at home' (Destler and Sato 1982: 272-273).

Figure 3.8 US-Japan Merchandise Trade Imbalance



Source: World Bank data, International Economic Databank, Australian National University.

Economic advisers in the Reagan Administration sought routinely to explain the US external imbalance in terms of an excess of national investment over national savings

and to caution against drawing trade policy inferences from bilateral imbalances.⁷⁹ But for a significant section of the American trade policy community, unfair trade barriers offered a more intuitive explanation for the bilateral imbalance — one reinforced by complaints from American commercial interests.⁸⁰

Niskanen (1988: 150) criticised both branches of the US government based on his experience on the Reagan Administration's CEA:

Congress does not yet recognize that the trade deficit is made in the United States. The trade deficit or, more accurately, the broader current account deficit is the difference between saving by Americans and investment in the United States. The only effective ways to reduce the trade deficit are to increase US saving, reduce the government deficit, or reduce private investment in the United States. The administration was not immune to this misrepresentation. In the early fall of 1984, I made a presentation to the cabinet on this relation of US foreign and domestic balances. Although my presentation involved little more than stating the implications of some accounting identities, this relation was not broadly understood. Only the usual courtesies of a cabinet meeting prevented the pragmatists and trade hardliners from commenting that I might understand economics, but I did not understand the real world. I was no more successful in making this point in personal discussions with members of Congress. An alternative explanation of their response may be that they understood this relation perfectly well, but that concern about the trade deficit provided a convenient rationalization for trade measures they believed were important for political reasons.

Compounding the pressures on the American policy regime and narrowing the outlets for market opening initiatives was the failure of the GATT Ministerial Meeting of November 1982 to endorse proposals for a new multilateral trade initiative (Schott 1983). With the Reagan Administration deprived of the traditional mechanism of export politics, American frustration with the efficacy of multilateral market opening approaches correspondingly increased. The most immediate result was the emergence in Washington of a more favourable attitude towards free trade agreements (FTAs). The United States commenced negotiations on FTAs with Israel in 1983 and with Canada in 1986.⁸¹ Failure to advance multilaterally left bilateral mechanisms as the main channel for a rising tide of frustration with foreign trade barriers. Without the overarching

⁷⁹ See, for example, CEA (1983).

⁸⁰ In the case of Japan, Bruce Smart, who became Under Secretary of Commerce for International Trade in 1985, observes that in both Congress and the executive 'a lot of people thought that Japanese closure of markets caused the trade deficit'. The role of macroeconomic factors 'was not clearly understood ... The guy that understood it best in the administration was George Shultz, but on the other hand it was easy to blame the Japanese'. S. Bruce Smart, telephone interview with author, 19 July 1996.

⁸¹ Former USTR Brock notes that the GATT impasse resulted in 'a very different attitude about what we needed to do to construct the new trading system and we began to talk about free trade areas as models'. Brock, interview, 1996.

momentum provided by a multilateral negotiation, results on bilateral market access negotiations would become a litmus test for success or failure of the administration's trade strategy. Moreover, opposition to American plans to expand GATT's coverage meant that many Japan market issues could only be taken up in a bilateral context.⁸² The fact that the GATT was not moving forward in the first half of the 1980s, both in terms of liberalisation measures and coverage, fuelled the search by US officials for other ways of playing the game of export politics.

The Trade and Tariff Act of 1984, the first major piece of trade legislation since 1979, was notable for the absence of any fast-track authorisation for a new round of multilateral trade negotiations. The main features of the 1984 Trade Act were authorisation for the executive to negotiate an FTA with Israel, the renewal of the Generalized System of Preferences program, the amendment of Section 301 of the 1974 Trade Act to provide for executive branch self-initiation of cases against foreign trade barriers, and the instruction that the executive make an annual report of foreign trade barriers and their impact on US exports (Schwab 1994: 62). The institutionalisation of annual reports on foreign trade barriers underscored congressional frustration with the executive branch. According to Judith Bello, former General Counsel at USTR:

The fundamental idea which the administration found impossible to object to, and even more impossible to get anybody in the Congress to see the cause of concern, was to force the administration on an annual basis to catalogue trade barriers against US goods and services and intellectual property. And once you institute that catalogue on a systematic basis you have significantly increased the pressure on the administration to report on an annual basis what the hell they've done about each of those barriers. Because you have given the Congress a telephone book of problems from which they can then grill each trade representative. ... That single change was the beginning of the process of really holding USTR's feet to the fire to be more aggressive on trade policy.⁸³

Early 1985 saw congressional impatience with the Reagan Administration's trade policy reach new heights. Susan Schwab, then trade adviser to Senator John Danforth, outlines the mood at the start of the 99th Congress (1985-86):

The US trade deficit was rising to historic levels with few nonlegislative outlets for release of the frustration that had been building in Congress. Although "unfairness" in

⁸² James Murphy, a US negotiator in the early 1980s on legal services access and copyright protection in Japan, maintains that 'we'd always look for a GATT angle if there was one. But for the most part the kinds of problems we had were not susceptible to GATT actions. It just didn't cover them so we didn't find GATT that helpful'. James Murphy, interview with author, 8 July 1996, Washington DC.

⁸³ Judith Bello, interview with author, 26 July 1996, Washington DC.

the international trading system was no more prevalent at this time than at any other during the era, the tolerance of American politicians for it seemed to plummet. They were inundated by complaints about the high dollar and its impact on US exports and import-sensitive industries, with the message coming loudly from sectors normally in the forefront of the free-trade movement as from industries from which the politicians had come to expect it. While the size of the US trade deficit was a factor, its composition was even more so.

Industries that had never before experienced foreign competition in their home markets or faced an erosion of their international market share, brought their trade problems to the attention of politicians who had rarely given trade issues much thought (Schwab 1994: 64).

The administration began 1985 heralding a new framework for negotiations with Japan — the Market-Oriented, Sector Selective talks agreed to by President Reagan and Prime Minister Nakasone in early January. The MOSS proposal carried the stamp of the US Treasury Department that had recently concluded negotiations with Japan on financial market liberalisation and the internationalisation of the yen — the so-called yen/dollar talks (Frankel 1984). The proponents of MOSS saw it as moving beyond product-by-product negotiations that tended to deal only with specific government barriers that had been the subject of formal complaints. MOSS was geared to a handful of areas where a broader range of impediments could be addressed, including private sector as well as government-imposed barriers. But the Reagan Administration's new initiative generated a luke-warm response on Capitol Hill as it was becoming clear to the 99th Congress that the 1984 Trade Act offered negligible relief for American industry still burdened by the high dollar.

Before the MOSS talks made any tangible progress, the congressional mood towards Japan soured abruptly once more. The catalyst was President Reagan's decision in early March not to ask Tokyo for a fifth year extension of the automobile VER and Japan's subsequent announcement that the export restraint would be retained, but with the numerical limit raised by nearly 25 per cent. Congressional resolutions calling on the administration to retaliate against Japan's unfair trading practices followed in March and April. Both houses passed resolutions threatening retaliation against Japan whose bilateral surplus with the United States would reach \$50 billion in 1985. The Senate resolution, passed by a vote of 92-0, dismissed all previous US market access negotiations with Japan as 'largely unsuccessful' and asserted that 'the bilateral trade imbalance' was 'costing the United States hundreds of thousands of jobs every year'

(Destler 1986: 179).⁸⁴ Congressional confidence in the Reagan Administration's trade policy suffered a further setback in March 1985 when the President announced that he was appointing USTR William Brock to become the new Secretary of Labor. Brock's replacement, Clayton Yeutter, faced a barrage of demands for a tougher trade policy during his confirmation hearing before the Senate Finance Committee in June.⁸⁵

For the first time in the modern era of US trade policy, trade was shaping as a viable partisan issue in Congress as the Democratic Party looked for strategies to help it recapture control of the Senate at the 1986 congressional elections. In July 1985, Representatives Dan Rostenkowski (D, IL) and Richard Gephardt (D, MO) and Senator Lloyd Bentsen (D, TX) introduced legislation (H.R. 3035) to impose a 25 per cent import surcharge on countries like Japan that ran big trade surpluses with the United States.⁸⁶ Especially significant was the fact that Congressman Rostenkowski was Chairman of the House Ways and Means Committee and Senator Bentsen was the ranking Democrat on the Senate Finance Committee — two individuals and two institutional positions normally synonymous with trade liberalising measures. 'I know I've been a free trader all my life,' Bentsen stated in a *New York Times* op-ed article, but the United States must now accept its trading partners 'for what they are' and 'establish a trade policy built on results' (Dryden 1995: 309-310). Not surprisingly, Republicans controlling the Senate looked to demonstrate their own credentials as being tough on trade. In July, Senator Bob Packwood (R, OR) introduced a bill (S. 1404) requiring retaliation against Japan for its unfair trade practices. The Unfair Trade Practices of Japan Act of 1985 was a binding version of the resolution passed by the Senate in March.⁸⁷

⁸⁴ The House of Representatives adopted a similar resolution by a vote of 394-19. As Schwab (1994: 66) points out in the case of the Senate action, the resolution itself 'was not so unusual, since the Congress regularly passes nonbinding resolutions commending or condemning all manner of individuals, nations, and activities. Rather it was the speed and manner in which the resolution emerged that set it apart, offering a glimpse of tensions in the trade arena that were to characterize the period'.

⁸⁵ Yeutter recalled later: 'I just got an ear-full and it was very bitter; bitterness at the whole executive branch, including the White House. ... They didn't blame President Reagan personally because everybody loved President Reagan, but boy did they blame everybody else. They hated the State Department, hated the National Security Council (NSC), hated the White House staff. They felt that all these folks had a conspiracy to protect the interests of foreign countries and forget about US interests. So that was the psychology of the moment'. Clayton Yeutter, interview with author, 2 August 1996, Washington DC.

⁸⁶ Later versions of the bill sponsored solely by Representative Gephardt became known as the "Gephardt amendment" (Schwab 1994: 69).

⁸⁷ S. 1404 failed to reach the floor of the Senate in the 99th Congress, but it emerged later as the conceptual basis for "Super 301" in the Omnibus Trade and Competitiveness Act of 1988 (Schwab 1994: 67).

Soon after, President Reagan's rejection in August of an ITC recommendation for import relief to shoe manufacturers set off a storm of protest in Congress about the administration's trade approach. By September 1985, protectionist sentiment in Congress had mushroomed with over 100 protectionist bills on the congressional calendar, many directed specifically at Japan (Ahearn 1986, Destler 1986: 75).⁸⁸ Finally, the administration acted to stem the tide of congressional trade activism. September 1985 marked a watershed in American market opening policy with the Reagan Administration's embrace of Section 301 as a market-opening tool. In a speech at the White House on 23 September 1985, President Reagan outlined his administration's intent to self-initiate a series of 301 investigations — into Japan's barriers to cigarette imports, Brazil's information industry policies, and South Korea's restrictions on insurance providers. He also authorised accelerated action to resolve two existing 301 cases against Japan (leather quotas) and the EC (canned fruit) and announced a trade policy "strikeforce" to come up with further recommended targets. President Reagan pointedly made the case for fair trade declaring that he would not 'stand by and watch American workers lose their jobs because other nations do not play by the rules' (Dryden 1995: 311).⁸⁹

President Reagan's fair trade speech came one day after US Treasury Secretary James Baker unveiled the Plaza Accord in which the world's five major industrial countries — the United States, Japan, West Germany, France and Great Britain — agreed on concerted efforts to drive down the US dollar.⁹⁰ Baker had played an important role in the reorientation of US foreign economic policy from his position as chairman of the newly-created Economic Policy Council (EPC). It was Baker's EPC which finally decided that the US government should for the first time initiate Section 301 cases against foreign trade barriers rather than wait for private sector petitions. Secretary of State George Shultz was wary of the reaction of America's allies to such confrontational

⁸⁸ The congressional mood was exemplified by the rapid movement through the legislative process of a highly restrictive textile bill (H.R. 1562) introduced in March 1985. The so-called Jenkins bill easily passed both the House and the Senate in the (northern) fall, but the margins proved insufficient to override an eventual presidential veto (Destler 1995: 90).

⁸⁹ According to former US trade official William Piez, 'up until that point, a number of agencies in Washington had resisted the use of "fair" because they said it was cover for protectionism. But after Reagan made the statement these reservations were overcome. And whereas we used to say that market opportunities should be "equal, competitive and transparent", we started putting the word "fair" in'. William Piez, interview with author, 17 July 1996, Washington DC.

⁹⁰ James Baker had become US Treasury Secretary in February 1985 in a job switch with Donald Regan who became President Reagan's chief-of-staff.

actions, but Baker, Yeutter and Commerce Secretary Baldrige prevailed, arguing that an unambiguous signal had to be sent to Congress (Dryden 1995: 310).⁹¹ The Reagan Administration's September 1985 initiatives averted what might otherwise have become a wholesale congressional revolt against executive branch primacy on trade policy. As it stood, Congress had already embarked on a path towards new omnibus trade legislation designed to tie the hands of the executive with a more mandatory approach to targeting trade barriers of other countries — and especially Japan. In this sense, the September 1985 measures were, as Yeutter readily concedes, 'too little, too late'.⁹²

The Reagan Administration's embrace of Section 301 was an important turning point, ushering in a new policy environment more favourable to critics of Japan's trade policies. As Destler (1995: 127) observes:

Section 301 was "export politics" pursued by exceptionally aggressive means, a product of the egregious trade imbalance and frustration at foreign unfairness, real and perceived. And its most important single target was Japan. The administration worked, for policy and political reasons, to spread the pain among countries, but there was no doubt which country Congress had most in mind.

Japan was not singled out in actual legislation passed by Congress or by the executive branch's actions. As former USTR official Geza Feketekuty has noted, 'The decision was made that the administration had to get ahead of the pack; not just with Japan, but all across the board on enforcement of [Section] 301 issues in a much more structured way to keep the focus on the export side and off the import side'.⁹³ Yet, Japan remained the focus of the most intense US demands for new market access. Feketekuty associates the early part of the second Reagan Administration with the end of a pattern of 'political orchestration' associated with process-oriented negotiations with Japan up to that time.

Up to then it was really all a process of seeing what problems we could fix in order to keep the protectionists at bay when they complained about all these Japanese goods coming in. It was a political process — trying to manage a set of pressures, but do some good as well. After we had a sufficient number of rounds [with the Japanese government] we'd come up with a resolution on an issue that would help defuse it. ...

⁹¹ Baker's close aide at Treasury, Robert Zoellick, suggests that 'a wide range of people in the Reagan Administration had different views about what these [Section 301] trade actions amounted to. Some saw them as defensive, some saw them as bad in any form, and some really got into it'. Robert Zoellick, interview with author, 19 June 1996, Washington DC.

⁹² Yeutter, interview, 1996.

⁹³ Geza Feketekuty, interview with author, 22 June 1996, Washington DC.

The procedural change in itself appeared to be satisfactory in a way because it had solved the political problem. After 1985, that no longer became acceptable.⁹⁴

The four sectors identified for the MOSS negotiations in 1985 would be followed by a new set of targets at the start of 1986. Japan was clearly the focus of America's trade and competitiveness problems as US high-technology industries intensified efforts to secure new trade remedies against Japan. The political pressures surrounding a trade deficit in excess of \$50 billion in 1985 guaranteed that Japan would be the main target of the new aggressive bilateralism in US trade policy. Then USTR Clayton Yeutter observed later that the American trade policy community 'looked at the Japan situation as being the most difficult challenge. Everybody recognised that we had a major problem globally because of the trade deficit being so great overall, but the biggest chunk of that problem was the Japanese'.⁹⁵

Conclusion

In the first half of the 1980s, America's postwar trade strategy of process-oriented multilateralism was shaken by a crisis of legitimacy of the American trade policy regime. This crisis stemmed from the interaction of long-run change in the international position of the American economy and domestic macroeconomic policy decisions of the Reagan Administration. It would have long-lasting consequences in the form of higher protection for US industries, a resurgence of congressional activism in trade policy, and the embrace of aggressive bilateralism in market access policy. Given the scale of its competitive challenge and the size the bilateral trade imbalance, Japan would be the primary target of American grievances about unfair trade barriers. The trade regime crisis was critical in connecting external shocks to the policy regime with the second Reagan Administration's more aggressive bilateral market access policy and, ultimately, the rise of a results-oriented Japan policy. The following chapter probes more deeply into how the political struggle between key actors explains specific Japan policy innovations.

⁹⁴ Feketekuty, interview, 1996.

⁹⁵ Yeutter, interview, 1996.

4 Hardliners versus Free Traders

'The US government establishment went through a collective tutorial on Japan that was a unique experience'.

Maureen Smith, former Director, Office of Japan,
US Department of Commerce.⁹⁶

Introduction

The previous chapter argued that a crisis in the American trade policy regime was critical in conditioning a general shift towards aggressive bilateralism in US trade policy in the mid 1980s. That Japan would receive particular attention can be explained in part by the dimensions of its competitive challenge to the United States and by the growth in the bilateral trade imbalance. But why Japan alone would in time become the focus of a unique type of results-oriented market opening policy still is not explored adequately. While external shocks to the policy regime can be seen as the broad determinants of policy change, they have more trouble explaining the substantive content and timing of policy innovations. A more complete analysis of the evolution of US market access policy towards Japan highlights the role of human agency and choice in the policy-making process. This requires moving beyond a focus on the trade policy regime.

An advocacy coalition approach directs attention to the actors who constantly seek to control or reformulate the rules of the game, to claim the authority and resources of institutions, and to persuade centres of policy-making authority of the merits of their ideas and policies. As noted previously, advocacy coalitions are sub-regime groups comprised of state and non-state actors who interpret policy problems, identify cause-effect relationships and, ultimately, shape the content of state preferences. The postwar US trade strategy of process-oriented multilateralism embodied the regime power and preferences of a Free Trade-Good Relations coalition (free traders). The trade regime crisis of the 1980s would leave this coalition fragmented and reactive to an emergent Hardline-Japan is Different coalition (hardliners). The rise of a results-oriented Japan policy reflected the ascendancy of the hardliners over the free traders in the US policy-making process. A process of learning across the American trade policy community that

⁹⁶ Maureen Smith, interview with author, 18 July 1996, Washington DC.

Japan was different from other industrialised countries in terms of its international openness and responsiveness to process-oriented trade negotiations was one element of this ascendancy.

This chapter traces the development of a hardline coalition from the ranks of US trade officials, congressional actors, industry groups and manufacturing-oriented policy analysts in the late 1970s and early 1980s. Against the backdrop of a rising bilateral trade imbalance and intensified Japanese competition in high-technology products, heightened exposure of front-line US trade agencies to market access problems in Japan helped to crystallise the core hardline idea that Japan was different from other advanced economies in terms of its structural barriers to imports. But prior to the regime crisis reaching a head in 1985, the hardliners faced effective resistance from an alliance of free trade-oriented officials and economists, as well as policy-makers in the national security apparatus of the American state. To the free traders, the idea that Japan was sufficiently different to warrant a departure from process-oriented negotiations was either challenged on intellectual grounds, or considered irrelevant in light of bigger international and domestic challenges facing the United States.

The regime crisis was significant in elevating the hardliners to a new level of political and policy relevance and in weakening the position of the free traders. The MOSS talks, begun at the start of 1985, signified the transition by the second Reagan Administration towards a more structured and aggressive approach to Japan market access problems. This involved demands for more formal market access agreements and a widening network of US government actors with a bigger stake in securing results in the Japanese market.

NTT and high-tech targeting: Focal points behind-the-border

The late 1970s offer the most compelling, if inevitably arbitrary, point of departure for tracing the emergence of a hardline coalition in the American trade policy community. Through the Carter Administration (January 1977-January 1981), Japanese import penetration of the US market remained the most economically and politically salient dimension of US-Japan trade relations with large industrial sectors such as steel and automobiles under intense competitive pressure. American market opening energies were

concentrated largely on the multilateral Tokyo Round negotiation where NTBs of the major trading states, including Japan, came under much closer scrutiny. Japan's remaining formal trade barriers, in particular its quantitative restrictions on imports of leather, wood products and a range of agricultural products, were the main market access irritants at the time.⁹⁷

In 1977, policy-makers in the newly installed Carter Administration focused on Japan in the context of a sharp rise in its global and bilateral external imbalances (see Table 4.1). They argued that Japan's lagging domestic demand, rising external surpluses and import restrictions were incompatible with its increased responsibilities in the international economic system. The rise in the US merchandise trade deficit with Japan served as the most visible peg for claims that Japan enjoyed the benefits of relatively open access to US markets for its manufactured products, while restricting access for agricultural products in which the United States was relatively competitive. In what the US government hailed at the time as a landmark in bilateral economic relations, Japan agreed to a package of macroeconomic stimulus measures and improved access for beef and citrus products in the Strauss-Ushiba Agreement signed in January 1978.⁹⁸

Table 4.1 External Balances of the US and Japan (1970-80) \$billion

| | Global Current Account | | US-Japan |
|------|------------------------|-------|---------------------------|
| | United States | Japan | Merchandise Trade Balance |
| 1970 | 2.6 | 2.0 | -1.6 |
| 1971 | -1.0 | 5.8 | -3.7 |
| 1972 | -5.3 | 6.6 | -4.7 |
| 1973 | 7.6 | -0.1 | -1.9 |
| 1974 | 1.7 | -4.7 | -2.7 |
| 1975 | 17.9 | -0.7 | -2.8 |
| 1976 | 3.8 | 3.7 | -6.8 |
| 1977 | -15.1 | 10.9 | -9.7 |
| 1978 | -15.8 | 16.5 | -13.6 |
| 1979 | -0.1 | -8.7 | -10.6 |
| 1980 | 2.2 | -10.8 | -12.2 |

Source: IMF, *International Financial Statistics*, International Economic Databank, Australian National University.

⁹⁷ At the time, Japan retained 27 residual import quotas. See Komiya and Itoh (1988) for a detailed assessment of formal Japanese trade liberalisation in the postwar period.

⁹⁸ Destler and Mitsuyu (1982) describe this episode of macroeconomic diplomacy, while Sato and Curran (1982) analyse the beef and citrus negotiations.

Through 1977-78, new mechanisms providing for a more continuous, institutionalised dialogue between American and Japanese economic and trade officials were taking shape. One of these was the Trade Facilitation Committee (TFC) which included officials from the US Department of Commerce and Japan's Ministry of International Trade and Industry (MITI). The TFC was established in September 1977 to handle complaints from American industry about barriers to the Japanese market. It provided a new outlet not just for US firms with product-specific market access problems, but for career officials in the Commerce Department with considerable Japan-related experience who 'thought that, too often, the United States had wasted its political leverage in removing trade barriers of little consequence to overall trade flows' (Curran 1982: 198).⁹⁹

Against this backdrop, the negotiation surrounding the procurement practices of NTT begun in 1978 was an important early landmark in bringing Japanese behind-the-border policies and practices into sharper focus within the US government. These talks focused unprecedented attention of the STR's office, the Commerce Department and congressional actors on Japanese industrial organisation and high-technology policies. While the TFC had fielded a small number of complaints about NTT's corporate practices, formal negotiations arose not from an American industry complaint but from the Tokyo Round's attempt to establish a code for open-bidding procedures on government procurement. By the middle of 1978, each of the major GATT contracting parties had offered to place a certain amount of government procurement under the code. Japan's initial offer (\$3.5 billion) was considerably less than offers made by the United States (\$16 billion) or the European Economic Community (EEC) (\$10.5 billion). American officials requested that Japan increase its offer; specifically, that it go beyond procurement by central government ministries and place purchases of its state-owned corporations under the code. NTT immediately came under scrutiny as the largest such corporation with annual procurement amounting to \$3 billion. Hence, it was the size of NTT's procurement rather than any particular high-technology targeting or industrial

⁹⁹ The US-Japan Trade Study Group was formed around the same time. Comprised mostly of business representatives from both countries, it was designed as a more informal, analytical body to review bilateral trade issues and make recommendations to the respective governments.

policy measure which drew official American attention to NTT in 1978 (Curran 1982: 192).¹⁰⁰

At the time, NTT was a quasi-government body with a statutory monopoly over Japanese domestic communications services and equipment procurement. Although nominally under the supervision of the Ministry of Posts and Telecommunications (MPT), NTT was operationally autonomous, especially when it came to procurement decisions. Historically, it sourced the bulk of its purchases from a small “family” of four Japanese suppliers — Fujitsu, Hitachi, Nippon Electric Company (NEC) and Oki — and some 200 subsidiaries and affiliates.¹⁰¹ So-called “sole-source” procurement practices linked product development with product procurement from the NTT family to the exclusion of both foreign and other Japanese firms. Most European government-owned telephone systems followed similar closed procurement practices while American Telephone and Telegraph (AT&T), then a near-monopolist in the United States and the largest telephone company in the world, relied on its subsidiary, Western Electric, for around two-thirds of its equipment supplies. Hence, NTT’s close buyer-supplier relationships were not unusual when compared with practices in other national telecommunications markets.¹⁰²

NTT protests that other national telecommunications carriers followed similar procurement practices were met with US government complaints about the lack of sectoral reciprocity in the Japanese and American telecommunications markets. NTT’s political vulnerability stemmed from both the bilateral trade statistics and structural differences in the respective markets. In 1977, the US merchandise trade deficit with Japan had reached a new high and US imports of network telephone and telegraph equipment from Japan of \$35 million far exceeded US exports to Japan of \$4.5 million.¹⁰³ Moreover, Japanese telecommunications firms were seen to have benefited

¹⁰⁰ Former US Commerce Department official Maureen Smith confirms that initially ‘the truth of the matter is that nobody in the US government fully understood what NTT was all about. It was just a notion that they buy a lot of telecommunications equipment so they ought to be in [the procurement agreement]’. Maureen Smith, interview, 1996.

¹⁰¹ In 1977, the four major suppliers filled nearly 70 per cent of NTT requirements for communications equipment (Gresser 1980: 3).

¹⁰² Curran (1982: 187) states that while NTT’s practice of maintaining close relationships with a small number of suppliers was common, its practice of excluding foreign firms from the supplier network, including foreign firms with local subsidiaries, was unusual.

¹⁰³ US Congress, House Committee on Ways and Means (1979: 33).

greatly from regulatory developments in the United States.¹⁰⁴ By the mid 1970s, a series of court decisions in the United States had broken AT&T's monopoly of the US telecommunications market, both in terms of mainline services and interconnect equipment. This allowed a number of firms, including Japanese companies within the NTT family, to supply equipment to end-users who could plug into AT&T's central network. In addition, Japanese and other foreign firms had enjoyed the benefits of the patent licensing requirements placed on Bell Laboratories and of the constraints on Western Electric's capacity to compete internationally.

Even if access to US government telecommunications procurement was denied to Japanese suppliers, it was argued, they would still have an immense opportunity in the private sector American market, while American suppliers did not have similar access to the Japanese market (US GAO 1979). Okimoto (1986: 57) observes that the divergent industry structures at the time in the United States and Japan were 'entirely fortuitous but far-reaching'.

AT&T's structure and the international diffusion of Bell technology kept the barriers to new entry low not only for US companies but also for Japanese and foreign latecomers. NTT's structure, particularly the lack of a Western Electric counterpart and the intimate give-and-take relationship between NTT labs and private Japanese companies, provided Japan's private sector the opportunity to speed up the process of industrial catch-up. Japan as a latecomer happened to be the beneficiary of America's open structure and strict antitrust enforcement (Okimoto 1986: 57).

Rather than appearing fortuitous, US officials working on Japan trade issues saw NTT's organisational structure and procurement practices as a revealing insight into Japanese "industry targeting" — an arm of the Japanese government in cooperation with domestic firms restricting foreign access to a high-growth, high-technology sector and providing Japanese firms with a secure home market from which to export aggressively. As the American government's focus shifted from the overall quantum of NTT procurement to its high-technology component, NTT's standards and approval procedures and its

¹⁰⁴ In 1956, a US Department of Justice suit against the vertically-integrated Bell System and its parent company, AT&T, was settled by a Consent Decree which: (1) confined AT&T and its Western Electric subsidiary to domestic regulated telephone services; (2) constrained Western Electric to manufacture equipment solely for domestic use by the Bell System; and (3) forced the Bell companies to license their patents under reasonable and nondiscriminatory terms to all applicants.

extensive research and development (R&D) programs came under particular scrutiny.¹⁰⁵ Equivalent access to new technologies became another major area of contention as the scale of NTT's R&D programs and their wider importance for telecommunications and computer-related technologies came to be appreciated.¹⁰⁶

Former US trade official Maureen Smith recounts the wider lessons drawn from the NTT experience by US officials involved in the negotiations:

We started to get to know what NTT was all about. It was an excellent roadmap and learning experience to get into the broad, naked, blood-bleeding heart of Japanese industrial policy. When you started saying, for example: "How come you are not buying [American] semiconductors for manufacture of your telecommunications equipment?" Well the answer was really simple because of the fact that there are companies in the NTT family that manufacture all the semiconductors. ... Fujitsu, Hitachi etc. had all participated in joint research so they all knew the specifications that NTT needed in telecommunications equipment. ... It was just an incredible experience to walk through this dialogue with NTT and that started telling us an awful lot about what was really going on in Japan.¹⁰⁷

The interaction of experiences at the operational level of US-Japan negotiations with changing political imperatives at higher levels in the American trade policy process would prove a recurring theme in the emergence of the hardliners. Staff analysis by the STR's office, the TFC and the National Telecommunications Agency on the importance of access to the Japanese telecommunications market to the US industry began to filter up to more senior policy-makers in the Carter Administration (Curran 1982: 207). This new information intersected with demands on STR Robert Strauss to deliver a substantial high-technology component in the GATT procurement agreement in order to assure congressional ratification of the Tokyo Round in 1979. The domestic constituency Strauss needed to satisfy in the NTT negotiations was more conspicuous following the

¹⁰⁵ Criticism centred on NTT's reliance on detailed "design" specifications for equipment known only to members of the NTT family, rather than on more general "performance" specifications. Their impact was seen as especially severe on US firms attempting to sell high value-added telecommunications equipment such as PABX's (Private Automatic Branch Exchanges) into the Japanese inter-connect market, a part of the market in the United States where Japanese manufacturers had made significant inroads.

¹⁰⁶ NTT's main arguments against US demands for its inclusion under the GATT procurement code were that: (1) other national telecommunications monopolies were not being compelled to adopt open-bidding procedures, (2) standards were proprietary information which it should not be compelled to divulge, (3) non-family equipment would compromise the integrity of the Japanese telephone system because of poorer quality, and (4) technology developed in NTT-sponsored research may leak to foreign competitors if NTT lost control over product development (Curran 1982).

¹⁰⁷ Maureen Smith, interview, 1996. Prestowitz (1988: 260) would describe Smith, Director of the Japan Office at the Commerce Department through most of the 1980s, as one of only two 'sources of institutional memory' on Japan trade issues in the US government.

formation in April 1978 of a House of Representatives taskforce on US-Japan trade drawn from the powerful Ways and Means Committee. The taskforce spotlighted the NTT issue following a visit to Tokyo in November 1978 during which the congressmen encountered determined opposition to any move towards open-bidding procurement at their NTT meetings.¹⁰⁸ In a strongly-worded report in January 1979, the congressional taskforce concluded:

It appears that the Japanese are using their protected home market to improve their telecommunications technology while exporting as much as they can into the open American market. Since telecommunications is one of the industries "of the future", this type of one-sided and unfair trade competition is particularly serious.¹⁰⁹

The NTT negotiations remained deadlocked at the start of 1979 with the United States requesting the Japanese telecommunications carrier be placed under the procurement code in its entirety and Japan adamantly opposed to any such outcome. Due to NTT's significant autonomy, the Japanese government had considerable difficulty in establishing the grounds for negotiating flexibility.¹¹⁰ Only when the NTT dispute threatened to sour a May 1979 summit meeting between President Carter and Prime Minister Ohira did American and Japanese negotiators strike an interim deal in which both governments agreed on the goal of 'mutual reciprocity' in telecommunications with a deadline for a final agreement by 31 December 1980.¹¹¹ Japan proposed a new bargaining position in mid 1980 which divided purchases into three categories: one which applied competitive bidding procedures under the GATT procurement code, a second which provided for negotiated bids on general telecommunications equipment, and a third which included equipment still in the experimental or development stage to be handled under joint R&D programs. Although not satisfied with the assignment of products to each category, the United States accepted the basic framework.¹¹²

¹⁰⁸ During the delegation's stay in Japan, NTT President, Tokuji Akigusa, was reported to have remarked that the only things NTT would buy from the United States were "mops and buckets". Curran (1982: 201) notes that 'the mops-and-buckets story was widely circulated, especially in Japan, and, for the US officials, it came to symbolize NTT's uncompromising attitude, even though Japanese officials maintained that Akisuga had been misquoted'.

¹⁰⁹ US Congress, House Committee on Ways and Means (1979: 33).

¹¹⁰ Signs of flexibility appeared on both sides in the first months of 1979, but the United States rejected as inadequate an initial NTT procurement offer because it excluded purchases of items such as sophisticated digital-switching equipment and computers from open-bidding procedures.

¹¹¹ The United States indicated that it would deny Japanese firms access to US contracts under the GATT government procurement code unless a satisfactory deal on NTT was achieved.

¹¹² The final agreement saw NTT increase its offer in the open-bidding category from the earlier figure of \$600 million to \$1.5 billion with the residual \$1.8 billion in NTT procurement divided between the negotiated bids and joint research and development categories (Curran 1982: 235).

Announced in December 1980, the NTT agreement was designed initially to be in place for three years. But it became only the first in a series of difficult negotiations on access to the Japanese telecommunications market. In a scenario that would be repeated in many other contexts, the US government criticised Japan in subsequent years for following the 'letter' but not the 'spirit' of the NTT agreement (USTR 1982). With modest results gauged by sales of sophisticated American telecommunications equipment, the first NTT agreement left an imprint on US trade officials of the limits of purely process-oriented negotiations with Japan.¹¹³

In tandem with the NTT negotiations, the final two years of the Carter Administration witnessed a new level of American interest in the long-term sources of Japan's economic ascendancy, juxtaposed with increasing concern about falling US competitiveness. The politically-dominant trade issues continued to arise from Japanese import penetration in American markets for products such as steel and automobiles. But by the late 1970s, increasing evidence pointed to the loss of traditional US market share to Japanese competition in American, Japanese, and third country markets for high-technology products. Industries traditionally part of the free trade coalition in the United States began to make representations to Washington about the "structural" advantages enjoyed by their Japanese competitors. Building on the NTT experience, complaints about Japanese industry targeting in computers, robotics, machine tools and semiconductors received broad exposure in the American trade policy community for the first time.¹¹⁴ In this context, the American semiconductor industry was especially active in seeking to dramatise the role of industrial targeting in Japan's high-tech challenge to American industry.

Whereas US government officials and congressional actors were in the forefront of framing and publicising the case against NTT, the semiconductor industry's campaign against Japanese industrial targeting illustrates the importance of non-state actors in the hardline advocacy coalition. In both cases, the result was the same: to direct US

¹¹³ The American Chamber of Commerce in Japan (1997: 23-24) has described the first NTT negotiations as a 'pioneering effort' in the area of government procurement and noted that 'from the point of view of overall negotiations, the NTT case provided some valuable experience and precedents'. At the same time it quoted a former US trade official as saying that the agreement 'exemplifies that gradualism is often not a good course to liberalization'.

¹¹⁴ See, for example, US GAO (1979), US Congress, Joint Economic Committee (1980), Gresser (1980).

government attention beyond formal trade barriers to Japanese behind-the-border institutions and practices seen as unfairly favouring domestic high-technology firms. Of course, governments in both the United States and Japan had played active roles in the development of the semiconductor industry, albeit for different purposes.¹¹⁵ Following the invention of the transistor at Bell Telephone Laboratories in 1947, the US military seeded the growth and diffusion of American high-performance transistor technology in the 1950s through R&D funding and procurement. After the development of the integrated circuit (IC) in 1959, the market for ICs in the United States was dominated by military computer applications and the premium prices paid on military contracts facilitated the rapid application of IC technology to the commercial sphere.¹¹⁶ It was only after the mid 1960s that commercial computers became the primary market for American semiconductors. Defense-related support for the semiconductor industry declined sharply in the 1970s and by the end of the decade the standard of technology embodied in commercial applications far exceeded that used in defense systems.

Government laboratories in Japan were active in the early phase of semiconductor R&D in the 1950s, while MITI used its authority over foreign exchange to act as a gatekeeper to improve the terms by which Japanese firms gained access to foreign technology. Without a large military market, Japanese producers concentrated on applying existing technology to move rapidly into commercial applications, in particular consumer electronics. In the 1960s, Japanese firms pursued a successful export strategy centred on such products as transistor radios, tape recorders and televisions. In response, American producers at the technological frontier shifted into more advanced silicon transistors used in industrial and computer applications. In the mid 1960s, MITI launched an industrial policy to build a world-class computer industry in Japan in an effort to catch-up to the United States. Henceforth Japanese government support for the semiconductor industry was aligned with this broader goal. MITI's industrial policy included an outright ban on imports of advanced ICs, subsidised loans and tax credits for capacity expansion and an increase in semiconductor-related R&D subsidies. The technological gap between the United States and Japan remained, however, as the technological frontier shifted towards

¹¹⁵ The following overview of government involvement in the American and Japanese semiconductor industries draws heavily on Flamm (1996).

¹¹⁶ Over 70 per cent of integrated circuits manufactured in the United States went into defense and space applications in 1965 (Flamm 1996: 426).

replacing large numbers of chips with a smaller number of large-scale integration (LSI) chips, an area where American production technology was dominant.

Until the mid 1970s, American producers were able to rely on new technology to provide the basis for improved competitive performance by American producers vis-à-vis Japanese and European rivals manufacturing older products. Under pressure from the United States, the Japanese government liberalised formal trade and investment barriers in the mid 1970s at the same time as it increased subsidies to semiconductor R&D. NTT and MITI launched major Very Large Scale Integration (VLSI) research projects in 1975 and 1976 respectively, aiming to improve mass production technologies of high-volume chips used in the computer industry, in particular dynamic random access memory chips (DRAMs). These programs appeared successful in that by the end of the 1970s Japanese firms had closed the gap in many areas of semiconductor technology, extending the frontier in some.

The different development paths of the semiconductor industry in the United States and Japan gave rise to divergent industry structures which would become an important factor in future US-Japan disputes over semiconductor trade. In the United States, the large diversified electronics companies that invested heavily in the development of semiconductor devices in the 1950s were slow to make a major commitment to ICs. Aided by military contracts and relatively low capital requirements at the time, many small venture companies established a strong foothold in the American market and became instrumental in the development of semiconductor technology in the 1960s and 1970s. These so-called “merchant” producers specialising in semiconductor production became the prime movers in the political-economy of the American semiconductor industry. Alongside this group were the “captive” producers, firms such as IBM and, until the 1980s, AT&T which consumed virtually all of their semiconductor output without attempting to sell on the open market.¹¹⁷

In Japan, the bulk of semiconductors were produced by the semiconductor divisions of

¹¹⁷ By far the most important captive producer was IBM whose share of world semiconductor production, while declining, remained almost 10 per cent through the years of rising US-Japan trade tensions in the first half of the 1980s. As Flamm (1996: 20) points out, when it came to the definition of the US semiconductor industry, much of the empirical data fuelling policy debates omitted IBM.

large, vertically-integrated electronic systems companies (mainly manufacturers of communications equipment, computers and consumer electronics) which began producing semiconductor devices soon after the invention of the transistor (Okimoto, Sugano and Weinstein 1984). In the 1960s, the five largest Japanese computer producers — Fujitsu, Hitachi, NEC, Toshiba, and Oki, which were among the largest semiconductor makers in Japan — were also the main targets of MITI's industrial policy on computers. The capacity of the American merchant firms to define US-Japan semiconductor trade as a David and Goliath-type struggle of independent, market-oriented US firms versus large, structurally-advantaged Japanese conglomerates, with almost unlimited financial resources and active government industrial policy support, undoubtedly contributed to the level of economic friction in this high technology industry in the 1980s.

A group of American merchant semiconductor manufacturers formed the Semiconductor Industry Association (SIA) in August 1977, prompted in large part by Japan's emergence as a global force in industry capacity and processing technology. At the time, American semiconductor manufacturers still held an estimated two-thirds of the (non-communist) world semiconductor market, net earnings were in line with the US manufacturing industry average and Japanese imports accounted for less than 5 per cent of the US market (US Department of Commerce 1979). Given the comparative health of the American industry, STR Robert Strauss, as the Carter Administration's most senior trade official, accorded the California-based SIA a decidedly lukewarm initial reaction.¹¹⁸ The industry body subsequently took its case to Capitol Hill and in August 1978 convinced a Senate committee to request an ITC investigation into the competitive position of the US semiconductor industry. As if to vindicate the industry's concerns, by the end of 1979 Japanese manufacturers had successfully captured almost 40 per cent of the US market for 16K DRAMs after a shortage developed in that year for the most advanced semiconductor memory component then in quantity production (Flamm 1996: 139). In representations to executive branch officials and Congress, the SIA developed its case that the US industry was at a structural disadvantage relative to a coordinated Japanese

¹¹⁸ On the basis of interviews with industry executives and former US government executives, Flamm (1996: 138) records that: 'After a transcontinental pilgrimage to Washington intended to inform US Trade Representative Robert Strauss that "the Japanese are coming," semiconductor executives were reportedly dismayed to get a "so what?" reaction from Strauss'.

government-business industrial strategy.¹¹⁹ By 1980, American semiconductor manufacturers had succeeded in gaining a more sympathetic hearing for their grievances within the executive branch's trade policy agencies.¹²⁰

Inadequate market access in Japan was only one item on a long list of SIA complaints at the end of the 1970s. The more immediate concern of the industry was rapid Japanese import penetration and its main grievance at the time was the alleged imbalance in financial resources between US and Japanese firms. The SIA (1980: 38) claimed that 'the US semiconductor manufacturers are at a structural disadvantage in access to capital as compared to the Japanese and that this disadvantage coupled with the target product practice in Japan of focused export aggressiveness in the US and elsewhere abroad would put the semiconductor industry in dire competitive straits during the 1980's, unless public policy was invoked to prevent it'. As part of its evolving public policy strategy, the SIA enlisted Ambassador Alan Wolff, formerly Deputy Special Trade Representative under Robert Strauss, as its key adviser on trade policy.¹²¹ Among its activities, the SIA sponsored a major policy conference in June 1980 on *An American Response to the Foreign Industrial Challenge in High Technology Industries* which brought together semiconductor chief executives and several senior US government officials.

It is important not to overstate the impact of this first phase of the US merchant semiconductor industry's campaign to bring the US government's attention to its deteriorating competitive position vis-à-vis Japanese manufacturers. At the end of the 1970s, it remained one of America's healthiest industries and its case against Japan had yet to be tied concretely to policy instruments under US trade law. But in terms of the crystallisation of hardline thinking about Japan, the SIA was effective in dramatising for

¹¹⁹ For example, testifying on behalf of the SIA at hearings in October 1979, L.J. Sevin argued that: 'In a free market, the US semiconductor companies are competitive with any private companies in the world. We question, however, whether the Japanese semiconductor firms fairly fit the description of private enterprise. Rather, when we look closely at the Japanese companies, we feel that we are competing with the central Treasury of the Japanese government'. US Congress, Joint Economic Committee (1980: 21). See also SIA testimony before the US Congress, House Committee on Ways and Means (1980a).

¹²⁰ Late 1979 saw the first attempt by Commerce Department officials to establish a more systematic industry-government dialogue based around an inter-agency group at the assistant secretary level (SIA 1980: 24).

¹²¹ At STR, Wolff had chaired the inter-agency Assistant Secretary's Group on Japan. His subsequent influence as one of Washington DC's most high-profile trade lawyers reinforces the need to integrate both state and societal actors within the advocacy coalition approach.

sections of the US trade policy community the scale and speed of Japan's technological advance. It also laid the base for Japanese industry targeting to become a rallying point for hardline critics of Japan in later years. More narrowly, the SIA was able to test which arguments could or could not withstand scrutiny in the American trade policy process.¹²²

An increasing bilateral trade imbalance, the NTT negotiations and the alarm bells rung by the SIA ensured wider and deeper scrutiny of Japan by those parts of the US trade policy community most sensitive to industry complaints about unfair foreign government practices and lack of sectoral reciprocity. Still, within the state policy-making apparatus most hardliners were concentrated at a relatively low level of the Carter Administration. Moreover, the generalised complaints about Japanese industrial targeting and close buyer-supplier relationships had yet to be linked effectively to specific trade policy remedies or actions. For example, after extensive hearings into the semiconductor industry in 1980, the House Ways and Means Committee taskforce on Japan trade issues concluded that Japanese behaviour did not offer 'any clear evidence of the *traditional* types of unfair trade practices' and that the hearings 'have probably raised as many questions as they have answered'.¹²³

Remarks by Undersecretary of Commerce Robert Hertzstein, the ranking US government official at the June 1980 high-technology policy conference sponsored by the SIA, underscored how generalised claims about Japanese "structural advantages" still represented new policy territory in an official process reliant on a formal adjudication of unfairness. Hertzstein argued that:

I think the government needs to ask questions and then take concrete action. I think we ought to start exploring what are the factors that affect the competition in global markets. Is it capital? Is it access to technology? Is it market access? Is it access to engineers? Is it innovation and flexibility? Is it language? We must then ask to what extent those factors are equally available to the different players in the game, to what extent access to specific resources is affected by the location of the company's ownership or by the location of its headquarters, or its manufacturing facilities. When we can get that understanding, we will have an idea of what's fair and what's unfair. To some extent, we may decide that on some of these it's just a matter of each company making the best use

¹²² In particular, claims about the industry's special economic status — that semiconductors were the "crude oil of the 1980s" and also that it was a uniquely volume-driven industry with market share as the overriding determinant of future industry competitiveness — received sustained exposure and ultimately became influential in US government circles (US Congress, Joint Economic Committee 1980: 15).

¹²³ US Congress, House Committee on Ways and Means (1980b: 40).

of the opportunities that it finds. For others, we may find that there's an element of unfairness there (SIA 1980: 58).¹²⁴

Traditional tariffs and NTBs remained the major market access irritants in the bilateral relationship and on this score there was recognition that Japan had taken steps to liberalise its economy. In October 1979, the General Accounting Office released what to that point was one of the most wide-ranging official reports on US-Japan trade relations. It concluded that the sharpest policy contrast between the two countries was that Japan encourages its strong industries while the United States protects its weak ones. Based on seven industry case studies, the report restated traditional NTB complaints about Japan's complex distribution system and rigid design and safety standards, while being equally critical of structural trends in the American economy and the domestic market orientation of US industry (US GAO 1979).¹²⁵ The second report of the House Ways and Means Committee taskforce on Japan trade released in September 1980 adopted a conspicuously moderate tone describing Japan as 'a reasonably open market for many products, other than certain agricultural and high-technology items'.¹²⁶ Stronger congressional criticism accompanied a House of Representatives resolution (H. Con. Res. 376) in November 1980 calling on Japan 'to assume a greater sense of responsibility for the trade deficit'. But, with the exception of NTT, the policy focus was on formal quantitative restrictions on products such as beef, citrus, lumber, tobacco and leather goods.

The broader American political context underlines the relatively low priority attached to Japanese trade barriers and the low stakes in aggressively pursuing market access issues. In terms of the size of trade flows and current employment in the United States, disputes over beef and citrus access and NTT during the Carter Administration were far less

¹²⁴ This early phase of the SIA campaign illustrates the degree to which its message had yet to make a major impression. SIA trade adviser Alan Wolff recalls: 'I was on a Joint Economic Committee panel after I left government [in 1979] and there was this semiconductor guy talking about industrial targeting and no-one in the room had a clue what in the world he was talking about. ... They had this notion that you go to Washington and tell the guys, whoever is in the room, and Uncle Sam will take care of your problem. Well Uncle Sam went on to think about getting hostages out of Iran, or whatever Uncle Sam was worried about'. Alan Wolff, interview with author, 22 May 1996, Washington DC.

¹²⁵ NTT was deemed 'an exception to liberalization' in Japan rather than representing a norm of intractable structural barriers in the Japanese economy.

¹²⁶ The taskforce commented that 'it has become increasingly clear to us, and to many businessmen dealing with Japan, that our trade problems result less and less from Japanese import barriers, and more and more from domestic, American structural problems of competitiveness and quality' (US Congress, House Committee on Ways and Means 1980b: iv).

visible than disputes over Japanese exports of steel and automobiles (Destler and Sato 1981: 351). At higher levels of the US executive branch, the conventional wisdom remained that trade disputes with Japan could not be allowed to damage the overall US-Japan relationship. The Free Trade-Good Relations coalition that had dominated the institutional positions and policy thinking of US administrations since Franklin Roosevelt remained dominant in the Carter Administration. Finally, Japan market access problems and trade issues in general were all but invisible during the presidential election campaign of 1980. Moreover, given that Republican candidate Ronald Reagan's winning platform undertook to follow a more market-oriented approach to economic affairs, those seeking a more activist American government response to the competitive challenge of Japan could seemingly take little comfort from the result (Drew 1981).

The report released in January 1981 by the Japan-United States Economic Relations Group (the so-called "Wise Men's Group") serves as a useful marker of this early phase in the American trade policy community's puzzling about the Japan problem. Commissioned by President Carter and Prime Minister Ohira in May 1979, the group comprised senior private sector figures from business and academia, as well as former high-level officials from each country. The group was asked to recommend ways of ensuring a healthy bilateral economic relationship in the future and its report drew widespread praise for its balanced, but candid, assessment of US-Japan trade issues. Key members of the Ways and Means Committee's international trade subcommittee urged the incoming Reagan Administration to make the report 'a keystone in its approach to Japan, so that disputes may be reduced and bonds strengthened between our two nations during the next four years' (Japan Economic Institute of America 1981: 45). Among the relevant conclusions of the Japan-United States Economic Relations Group (1981) were that:

— 'there needs to be a better understanding of the reasons for trade and current account imbalances. There have been serious adverse consequences of a continued, narrow United States focus on the bilateral trade imbalance' (v).

— 'In terms of tariffs and quotas, the Japanese market is as open as the American market for comparable manufactured goods' (x).

— 'In terms of government procurement practices, foreign investment rules, entry of services, and procedures for standards, inspections and testing, Japan's market is not as open as the American market and more needs to be done to liberalize market access in Japan's own national interest' (x).

— ‘There are special difficulties for foreign business in Japan from more intangible factors such as administrative procedures, traditional business customs and mores, and cultural and social barriers to foreign influence’ (x).

— ‘It is impossible to measure how “open” any nation’s market is. [But] ... the Group believes that Japan is not yet as “open” as the United States to foreign imports, capital, and influences. On the other hand, Japan appears to be generally meeting its international obligations to provide equal national treatment in those areas where there are treaties or international trade codes, and in this sense, Japan is playing according to the rules’ (55).

— The “Japan, Inc.” image ‘presents a very false and misleading impression of the Japanese economy. It is also harmful to United States-Japan economic relations because it creates the false impression that Japan can manipulate exports and imports at will. Business does not meekly respond to government fiat nor is government the creature of business’ (61).

— ‘How administrative guidance affects foreign trade is not clear. In recent years, there has been little evidence of government pressure to restrain imports. Much more prevalent have been government efforts to restrain exports, as in the case of Japanese automobile exports to the United States. In this case, the industry has apparently paid little attention to the government’ (62).

It would be a mistake to overestimate this report’s influence, especially as it can be read as vindicating a range of perspectives on Japan market access. Its findings nevertheless mirror the limited impact on US trade politics at this time of arguments that Japan was inherently different in the way its economy operated. The report largely reinforced an orthodox free trader’s policy perspective that intervention in trade flows was inappropriate and to be discouraged, and that market access problems in Japan should be handled gradually, with minimal politicisation, and consistent with rules and norms of the multilateral trading system.

“Peeling the onion” and debating industrial policy

As noted in chapter 3, the most pressing trade issue confronting the incoming Reagan Administration was the American automobile industry’s demand for relief from Japanese imports. Japan drew no explicit reference in the July 1981 White Paper on trade policy released by USTR. The only hint of a more robust bilateral market access policy was the undertaking to seek new ways of dealing with government intervention not covered by the NTB codes negotiated in the Tokyo round.¹²⁷ A more deliberate approach would soon emerge with the Commerce Department seeking MITI’s agreement to upgrade the Trade Facilitation Committee to undersecretary level. The TFC was seen as reasonably

¹²⁷ US Congress, Senate Committee on Finance (1981).

effective in handling product-specific complaints, but officials at the Commerce Department were now keen to extend its mandate to cover more general topics such as industrial policy.¹²⁸ Consultations on a number of market access issues took place through 1981, and in November of that year USTR lodged a list of desired tariff and NTB reductions with the Japanese government in advance of formal sub-cabinet discussions the following month.

Prominent items on the list were tariff cuts on computers and computer parts, as well as long-standing demands for greater agricultural liberalisation, including a request to speed up the timetable for Japanese liberalisation of beef and citrus import restrictions. Some months earlier, Japan had moved to head-off bilateral tensions over semiconductors by accelerating planned tariff reductions to bring Japanese tariffs into line with American tariffs. Meanwhile, NTT's initial efforts at implementing the December 1980 agreement drew positive, or at least neutral, responses from US officials prepared at that stage to give the agreement time to work. Congress served as the focal point for a more confrontational approach with Senator John Danforth leading a push for stricter reciprocity with Japan.

In 1982, officials in Commerce and USTR sought to engage their Japanese counterparts more formally on a wider array of Japanese public and private sector practices claimed to be impeding US exports. At the April 1982 meeting of the TFC, Undersecretary of Commerce for International Trade Lionel Olmer proposed a long-range program to assess differences in American and Japanese industrial organisation and business practices and the obstacles to US exports created by administrative guidance, depressed-industry cartels and industry-targeting practices (Japan Economic Institute of America 1983: 49).¹²⁹ The widening of the American government's net beyond traditional tariffs and NTBs was further illustrated in November 1982 with the release by USTR of its most comprehensive inventory yet of Japanese trade barriers. This 85-page report

¹²⁸ As of December 1980, US commercial interests had filed 93 complaints against Japan with the American side of the TFC. Of these, 31 were dropped after review by the Washington TFC staff, and 61 were forwarded to the US Embassy in Tokyo. The Embassy, in turn, transmitted 22 for action by the Japanese side of the TFC. Of these, 16 cases were favourably resolved, one was withdrawn and five were in progress (Nanto 1982: 106).

¹²⁹ Olmer embodies both the emergence within the executive branch of a harder-line view of Japan and the fluid nature of the American trade policy community. Prior to entering the Reagan Administration, he had led Motorola's project to sell pocket pagers to NTT (Prestowitz 1988: 15).

included criticism of market access barriers resulting from Japanese industry targeting, regulated and unofficial cartels, government-sponsored cooperative research and development programs, administrative guidance and anti-trust exemptions. It also sought to frame the debate on Japanese structural barriers more broadly by pointing to the way in which *keiretsu* corporate groupings restricted market access in Japan. Releasing the report, Deputy USTR David McDonald warned that, 'The political consensus for free trade in the United States is badly eroded. If we are to rebuild it, quick action by the Japanese on its own announced measures, as well as agricultural liberalization, is vital' (USTR 1982: 2).

The view that Japan was different in terms of government intervention and the scale of structural, behind-the-border barriers to trade was becoming lodged firmly within the US government agencies with day-to-day responsibility for trade policy. Congressional testimony by USTR William Brock in June 1982 points to the evolution in official thinking about Japan, and its greater emphasis on behind-the-border barriers. Brock remarked that:

protectionism [in Japan] takes on so many different colorations. We started out with tariffs; we have pretty well dealt with tariffs. Then we came with [sic] nontariff barriers, and we have come a long way in dealing with some of those.

Now we have a new form of protectionism called industrial policy. And in industrial policy a government can skew patents to selected firms, it can skew capital systems so credit is available to some and not others. It can engage in all kinds of bureaucratic processes which allocate resources, talents, and government opportunities for contracts, priced high, which constitute an effective backdoor subsidy. All of those things can have an enormous protective impact.¹³⁰

Commenting on Prime Minister Suzuki's May 1982 liberalisation package before the same forum, Commerce Undersecretary Olmer claimed that it 'identified and thereby acknowledged a broad range of structural and other problems which inhibit imports. Attention will focus no longer on minor technical issues when seeking solutions to the overall problem. Nor will private business practices be described as having no effect on imports'.¹³¹ Deputy USTR David Macdonald told the same hearings that:

Although all countries have nontariff barriers, those in the Japanese market are unique in the extent to which they keep out imports from all over the world, not just the United States (49). ... we, nor the Japanese political leadership, have yet plumbed the essential

¹³⁰ US Congress, House Committee on Foreign Affairs (1982: 848).

¹³¹ US Congress, House Committee on Foreign Affairs (1982: 746).

market access problem which at the bureaucratic level can be described as institutionalized (51). ... Those who deal with the trade problem on a day-to-day basis find it to be primarily a structural imbalance, only partly resulting from other factors such as the yen-dollar ratio (52). ... Japanese NTBs represent a “difference in kind” compared with Europe. It is a mental attitude running through the entire Government and the business community, and less so, the retail public. To buy foreign where domestic is available, or to allow foreign importation where domestic competitive products are available is, I wouldn’t say unpatriotic, but something approaching that feeling (82). It is like peeling an onion. Behind those dozens [of barriers] we are not sure there are not more (85).¹³²

The peeling onion metaphor would become a constant theme of the hardline critique of traditional, process-oriented market access negotiations with Japan. The case that best exemplified this experience surrounded attempts by American firms to sell aluminium softball bats in Japan. Through the 1970s, all metal bats were designated “specified products” under Japan’s Consumer Product Safety Law with the requirement of an “s-mark” label to certify product safety. The Japan Softball League (JSBB) also established standards for a “JSBB-mark” for metal bats used in league games. American bat manufacturers looking to sell into Japan were refused JSBB certification when this was requested in 1980 and the American government took up the issue in the second half of 1981. In the liberalisation package announced by Prime Minister Suzuki in May 1982, the Japanese government endorsed the principle of foreign participation in setting product standards and testing procedures, and specifically that US metal bat suppliers be allowed access to the JSBB standard system. However, bat sales were still obstructed when the JSBB refused to change their standard that demanded a rubber or plastic plug be inserted in the base of all bats and that bats use a particular aluminium alloy not used in US bats. The United States argued that use of such “design criteria” and not “performance criteria” was contrary to the GATT Standards Code. But only after a further US government complaint and intervention by the Japanese government did the JSBB agree to approve US bats that met MITI’s requirements for obtaining the “s-mark” signifying a safe product.

¹³² US Congress, House Committee on Foreign Affairs (1982). The assertion that Japan was a more closed market than Europe was still seen by some as controversial at the time. Chairing the 1982 Foreign Affairs Committee hearings on US-Japan relations, Congressman Stephen Solarz (D, NY) registered his surprise at Commerce Undersecretary Olmer’s view that Japanese NTBs were greater than those in Europe. He stated that, ‘you are the first person I have ever heard argue that Japan has more nontariff barriers to trade than the European countries. Virtually everyone to whom I have spoken about this has said Japan has more than the United States, but not nearly as much as Europe’ (US Congress, House Committee on Foreign Affairs 1982: 750).

A more general problem was then exposed in that under the existing MITI procedures each imported bat had to be individually tested to certify compliance with standards and acquire the product approval labels. Only Japanese manufacturers could use the streamlined lot-inspection system that allowed for self-certification after a factory and its quality-control system had been inspected and registered. MITI interpreted Japanese law as prohibiting the inspection of foreign factories. In August 1982, American officials complained that the lot-inspection system was discriminatory and a violation of the GATT Standards Code that Japan had signed in the Tokyo Round.¹³³ It appeared that while Japan had signed the code and revised the general Japan Industrial Standards law, detailed customs procedures were left unchanged at a lower level within the Japanese bureaucracy. In its November 1982 inventory of Japanese trade barriers, USTR (1982) noted that ‘unless US producers opt for the burdensome dock inspection procedure, they cannot obtain the “s-mark”. Without the “s-mark” they cannot obtain the JSBB mark. Without the JSBB mark US bats cannot be used in official games and are not afforded the commercial advantage that goes along with carrying the JSBB mark’. After further bilateral consultations and a signal by the American government that the case may be taken to GATT dispute settlement, the Japanese government agreed to bring its detailed procedures into line with the Standards Code across a range of areas. But it was 1984 before MITI published the standards and application procedures applicable to imported metal bats and began to register US factories. In a final gambit, the JSBB tried unsuccessfully to block approval of the “s-mark” by attempting to require three years of testing in league games before the mark could be granted.¹³⁴

Among US trade officials, the peeling onion experience encapsulated a widely-shared perspective on the distinctiveness of the Japan market access problem. A steady stream of complaints and frustrating negotiations had uncovered numerous problems at low levels of the Japanese bureaucracy where decision-making on access for foreign products was often slow, arbitrary and opaque. This meshed with cultural and attitudinal explanations of Japanese resistance to imports. But for the emergent group of Japan

¹³³ Article 7 of the code required that foreign and domestic suppliers of similar products receive equal treatment under certification systems, while Article 5 required the same conditions of inspection apply to foreign and domestic products.

¹³⁴ In interviews for this study, a number of former US government officials made reference to the symbolic importance of this case and its contribution to mounting frustration with the deep-seated nature of Japanese market access problems. For a more detailed discussion of this episode, see Rapp (1986).

hardliners, the problem went well beyond a legacy of regulatory controls, recalcitrant low-level parts of the Japanese bureaucracy and cultural import resistance. The Japanese government was seen as having mastered the art of industry targeting with a highly coordinated strategy to displace American industry from the commanding heights of the international economy. This in turn was alleged to threaten American high-wage jobs, technological ascendancy and potentially long-term national power and security. Government-directed industrial policy, research cartels, administrative guidance, anti-trust exemptions and the like were viewed as a continuation of past Japanese mercantilism by means other than traditional tariffs and quotas.

Most active within the executive branch in the US Commerce Department, the hardliners despaired at the naivety of the Reagan Administration's free trade philosophy at a time of continually rising US trade deficits with Japan and deterioration in the competitiveness of US high-technology industries. Prestowitz's (1988) account of his period as Counselor for Japan Affairs to the Secretary of Commerce in the Reagan Administration is the exemplar of the views and policy frustrations of the hardliners in the first half of 1980s. He also identifies clearly the degree to which Congress formed a critical part of the hardline coalition in US-Japan trade negotiations.

Congress is the central institution in negotiations between the United States and Japan. Were it not for Congress, it is unlikely that there would be any negotiations at all. All postwar US administrations have been reluctant to press hard for US commercial advantage and have hesitated to enforce US trade law.

... national security issues are seen as far more important than a few dollars' worth of trade. Thus, denied significant assistance from the executive branch, those injured by imports or unfair trade turn to Congress, which — because it cannot help by negotiating directly itself — usually responds to the complaints of its constituents in the only way it can: by introducing bills that threaten to impede the entry of foreign goods into the US market.

The reigning administration normally responds by labeling such measures "protectionist" and hastening to negotiate, not primarily to solve the problems but to give an appearance of progress so that Congress, not really wanting to act beastly to US trading partners, will find an excuse to keep from doing so.

... In this way, successive administrations have hoped to demonstrate to Congress that they are doing "something", and to Japan that they are not violating free-trade doctrine any more than political reality necessitates. The game is complex and is played at several levels: sometimes congressional threats are real; sometimes they are merely to frighten reluctant administrations into action; and sometimes an administration asks to be frightened so that it can then point to the danger of congressional action as a negotiating tool (Prestowitz 1988: 250-251).

The rising bilateral trade deficit, the early 1980s recession and the structural problems of American manufacturing industry provided fertile political ground for the hardliners in the administration, Congress and the most trade-sensitive parts of the US economy. Also important in the codification of hardline ideas was the stream of analysis challenging orthodox economic interpretations of US-Japan trade based on the principle of comparative advantage. An increasing number of manufacturing industry-oriented policy analysts sought to provide an alternative interpretive framework of US-Japan economic relations based around the postulated role of industrial policy in Japan's economic success. This work sought to highlight Japan's capacity to use industrial policy to shape comparative advantage, in contrast with American commercial policies seen as reactive and backward-looking. In an American policy context, debate tended to range loosely around whether Japanese industrial policy should be punished because it was unfair or emulated because it was successful. Favouring punishment were a range of business organisations and companies seeking relief from Japanese imports (including the SIA, the Labor-Industry Coalition for International Trade, and the US Trade Policy Council). A number of academic analysts leaned towards some form of emulation (including John Zysman, Stephen Cohen and Chalmers Johnson of the University of California at Berkeley, Ezra Vogel at Harvard University, Bruce Scott and Robert Reich at Harvard Business School and Lester Thurow at Massachusetts Institute of Technology).¹³⁵

The free traders: Keeping the hardliners in check

During the first Reagan Administration, the hardliners faced strong and effective opposition to their efforts to draw the US government away from traditional, process-oriented market access negotiations with Japan. According to the former Undersecretary of Commerce Lionel Olmer:

The people that entered the Reagan Administration at a senior level in the national security apparatus and economic policymaking apparatus were ideologically committed to a pure free trade policy — I'm thinking of David Stockman, George Shultz and Don

¹³⁵ See Lincoln (1984: 55) for a comprehensive study of Japan's industrial policy and its relation to US policy debates in the first half of the 1980s. For a sample of the literature from analysts who sought to spotlight the importance of industrial policy to Japan's economic success, see Magaziner and Hout (1981), Johnson (1982), Magaziner and Reich (1983), Reich (1983), Zysman and Cohen (1983) and Zysman and Tyson (1983). Noble (1989) provides an excellent survey of the academic debate on Japanese industrial policy.

Regan. And so the mind-set was clearly one of believing that companies who complained about the lack of market access are essentially whiners seeking a government hand-out or government assistance to achieve for them what they should have been able to achieve for themselves.¹³⁶

Prior to the trade regime crisis, the Free Trade-Good Relations coalition successfully contained any movement towards a results-oriented market access policy. This coalition held that, notwithstanding frustrations surrounding market access barriers in Japan, neither the economic nor the political stakes for the United States warranted any radical departure from traditional process-oriented negotiations. As one pillar of this alliance, supporters of free trade on intellectual grounds tended to see American trade problems with Japan as largely self-inflicted and/or much less important than the large domestic economic challenges facing the United States. The second group, concentrated in the national security apparatus of the American state and the postwar internationalist foreign policy elite, was concerned principally to avoid trade tensions with Japan that might jeopardise American global military-security objectives, primarily containment of the Soviet Union. For this coalition, special pressure on Japan to assure sales of US products was contrary both to market-based rules of the international trading system *and* to America's broadly-defined foreign policy interests. The idea that Japanese economic institutions and policies were sufficiently different to warrant an unorthodox market access policy was either challenged on intellectual grounds, or considered largely irrelevant when set against the more important domestic and international policy challenges facing the United States.

Informed by orthodox economics, the dominant view among the free traders was that the Japan problem was either a political problem, or a macroeconomic problem of America's making rather than one caused by Japanese barriers. The presumption that free trade invariably was the best trade policy independent of the policies of other countries was a powerful orienting idea for this group. A number of propositions tended to follow from this free trade policy paradigm. First, just as any Japanese barriers to trade were primarily to the detriment of the Japanese economy, so the United States would be the loser from any restrictive actions against Japan. Second, a bilateral US trade deficit with

¹³⁶ Lionel Olmer, interview with author, 31 May 1996, Washington DC. Stockman, Shultz and Regan were, respectively, Director of the Office of Management and Budget (OMB), Secretary of State and Secretary of the Treasury in the first Reagan Administration.

Japan had few if any implications for American economic prosperity which depended fundamentally on domestic sources of economic growth and productivity. And third, any Japanese actions to reduce trade barriers would have negligible impact on the trade imbalance in the absence of changes in underlying macroeconomic variables such as national savings, investment and exchange rates. Hence, the (small) economic stakes for the United States did not warrant: (1) protection for American industry faced with intense competition from Japan; (2) narrowly-defined reciprocity policies which would block Japanese access to the American market as retaliation against Japanese barriers; or (3) other US government action to interfere with outcomes in the Japanese market in favour of American industry. In the early 1980s, free traders gave little credence to arguments that there was something inherently different about trade with Japan that would justify new forms of policy intervention to distort trade flows.

Vigorous opposition to the Japan hardliners on economic grounds in the first Reagan Administration came from such agencies as the US Treasury Department, the CEA and the OMB.¹³⁷ The CEA was especially assertive in various policy debates seeking to explain the underlying determinants of Japan's trade surplus in manufactures, arguing against the continued emphasis of US policy on the bilateral trade imbalance, and challenging claims about the threat to US interests of Japanese behind-the-border practices. In its 1983 annual report, the CEA (1983: 57) devoted considerable attention to US-Japan trade issues arguing that:

Japan runs a huge surplus in its manufactured trade, while the United States runs only a small one, and Japan also has a large surplus in its bilateral trade with the United States. These facts are often attributed to Japanese trade restrictions which seriously hurt US businesses. Trade restrictions, however, do not in the long run improve the Japanese trade balance. ... they lead to offsetting increases in other imports or declines in exports. The main explanation of Japan's surplus in manufactures trade and in trade with the United States is that Japan, with few natural resources, incurs huge deficits in its trade in primary products, especially oil, and with primary producers, especially the Organization of Petroleum Exporting Countries (OPEC). The surpluses in the rest of Japan's trade offset these deficits.

Council member William Niskanen (1983: 74) reflected the traditional free trader's view on Japan's differentness and the effects of Japanese industrial policy:

¹³⁷ The State Department also maintained a strong policy commitment to free trade on economic grounds with George Shultz (an economist) as Secretary of State.

It is dangerous to suggest that it is not in our interest to trade with countries that do not have similar economic policies, or economic history, or institutions, or even language. Differences among countries are in some sense trade barriers; they are also a basis for comparative advantage. We should be very careful not to let our lack of understanding about the consequences of Japanese industrial policy lead us into a stricter form of reciprocity standard under which we restrict trade with countries that do not have regulations or antitrust policies or other economic policies like our own. I see little reason to export US antitrust laws or regulations, and I am not sure that I would want to import those of any other country. ...

I also think that we should be prepared to live with subsidies that are in some sense a part of the permanent policy of another government, except in those conditions in which strong national security considerations dominate. By and large, if other governments over a sustained period of time choose to subsidize some particular good or service in international trade, a share of the benefits of such a subsidy will accrue to us.

In addition to the free traders within the executive branch agencies, academic economists and free trade policy analysts in the think tank community sought to counter arguments for more interventionist US trade strategies. The free trade think tanks ranged across the political spectrum from the traditionally liberal Brookings Institution to the conservative Heritage Foundation, as well as more narrowly-focused institutions such as the Institute for International Economics (IIE). Via publications and regular appearances at congressional hearings, individuals from these privately-funded organisations attempted to steer public policy attention in Washington more towards US domestic policies, with less focus on sectoral reciprocity and industrial targeting grievances directed at Japan. Founding Director of the IIE and former Carter Administration Treasury official, C. Fred Bergsten, was especially active in making the case that a seriously overvalued dollar-yen exchange rate was the central factor underlying growth in the US-Japan trade imbalance and the political tensions associated with it. Bergsten's critique was directed at the Reagan Administration's macroeconomic policies and the resulting high US interest rates and exchange rate (Bergsten 1981, 1982a, 1982b). Policy analysts at the Brookings Institution including Charles Shultze, chairman of the CEA under President Carter, and former State Department official Philip Trezise, were prominent in challenging arguments about the scale and importance of industrial policy in Japan's postwar growth and its possible application in an American setting (Shultze 1983a, 1983b; Trezise 1983).

Academic specialists on the Japanese economy such as Professors Hugh Patrick (Yale University) and Gary Saxonhouse (University of Michigan) also sought to counter simplistic claims about the scale of Japanese trade barriers and government intervention

in the Japanese economy.¹³⁸ Saxonhouse in particular challenged the widespread view that Japan's relatively low level of manufactured imports was in itself evidence of uniquely restrictive Japanese barriers. Based on a multicountry, empirical model of international trade, Saxonhouse (1982, 1983a) concluded that the pattern of Japanese trade was well explained by a Hecksher-Ohlin framework based on orthodox international trade theory. He argued that Japan's distinctive trade structure compared with other industrial economies simply reflected how the Japanese economy's other attributes were also distinctive.¹³⁹ In a widely-cited paper delivered at a conference sponsored by the IIE in June 1982, Saxonhouse (1983a: 285) concluded that:

Most of the current emphasis placed on opening the domestic Japanese market to foreign product competition is misplaced. By the traditional indices of the international economic system foreign access to the Japanese market would have to be considered excellent. Indeed, when the distinctive endowments of the Japanese economy have been appropriately considered not only is foreign access good but so is foreign performance. By these standards foreign penetration of the Japanese market is equivalent to the experience of other major industrial economies.

In the debate on industrial policy, Saxonhouse (1983b) also cited evidence to show that by the beginning of the 1980s, Japan's direct industrial subsidies were negligible and special tax preferences were small by international standards. Saxonhouse argued that distinctive Japanese institutions and other forms of government intervention in Japan (e.g., direct influence on the size and composition of bank loan portfolios, government-business R&D programs and special aid through government procurement) were better thought of as substitutes rather than complements for functionally equivalent institutions in the United States. While it is difficult to argue that in isolation the Saxonhouse analysis was especially influential on the US policy process, it did provide a focal point for free trade-oriented actors in the American trade policy community looking to steer the US government away from greater intervention in US-Japan trade flows.¹⁴⁰

In coalition with those arguing for free trade on purely economic grounds, the second major source of opposition to the Japan hardliners during the first Reagan Administration

¹³⁸ See, for example, testimonies before US Congress, House Committee on Foreign Affairs (1982).

¹³⁹ 'No other advanced industrial economy combines such high quality labor with such poor natural resources at such a great distance from its major trading partners' (Saxonhouse 1983a: 273).

¹⁴⁰ See, for example, the statement by C. Fred Bergsten to US Congress, House Committee on Foreign Affairs (1982). Chapter 8 identifies how the conclusions drawn by Saxonhouse were challenged by other mainstream economists in the second half of the 1980s.

resided in the political-security policy apparatus. President Reagan had won office with a pledge to project a more assertive American defense and foreign policy posture backed by significantly increased military spending.¹⁴¹ The election of Yasuhiro Nakasone as head of the governing Liberal Democratic Party (LDP) and Japanese Prime Minister in November 1982 ushered in a new era of US-Japan high-level exchange on global issues. Prime Minister Nakasone's early and clearly-stated support for American defense and foreign policy objectives became the foundation for a much-touted personal rapport between President Reagan and the Japanese Prime Minister. The Williamsburg summit of 1983 would see 'an implicit extension of the Western security alliance to include Japan' (Frost 1987: 123). And in the interests of a more equal US-Japan security relationship, both governments also agreed in 1983 to permit the export of Japanese military technology to the United States and to promote the transfer of dual-use technology, capable of both commercial/civilian and military applications (Frost 1987: 131). At the Shimoda conference of September 1983, Secretary of State George Shultz used his keynote speech to argue that the time had come to think of US-Japan relations less in bilateral terms and more as an 'international partnership', a theme amplified by President Reagan in his November 1983 speech to the Japanese Diet.¹⁴²

Prior to the trade regime crisis, the relationship between US-Japan trade issues and security matters was essentially a continuation of the established Cold War pattern. The two sets of issues rarely if ever became entangled at the operational level of policy. Both political-military and trade officials tended to recognise that any specific problems would be handled in separate domains. But to an important extent this separation only served to underline the prevailing Cold War hierarchy between "high" and "low" foreign policy priorities and the institutional dominance of the Free Trade-Good Relations coalition. This was manifest in the limits on the types of trade action could gain the necessary inter-agency consensus in the US policy process. Richard Holbrooke (1991-92: 47), the

¹⁴¹ A strong Cold War prism confirmed Japan's strategic importance in containing the expansion of Soviet influence in the Asia-Pacific. In early 1981, the Reagan Administration began a campaign to persuade Japan to upgrade its self-defense capabilities in such activities as patrolling sealanes and defense surveillance. Executive branch officials tended to emphasise sharing of roles, missions and increasingly defense technology rather than specific Japanese defense outlays. See, for example, Dam (1984: 12).

¹⁴² See US Department of State (1984) for texts of addresses by President Reagan and Secretary of State Shultz. Prime Minister Nakasone's most famous statement of support came during his first visit to Washington DC as Prime Minister in January 1983 when he proclaimed Japan as an 'unsinkable aircraft carrier' for American policy in the Pacific (Nacht 1983).

Carter Administration's Assistant Secretary of State for East Asia and the Pacific, has described the Cold War pattern whereby:

if a trade negotiation appeared to be headed for collapse, the leaders of both nations would often step in to make a deal that would be justified on grounds that the only beneficiary from any crisis in Japanese-American relations would be the Soviet Union. This potent Cold War argument won the political or bureaucratic debate every time, although it annoyed many who thought it was invoked excessively or without proof.

Trade officials in the Commerce Department and USTR arguing for a more aggressive policy towards Japan certainly perceived that their capacity to pursue such a policy was constrained during the first Reagan Administration to the detriment of American commercial interests. Former Deputy USTR Michael Smith, chairman of the sub-cabinet Trade Policy Review Group (TPRG) through much of this period and the senior career trade official engaged in US-Japan negotiations, identifies the clear-cut divisions on Japan within the US government and the institutional checks on a more aggressive trade policy:

This town [Washington DC] was divided between the Chrysanthemum Club and the Black Ships Society. I didn't side with either of them, I just said I wanted to get into that market.

There were so many apologists. The State Department was owned by the Japanese. We used to call them the Japanese Embassy on 23rd Street. They would totally cave on us. I'm not faulting the NSC [National Security Council] as much as I fault the State Department. The State Department just had an acute case of clientitis — acute. ...

We had a lot of problems with the Department of Defense because they viewed Japan as their unsinkable aircraft carrier. One day in a Cabinet meeting we had [Defense Secretary] Cap Weinberger say that it was more important to have night landing rights for our pilots than it was to save the American semiconductor industry. There was a blindness on the issue.¹⁴³

Commerce Undersecretary Olmer provides a similar perspective pointing to the influence of policy-makers with:

genuine beliefs that leaving aside the question of creating jobs through building products in this country and exporting them, Japan was far more important to the United States for security reasons and that it was far more important to engage Japan in an ongoing relationship of the deepest sort in preparing for the 21st century. ...

¹⁴³ Michael Smith, interview with author, 10 May 1996, Washington DC.

The view was that: "I know there may be problems for some American companies, but I really think we need to work these things out cautiously. Don't break eggs; figure out another way to make an omelette".¹⁴⁴

Based on his time in the Reagan Administration, Prestowitz (1988: 269-270) provides a more caustic reading of the motivations of the key foreign policy players with input into US trade policy. He argues, for example, that: the State Department thinks trade problems 'are mostly the fault of the United States and particularly of lazy US businessmen. It often works with the Japanese to "control the crazies" in the US government (that is, Commerce, the US Trade Representative and the Congress) and is sometimes a conduit of confidential information to Japan'; the US Embassy in Tokyo 'is even more supportive of Japanese positions than is the [State] department'; the National Security Council is 'an outpost of the State Department in the White House on these issues'; and the Defense Department is 'generally not pro-business' and mainly concerned 'to maintain a harmonious military relationship'.

The clearest illustrations of the relative positions of the Japan hardliners and the free traders during the first Reagan Administration arose in the area of high-technology competition and associated allegations of Japanese industrial targeting. Inter-agency discussions on the goals of the High Technology Working Group, established in 1982 to try to reduce trade tensions, pitted hardliners and trade pragmatists in Commerce and USTR against the free traders. Discussions in 1983 remained largely exploratory despite American concerns about Japanese dumping in the US market and low US sales in the Japanese market. Threats of Congressional action and private sector unfair trade petitions led the US to demand a second round of negotiations focusing entirely on market access for semiconductors. But to the dismay of the Commerce Department's negotiator, 'the invocation of free-trade doctrine by most of the US government agencies made it impossible to negotiate for concrete results' (Prestowitz 1988: 52).¹⁴⁵

The American machine tool industry would serve as the unlikely lightning rod for the debate over Japanese industrial targeting. In May 1982, Houdaille Industries (a Florida-based machine tool maker) filed a petition calling on the US government to deny investment tax credits on purchases of Japanese-made machine tools because of Japan's

¹⁴⁴ Olmer, interview, 1996.

¹⁴⁵ The HTWG's focus on semiconductors is examined in more detail in the next chapter.

alleged subsidisation of its industry. Under Section 103 of the Revenue Act of 1971 (an otherwise obscure tax provision) the President could exclude a foreign product from investment tax credits in the United States if it was determined that a foreign government burdened US commerce through the 'tolerance of international cartels'. Prestowitz (1988: 223) would later describe the 1000-page petition submitted by Houdaille Industries as 'the most comprehensive vivisection of Japanese industrial policy and trade practices undertaken to date'. It pointed to a history of trade and investment restrictions in the 1950s and 1960s and the emergence of a cartel of Japanese machine tool makers to counter liberalisation measures undertaken in the 1970s. The most controversial aspects of the case surrounded the extent to which the Japanese government, and in particular MITI, actively shaped and subsidised the industry so that it became a cartelised sector targeting exports to the US market (Dryden 1995: 292). USTR and the Commerce Department backed the Houdaille case against Japan with congressional support, while Treasury, the CEA, and the State Department were the main opponents of any punitive trade remedy.

For the better part of a year, the Houdaille case ensured Japanese industrial policy received unprecedented scrutiny in Washington DC via numerous congressional hearings and official and non-official reports.¹⁴⁶ Houdaille's lawyer, Richard Copaken, used unconventional methods including videotaping supposed collusion by executives in the Japanese machine tool industry and 'exposing' a special Bicycle Racing Fund from which, it was alleged, MITI subsidised the machine tool industry with proceeds from bicycle and motorcycle races in Japan. As Dryden (1995: 292) notes, 'American TV and newspaper reporters latched onto Copaken's thesis, and Houdaille's case was soon enjoying a wave of favourable publicity'. Japan hardliners in the US government saw the Houdaille petition as a critical test case for mounting a more far-reaching official response to Japanese industrial policy. In a January 1983 memo to Commerce Undersecretary Olmer, Prestowitz stated that, 'Some positive action on this [Houdaille] petition would be a wonderful way to keep the pot stirring ... It would create uncertainty on the part of the Japanese not only with regard to machine tools, but also with regard to robotics and other targeted industries' (Dryden 1995: 292-293). Critics of the case within the Reagan Administration charged that US machine tool makers were in trouble largely

¹⁴⁶ See, for example, US GAO (1982a), US GAO (1982b), Wheeler, Janow and Pepper (1982), US ITC (1983).

due to their own mismanagement and the 1981-82 recession, and that a favourable decision for Houdaille would open the door to a flood of requests for import relief from US industries. They also argued that the case threatened to undermine long-standing US policy in multilateral forums which opposed the use of tax measures to affect trade flows.

As debate continued into 1983, Houdaille's claims came under greater scrutiny and the drive to pursue the remedy of rejecting tax credits weakened. At a cabinet-level meeting in January 1983, USTR Brock made the case for a finding of unfairness against Japan, but reportedly proposed a negotiated settlement more along the lines of a VER (Prestowitz 1988: 225). Even hardliners such as Prestowitz conceded by this point that the Houdaille petition 'may not be a perfect case, ... [but] there is probably no such thing ...; the nature of industrial policy is such that it is very difficult to find smoking guns' (Dryden 1995: 293). With the inter-agency process deadlocked over a finding or a recommended action against Japan, President Reagan on 22 April 1983 rejected the Houdaille petition citing his belief in free trade and his regard for Prime Minister Nakasone's efforts to expand Japan's defense role. Instead of official action on the petition, the President directed that a special series of industrial policy talks be held to determine whether Japan's industrial policies had an adverse effect on US trade. Reflecting the hardline perspective within the Commerce Department, Maureen Smith notes that 'with the Houdaille case we had learned a good deal about Japanese industrial policy and targeting. ... If that had not been short-circuited, the whole subsequent history might have been very, very different and it might have been the most effective policy tool to grapple with Japanese industrial policy'.¹⁴⁷

The subsequent industrial policy dialogue between USTR and MITI moved the issue of Japanese industrial policy into a setting which offered Japan hardliners no clear result or path towards an active US government policy response. Former US trade official William Piez who participated in the talks recalls the informal style and inconclusive outcome of the process:

We would sit with the Japanese for hours and talk about their industrial policy and ours. They were interesting and useful talks in part because they didn't have a specific

¹⁴⁷ Maureen Smith, interview, 1996.

negotiated result. The idea was just to understand things better and people didn't fret too much over documents. ...

The objective was really to determine whether Japanese industrial policy was trade distorting. Did it make them more competitive than they would otherwise be without government intervention in the process? ... I guess the conclusion of those talks was: "Maybe, but it's hard to prove". And they were reciprocal in that the Japanese would go after us on such questions as whether the Defense Department was subsidising the manufacture of semiconductors.

So although in form there were distinct differences, and the Japanese were quite frank that their industrial policy was intended to make them more competitive as exporters, we were presumably making the world safe for democracy and becoming more competitive as a by-product.¹⁴⁸

A strengthening US economy through 1983 eased the industrial policy debate into the background of US-Japan relations. The high-profile market access issues of that year — new demands for beef and citrus liberalisation and renewed criticism of low telecommunications imports under the NTT procurement agreement — tended to confirm the prevailing constraints on policy, despite the hardening opinion towards Japan in some US government agencies. Even these demands were checked temporarily in the second half of the year by the guardians of good relations with Japan — a signal of American support for Prime Minister Nakasone in upcoming Diet elections, and a gesture to smooth relations pending President Reagan's visit to Japan in November 1983. The only substantive announcement on economic issues during the visit related to Japanese capital market liberalisation. And in the wake of the visit, Vice President George Bush was enlisted to oversee inter-agency coordination on Japan policy as the White House looked to place bilateral trade frictions within a broad foreign policy context (Japan Economic Institute of America 1984: 12).¹⁴⁹

Soon after President Reagan's visit to Japan, American and Japanese officials renewed negotiations on NTT procurement and beef and citrus liberalisation given looming expiry dates for the existing agreements. The first NTT agreement failed to meet US government expectations as judged by the lack of major sales of high-technology

¹⁴⁸ Piez, interview, 1996.

¹⁴⁹ While head-of-state visits are invariably occasions for friendly speeches and pledges of mutual support, President Reagan's speech before the Japanese Diet in November 1983 was an exemplary papering over of bilateral trade differences. For instance, reflecting on Japan's historical drive to catch-up with the United States, President Reagan noted: 'I don't think I'll be making headlines when I say, you've not only caught up in some cases, you've pulled ahead. [Laughter] Here again, our partnership is crucial. But this time, you can be teachers' (US Department of State 1984: 65).

equipment during the three-year life of the agreement (US GAO 1983). NTT purchases of foreign telecommunications equipment had remained below 2 per cent of total procurement in the period following the December 1980 agreement (US ITC 1983: 6). In its November 1982 statement on Japanese barriers, USTR (1982) noted that no sales of high technology products had taken place due to what it described as the 'closed loop' between NTT and its suppliers. Those inside the loop were seen to benefit from economies of scale, cost and risk reduction and advances in production technology associated with industry targeting. In response to sustained criticism by USTR Brock, NTT took a series of initiatives in March 1983 in which it committed itself to accept bids in English and not just Japanese, to accept bids at its New York office instead of only in Tokyo, and to extend the application period for bids on more sophisticated telecommunications equipment. A new three-year accord was concluded in late January 1984, but only after the United States dropped demands linking renewal of the NTT agreement to changes in Japan's satellite development and purchasing policies. The new agreement provided for greater opportunities for involvement by foreign firms in NTT R&D programs for sophisticated telecommunications products and more regular agreement reviews.¹⁵⁰

The second NTT agreement was soon overshadowed in early 1984 by MPT's draft legislation to partially deregulate telecommunications services in Japan that included plans to privatise NTT. This opened the way to prolonged negotiations over reciprocal access in telecommunications, especially given further moves towards deregulation in the United States with the divestiture of AT&T in 1984. The main focus of these broader negotiations was Japanese regulations on the market for computer communications systems, otherwise known as value-added networks (VANs). By the second half of 1984, American concern over NTT procurement centred on whether a privatised NTT would continue to be bound by the government-to-government agreement. Other ongoing market access complaints pursued by the United States in bilateral negotiations in 1984 included tariffs on forest products, Japanese regulations on cigarette pricing and import distribution, the status of a group of 13 agricultural quotas, access to the legal profession in Japan and tariffs on a range of products — paper and forestry products, agricultural

¹⁵⁰ The satellites dispute centred on the domestic content procurement policy of Japan's National Aeronautics and Space Development Agency under the 1978 plan for self-reliance in space technology (US-Japan Trade Study Group 1984: 54).

machinery, alcoholic beverages and wine (Dam 1984). In negotiations on a new beef and citrus agreement, Japan resisted American demands for full liberalisation, but agreed in April 1984 to increased quotas on imports of beef, oranges and orange and grapefruit juice over four years (Japan Economic Institute of America 1984, 1986).

Regime crisis, MOSS and new policy thresholds

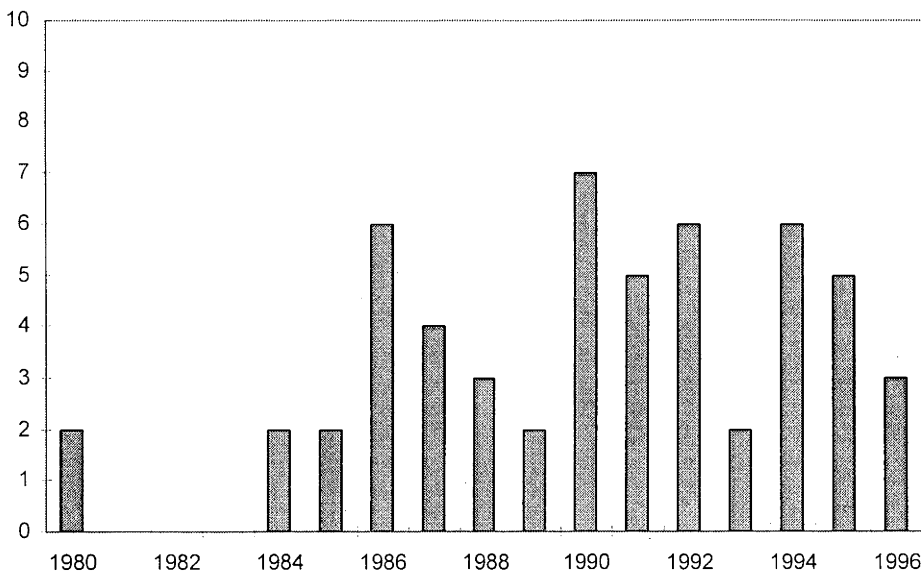
While the first Reagan Administration gave increased attention to select areas of high-technology and services trade, its approach remained one slanted heavily towards Japan's formal, product-specific trade restrictions on, for example, beef, citrus, leather, wood and tobacco products. Few *new* government-to-government agreements were negotiated.¹⁵¹ The first half of the 1980s saw a series of Japanese liberalisation "packages" which many free traders in the American trade policy community hoped would solve at least some complaints of corporate America. As one analyst has noted, when originally conceived:

the package approach seemed brilliantly designed to suit the taste of a people captivated by kits and how-to-do-it devices. By the seventh such package, however, American patience had worn thin. Each new collection of import-liberalizing measures announced by the Japanese Government seemed to confirm the alleged barrenness of concessions offered in the last one (Frost 1987: 13-14).

The trade regime crisis and policy turning point reflected in President Reagan's Section 301 initiatives in September 1985 relaxed the institutional checks on the hardliners. It paved the way for a more structured and aggressive approach to market access problems with a much greater emphasis on formal agreements linked to US trade law. The long-lasting importance of the trade regime crisis can be seen quantitatively in terms of the increase in US-Japan market access agreements beginning with the MOSS process. Figure 4.1 shows the jump in the number of bilateral agreements after 1985 as the US government adopted a more deliberate policy of negotiating formal agreements. Six market access agreements were secured in the first half of the 1980s. The next decade would see about 50 agreements signed.

¹⁵¹ The 1983 High Technology Working Group measures on semiconductors and the financial market agreement following the yen-dollar talks were the only new agreements negotiated by the first Reagan Administration. The administration renegotiated agreements with Japan on NTT procurement, beef and citrus liberalisation and bilateral air services.

Figure 4.1 US-Japan Bilateral Market Access Agreements



Source: Office of the US Trade Representative, various documents.

Premised on the need to address more systematically than hitherto the peeling onion phenomenon, MOSS was a deliberate attempt by free traders to deflect overt results-oriented strategies proposed by the hardliners. A January 1985 meeting between President Reagan and Prime Minister Nakasone offered scope for a broad reassessment of Japan market access issues within the Reagan Administration — what Prestowitz (1988: 296) would describe later as ‘the next round in the debate over process versus results’. A proposal favoured by USTR and Commerce Department officials that President Reagan ask Prime Minister Nakasone to set a target for imports attracted significant pre-summit speculation. An inter-agency coalition of free traders, including the political-military agencies, opposed such an approach as a violation of market principles and eventually won endorsement for the more process-oriented MOSS framework.¹⁵² The idea was to broaden negotiations away from specific products to a select group of industries and to address the full range of impediments seen as denying comparable market access to American producers. Following the Reagan-Nakasone summit, four areas were selected for the first round of MOSS negotiations —

¹⁵² *International Trade Reporter*, 1(24), 19 December 1984, p. 757. *International Trade Reporter* 2(1), 2 January 1985, p. 8. See also Prestowitz (1988: 296) and Mikanagi (1996: 44). Then Treasury official Robert Fauver maintains that ‘it was the structure and style of the yen/dollar talks that we used as the model for the MOSS talks and convinced the USTR and Commerce to follow that kicking and screaming’. Robert Fauver, interview with author, 2 June 1996, Washington DC.

telecommunications, medical equipment and pharmaceuticals, sophisticated electronics, and forest products. These targets had two characteristics in common. First, American suppliers appeared competitive in other international markets, yet had trouble making sales in Japan. Second, domestic regulatory practices were identified from past negotiations as barriers to comparable market access.

The broad foreign policy orientation symbolised by the Reagan-Nakasone relationship saw Secretary of State George Shultz and his Japanese counterpart, Foreign Minister Shintaro Abe, charged with oversight responsibility for the MOSS talks at the start of 1985. The State Department's Undersecretary of Economic Affairs, W. Allen Wallis, led the sub-cabinet talks with negotiating responsibilities parcelled out to other agencies: USTR acted as the lead negotiator in electronics, the Commerce Department in telecommunications, Treasury in medical equipment and pharmaceuticals, and the Agriculture Department in forest products. At the first MOSS sub-cabinet talks in late January 1985, Undersecretary Wallis explained that the American goal was to address the full range of 'laws, regulations, institutions and customs that could impede free access for foreign suppliers' (Japan Economic Institute of America 1986: 69).

The telecommunications sector quickly emerged as the main focus of bilateral negotiations as US officials demanded greater harmonisation between Japanese standards and certification procedures for telecommunications equipment and the more liberal regulatory approach in the United States.¹⁵³ Reforms to Japan's telecommunications laws timed to take effect on 1 April 1985 provided a *de facto* deadline for progress in MOSS.¹⁵⁴ By late April, Japan agreed to a range of measures to increase transparency in the development of telecommunications regulations, to liberalise equipment standards on issues such as voice quality and signal strength, and to accept foreign testing results in the certification of telecommunications network equipment.¹⁵⁵ Progress in other areas, including a second round of telecommunications talks centred on radio communications, proceeded more gradually through the (northern) spring and summer of 1985. The electronics sector negotiations included US proposals for intellectual property protection

¹⁵³ Congress also focused heavily on the telecommunications negotiations. Since the early 1980s, Senator John Danforth had led efforts to pass sectoral reciprocity legislation in telecommunications.

¹⁵⁴ For accounts of Japanese telecommunications reform in the 1980s, see Tomita (1992), Choy (1995) and Steven K. Vogel (1996: 137-166).

¹⁵⁵ *International Trade Reporter*, 2(17), 24 April 1985, p. 564.

of computer software and semiconductor designs, which carried over from talks in 1984, and demands for foreign participation in Japanese R&D programs and standards-setting groups. The medical equipment and pharmaceutical negotiations targeted Japanese acceptance of foreign test data in registering foreign products and the streamlining of procedures for the clearance and sale of such products. A July 1985 action program announced by the Japanese government dealt with a number MOSS-related measures, but slower progress was recorded in the politically-sensitive forest products sector with Japan holding out against demands for significant tariff cuts.¹⁵⁶

The September 1985 response by the Reagan Administration to the congressional trade backlash tied the White House more directly to MOSS and to securing identifiable market access improvement in Japan. In addition to the new Section 301 measures, President Reagan instructed Secretary of State Shultz to 'seek time limits on the current discussions with Japan designed to open access to specific Japanese markets, at the end of which specific commitments will be evaluated and follow-up procedures begun' (White House 1985). President Reagan's announcement also dashed any hope Japanese officials may have had that the December 1985 MOSS deadline would provide some respite from American market access demands. With protectionist trade bills (including many with a specific Japan orientation) still pending on Capitol Hill, the White House noted that the United States would 'take the initiatives necessary to achieve more equitable access in a number of foreign markets, particularly in Japan and major developing countries'. The Reagan Administration foreshadowed that after Japanese commitments in the four original MOSS areas had been secured 'new sectors will be added that offer the promise of expanded US exports'.

Citing 'important progress' from the MOSS process, American and Japanese officials announced agreements across all four negotiating areas on 10 January 1986.¹⁵⁷ MOSS can be seen as part of an evolutionary response by the American policy process to the Japan problem, formalising a shift in emphasis away from border barriers and towards domestic regulations and practices. As noted previously, the January 1986 MOSS agreements also set a new benchmark for detailed, formal market access agreements tied

¹⁵⁶ Mikanagi (1996: 115-124) provides useful chronologies of progress on each sector.

¹⁵⁷ *International Trade Reporter*, 3(3), 15 January 1986, p. 82. US officials identified the telecommunications and medical/pharmaceutical agreements as the most successful.

to US trade law with a stronger emphasis on institutionalised monitoring. Finally, the wider distribution of bureaucratic responsibility in MOSS ensured that traditional free trade agencies (the State Department and the Treasury as well as the White House itself) assumed a more direct stake in securing identifiably successful bilateral agreements. A resurgent Congress was the larger institutional force behind the Reagan Administration's September 1985 policy reaction that strengthened the authority of the hardliners and trade pragmatists in the US policy process. But at the same time, MOSS helped to erode of the sort of executive branch divisions on Japan policy characteristic of the first Reagan Administration. Former Deputy USTR Michael Smith recalled later that MOSS served a useful purpose by ensuring other agencies 'would get engaged in looking at the difficulties'.

And then they would get disgusted by what they saw; that was fine. So MOSS actually turned out to be fairly effective. It had the effect of deflecting some of the hard-asses — like [Commerce Department officials] Clyde Prestowitz and Lionel Olmer — and it kept the trade ball in play. State chaired one, Agriculture another — collegiality and all that crap. But in the end, even the State Department had to admit that the more they peeled off the layers of the onion, the more the problem was exposed. Eventually everybody knew Japan was a problem. Even the apologists knew it was a problem.¹⁵⁸

Conclusion

The high political salience of the Japan problem by 1985 reflected the rise of a hardline coalition challenging the dominant position of free traders in the US policy-making process. With increased exposure to Japan market access problems, the idea that Japan was different from other industrialised economies in terms of the scale of structural, behind-the-border barriers to imports was lodged firmly within US agencies with day-to-day responsibility for trade policy. The regime crisis weakened the institutional checks on the hardliners and paved the way for a more structured and aggressive approach to market access problems in Japan. The MOSS process demonstrated a new emphasis on formal agreements tied to US trade law and formed part of the transition to a selective results-oriented approach through the second Reagan and Bush Administrations. The following chapter explores the most dramatic example of this policy in the form of the 1986 US-Japan semiconductor agreement.

¹⁵⁸ Michael Smith, interview, 1996.

5 The Semiconductor Agreement: A Hardline Landmark

Introduction

The September 1986 semiconductor trade agreement was the most significant precedent in the rise of a results-oriented market access policy towards Japan and perhaps the most controversial US trade policy action of the 1980s. The agreement illuminates key dimensions of America's trade policy regime crisis, in particular Japan's rise as a powerful high-technology competitor to the United States and America's new aggressive bilateralism after 1985. More narrowly, it would become a critical landmark in the evolution towards a results-oriented market access policy towards Japan. The agreement represented a comprehensive managed trade response by US policy-makers determined to protect an industry seen as critical to America's future competitiveness and, at some level, its national security.

The market access dimension of the agreement, in particular a secret numerical target set at 20 per cent of Japan's semiconductor market, was a dramatic departure from traditional process-oriented market access demands by the United States. President Reagan's March 1987 decision to impose punitive trade sanctions against Japan for allegedly violating the agreement (the first such sanctions since World War II) demonstrated the US government's new policy purpose to secure concrete results in sectoral trade agreements with Japan. While trade conflict was never far from the surface of US-Japan relations in the 1980s, this series of measures was, as one analyst has noted, 'unprecedented for its swiftness, severity, and agreement with industry recommendations' (Yoffie 1988: 83). This chapter looks at how this agreement came about and its immediate aftermath.

As outlined in chapter 4, the US semiconductor industry's arguments against Japanese industrial targeting were in many ways a template for the policy network of hardliners inside and outside of the US government in their attempt to influence US trade policy towards Japan. This chapter traces the industry's campaign to enlist the US government's support for its trade policy objectives vis-à-vis Japan from the early period of the Reagan Administration through to the March 1987 sanctions decision. This provides a window into the shift in trade policy authority towards the hardliners and pragmatists in the US

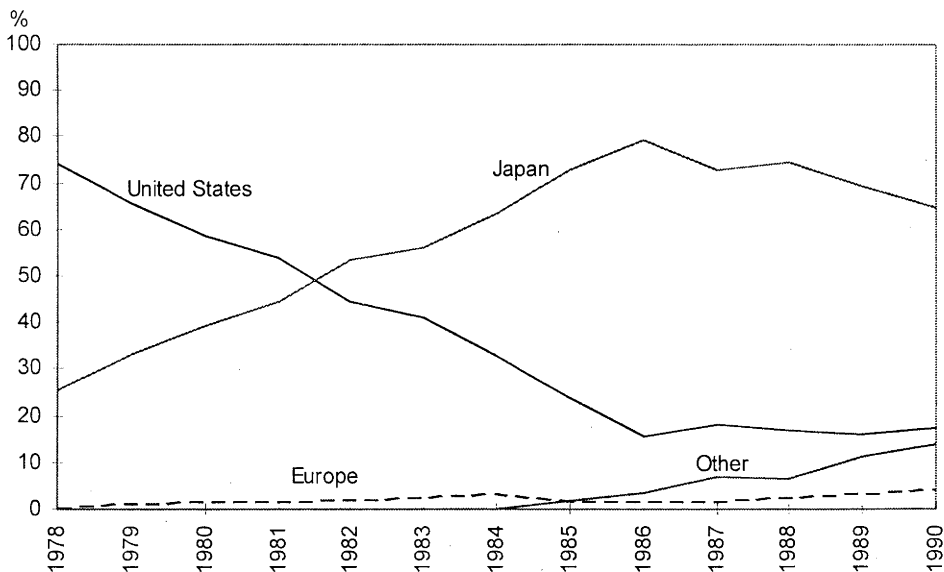
policy process and away from the free traders and national security guardians traditionally supportive of non-confrontational, process-oriented negotiations with Japan.

The numerical target demand was not the product of any systematic reassessment of Japan policy by the US government. In part, it reflected the political and bureaucratic cover that the trade regime crisis provided for a small group of officials to pursue a radical policy outcome. Still, over time the hardline premise of the agreement and the subsequent retaliatory action — that process-oriented negotiations with Japan in previous years had yielded little genuine market access — would encounter less and less opposition within the US policy community. Indeed, the semiconductor agreement would become a focal point for hardline attempts to legitimise a results-oriented policy towards Japan.

Japan's DRAM dominance and the High Technology Working Group

The major Japanese electronics firms surged to a position of global parity or leadership in semiconductor processing technology, cost competitiveness, product quality and innovation in the early 1980s. The most dramatic eclipse of American semiconductor dominance occurred in the memory chip market, specifically the market for DRAMs. Japanese firms captured around 40 per cent of the US market for 16K DRAMs in the late 1970s (Borras, Millstein and Zysman 1983: 219). They in turn surpassed many US merchant firms in the commercial development of the 64K DRAM chip, while NTT and NEC displayed prototypes of the first 256K DRAMs at the 1980 world semiconductor conference in San Francisco (Prestowitz 1988: 39). Japanese producers won about 70 per cent of the 64K DRAM market in the United States in 1981 (OECD 1985: 35). A key part of their competitive advantage appeared to be new benchmarks in quality control with lower semiconductor defect rates compared with their American competitors (Okimoto, Sugano and Weinstein 1984: 53). By 1982, Japanese firms' ascendancy in DRAM production was confirmed when merchant sales in Japan surpassed those in the United States (Figure 5.1). DRAMs accounted for less than 20 per cent of the total US semiconductor market at the time, but they were at the centre of the fast growing telecommunications equipment and computer markets. They also acted as critical

Figure 5.1: Shares in World Merchant DRAM Market



Source: Dataquest in Dohlman (1993: D5)

“technology drivers” for the semiconductor industry with learning benefits applicable to the production of other types of semiconductors and to future generation memory chips.¹⁵⁹ Thus it was hardly surprising that semiconductors moved to the centre of US-Japan trade conflict in the early 1980s.

Building on its initial foray into Washington trade politics during the Carter Administration, the SIA developed a three-pronged public policy wish-list in 1981 to meet the Japanese challenge. Two aspects were domestically-oriented: incentives for capital formation, and increased investment in R&D and engineering education. The third was increased foreign market access, and in particular the SIA requested for the first time that the Japanese government create an “affirmative action program” to offset the impact on foreign firms of past protection (Flamm 1996: 147). The SIA took its case to the newly-elected Reagan Administration whose initial response to the market access complaints was to negotiate accelerated mutual reduction in semiconductor tariffs with Japan.¹⁶⁰ Further initiatives were forthcoming on the SIA’s domestic priorities, but few in

¹⁵⁹ Historically, DRAMs with new design rules appeared six months before SRAMs (Static Random Access Memory Devices) and EPROMs (Erasable Programmable Read Only Memory devices), and two years before microprocessors, at the same design rules (Dohlman 1993: Appendix B).

¹⁶⁰ In May 1981, both countries agreed to accelerate Tokyo Round commitments and reduce semiconductor tariffs to 4.2 per cent by 1982 (Japan Economic Institute of America 1982: 55).

the Reagan Administration saw a case for more concerted trade policy action on the semiconductor industry's behalf. With the US economy headed into recession, other trade-sensitive sectors exhibited clearer signs of economic distress as the American semiconductor industry still accounted for over 50 per cent of world sales. Japanese import penetration amounted to only around 10 per cent of total US semiconductor sales despite the pressure of Japanese entry into the US DRAM market.¹⁶¹

A weakening in demand and a new round of aggressive Japanese semiconductor pricing prompted fresh complaints from some US producers in early 1982.¹⁶² Hardliners in the US Commerce Department warned their MITI counterparts that the US government may be forced to "monitor" chip prices and soon thereafter prices rose in response to Japanese cutbacks on exports to the United States (Prestowitz 1988: 49).¹⁶³ This episode led to the first formal semiconductor talks between the US and Japanese governments. In April 1982, the High Technology Working Group was formed to address bilateral trade issues in such sectors as semiconductors, telecommunications equipment and computers. As noted in the previous chapter, the main focus was on access to Japan's semiconductor market. This was largely because the US government had sold the HTWG to the domestic merchant semiconductor industry as an alternative to a dumping investigation (Flamm 1996: 153). As co-chairman of the American HTWG delegation, Prestowitz (1988: 51) later outlined the constraints that the US government inter-agency policy process placed on a hardline negotiating position.

Most of the key administration figures were not engaged. Although some of us thought otherwise, in the eyes of most of the cabinet this was a long way from arms control and Star Wars. Thus, there was no mandate to achieve anything specific. As a result, we had to operate within the bounds of a consensus obtained from the various agencies of the US negotiating team that included members of the Office of the US Trade Representative, the Council of Economic Advisers, the National Security Council, the Office of Management and Budget, and the departments of State, Labor, Treasury, Commerce, and Defense.

¹⁶¹ Then Commerce Department trade official Clyde Prestowitz (1988: 48) records that industry representatives 'got a reception as cool as the autumn weather in Washington. The lawyers, academic economists, and career bureaucrats who filled many key government positions shared a suspicion of business as protectionist and opposed to consumer interests. To them, the semiconductor industry seemed healthy: while it might have problems in one or two areas, over all it was 50 per cent bigger than the Japanese industry and remained profitable, while growing much faster than most US industries'.

¹⁶² The price of 64K DRAMs plunged from \$25 in the fourth quarter of 1981 to \$3 in February 1982. Motorola led complaints about unfair Japanese pricing in early 1982, but the SIA remained divided over any possible anti-dumping action (O'Shea 1995: 33).

¹⁶³ Flamm (1996: 149) writes that within the Japanese semiconductor industry 'these reductions in exports are openly acknowledged to have been spurred by MITI guidance'.

The consensus was that, while it was appropriate to request better market access, asking for a specific market share or sales volume would violate free-trade doctrine and hence be unacceptable. ... Thus before talking to the Japanese, we limited ourselves to asking simply for a more open market, whose meaning we did not define, and a system of gathering statistics on semiconductor shipments. Moreover, the consensus, strongly influenced by the State Department and the National Security Council, would not allow — even as a tactic — the suggestion of any retaliation if Japan did not respond favorably for fear that the overall relationship between the two countries might be harmed.

The first “Agreement on Principles” announced by the HTWG in November 1982 offered general support for free trade and investment in high-technology industries, called for equal national treatment in market access, and established a taskforce for semiconductor industry data collection.¹⁶⁴ Both the State Department and the Japanese Foreign Ministry’s Bureau of Treaties worked to water down the already-vague language in the original HTWG document while officials from the CEA, OMB and the Justice Department were on guard against anything that looked like government cartelisation of the semiconductor market (O’Shea 1995: 21). The United States pressed for a second round of talks in 1983 that again focused on semiconductor market access in Japan. The task reportedly set for US negotiators ‘was to get measurable sales without asking for them’ (Prestowitz 1988: 53). A second HTWG agreement announced in November 1983 set a timetable for semiconductor tariff elimination between the two countries, sought to enhance opportunities for investment, established procedures for improved intellectual property protection and institutionalised biannual governmental meetings to review semiconductor issues. And, for the first time, MITI undertook on behalf of the Japanese government to ‘encourage Japanese semiconductor users to enlarge opportunities for US-based suppliers so that long term relationships could evolve with Japanese companies’. A confidential “chairman’s note” set out a number of specific steps in this direction. Flamm (1996: 155) concludes that ‘US negotiators took these portions of the agreement to be a euphemistic articulation of an oral commitment by MITI to provide “administrative guidance” to Japanese firms to increase their purchases of US suppliers’ chips, and indeed the language of the confidential note would seem to support this proposition’.

The continued erosion of the American industry’s global position through 1982-83 saw

¹⁶⁴ Prestowitz (1988: 52) describes the November 1982 agreement as ‘more a monument to clever drafting than anything else’. The agreement was deemed to have the status of recommendations to the two governments and therefore not to have the force of law.

the SIA step up its campaign against Japanese industry targeting. The SIA's legal advisers drafted a Section 301 petition alleging unfair trade barriers in 1982, but the trade association stopped short of filing an official complaint. By 1982, the SIA had begun to frame its case against Japanese structural barriers, production and pricing practices more explicitly around claims of industry collusion and coordinated predatory behaviour, with the Japanese government in the role of providing administrative support and guidance (Flamm 1996: 152). In early 1983, the SIA released a major report entitled *The Effect of Government Targeting on World Semiconductor Competition: A Case History of Japanese Industrial Strategy and its Costs for America* which set out to 'describe the decade or more of coordinated effort by the Japanese government to put the Japanese producers in a dominant world-wide position in key product lines' (SIA 1983: v). With Japan accounting for around 30 per cent of global semiconductor sales, the SIA (1983: 90) emphasised the high stakes for the US industry in breaking into the Japanese market:

While the Japanese export drive in high density RAMs has had a dramatic and visible impact on a number of US semiconductor firms, a less visible but equally serious threat to US firms is posed by the continuing inaccessibility of Japan's domestic semiconductor market. The problem here is not only denied opportunities, but an increasing threat to US firms in *all* world markets because of their continuing inability to penetrate the Japanese market.

The report alleged that the Japanese government had systematically targeted the industry in three ways: (1) it had subsidised Japanese chip producers with various forms of direct and indirect aid leading to large capital investments and aggressive export pricing; (2) MITI had actively cartelised the industry structure by presiding over the formation of research cartels, encouraging product specialisation by firms, and supervising the industry structure to ensure that firms moved in a direction consistent with national goals; and (3) after formal liberalisation, the government had promoted and condoned "Buy Japan" practices to block import penetration by foreign firms. All of this, it was claimed, had resulted in an industry structure where 'supply *and* demand is controlled by an oligopoly of Japan's leading semiconductor producers, who have both the *incentive* and the *ability* to adhere to "Buy Japan" practices' (SIA 1983: 74). According to the SIA, this structure ensured that the American share of the merchant semiconductor market in Japan never exceeded 12 per cent for a sustained period of time despite formal liberalisation, a more favourable exchange rate relative to the era of high border protection, and repeated US company efforts to expand their sales to Japan. This performance was contrasted with

the success of US firms in Europe where they held 56 per cent share of the merchant market. The SIA highlighted what it claimed were cases where new American semiconductor products enjoyed initial strong export growth to Japan, only to see sales fall away once a similar Japanese product was introduced. The report recommended that the US government: (1) establish a monitoring system to give “early warning” of export drives and possible predatory actions by Japanese firms; and (2) insist on fully equivalent commercial opportunities in Japan, including a requiring the Japanese government to establish an affirmative action program to compensate for past discrimination (SIA 1983: 6).

The Electronic Industries Association of Japan (EIAJ) rejected the SIA analysis arguing that Japanese government policies were GATT-legal and no different from government industry policies in the United States. It claimed that no obvious disparity in market access existed given Japanese import penetration measured roughly 13 per cent of the US merchant market in 1983, broadly comparable with US market share in Japan of around 10 per cent. The Japanese industry also cited differences in product quality and services as critical factors underpinning preferences for Japanese products.¹⁶⁵ In the event, bilateral semiconductor tensions receded in 1984 amidst a mini-boom in semiconductor demand. Indeed, there were signs that the HTWG negotiations had assisted American industry in increasing sales from around 10 per cent of the Japanese market to almost 12 per cent. But this fragile truce would be shattered in 1985 — a year of acute bilateral trade tension which happened to coincide with one of the largest slumps in the history of the semiconductor industry.

Saving a “strategic” industry in crisis

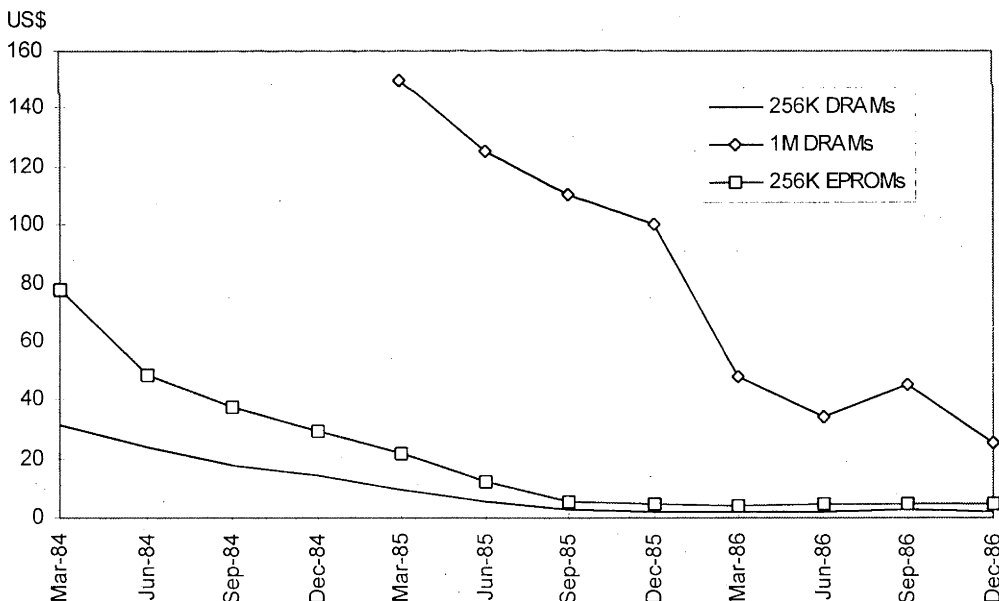
Precipitous falls in semiconductor demand and prices in 1985, plus the capacity of the large, vertically-integrated Japanese chip producers to sustain aggressive investment programs in the face of global over-capacity, drove events that culminated in the September 1986 semiconductor agreement. After rising by 27 per cent in 1983 and 46 per cent in 1984, the value of world semiconductor sales fell 17 per cent in 1985. The demand crunch was especially severe in the North American market where sales dropped

¹⁶⁵ *Inside US Trade*, 2(6), 10 February 1984, p. 5.

30 per cent compared with a 10 per cent decline in the Japanese market.¹⁶⁶ While the most proximate cause of the industry shakeout was a sharp drop in computer sales, pervasive unfair practices of Japanese manufacturers became the focus of the political reaction to the American industry's woes.¹⁶⁷ In the process, the American merchant semiconductor industry received the sort of high-level US government attention for which it had been clamouring since 1977.

The leading edge of the semiconductor crisis was once again the market for DRAMs where global merchant sales fell from a record \$3.6 billion in 1984 to \$1.4 billion in 1985 (Dohlman 1993: D5). Average prices for 64K DRAMs, the product in largest commercial production, dropped from between \$3 and \$4 in 1984 to a low point of 30 cents in June 1985, igniting charges of dumping and below-cost, predatory pricing by Japanese firms. Larger than normal "learning curve" declines in prices were also reported in merchant markets for later generation DRAMs and more sophisticated products (Figure 5.2).

Figure 5.2 Average Selling Prices (US dollars per chip)



Source: Dataquest; in Tyson (1992: 115, 122).

¹⁶⁶ Semiconductor Industry Association. www.semichips.org/stats.

¹⁶⁷ Irwin (1996: 35) identifies as the critical demand shock a decline in sales of microcomputers in 1985, a market that had grown five-fold from 1981 to 1984.

Japanese firms surpassed American merchant firms in the commercial development and production of 256K DRAMs as the latter struggled to earn the returns on other products needed to approach commercially viable output levels. Firms such as Intel, Motorola, Hewlett-Packard and AT&T still dominated markets for certain types of ICs such as microprocessors and read-only memories, but steep losses across a range of market segments undercut their capacity to cover R&D costs and sustain investment. By the (northern) spring of 1985, US semiconductor firms had laid off thousands of workers, shortened working hours for remaining employees, mothballed capacity and wound back new investment programs.

For the US semiconductor industry and its hardline allies in the US government, a fall in market penetration in Japan only confirmed their scepticism about the gradualist, low-key approach undertaken in the HTWG negotiations. Falling sales to the Japanese electronics groups saw the US merchant firms' share of the Japanese market drop from around 12 per cent to once again below 10 per cent. Japanese firms attributed at least part of the import decline to the incapacity of American firms to fully sustain fast delivery and customer service in line with the surge in industry demand in 1984.¹⁶⁸ But for the hardliners, it confirmed the need for the United States to press for specific results in agreements backed by a credible threat of retaliation. As one analyst has noted, the experience of the HTWG 'made US semiconductor makers and their representatives adamant that they would never again settle for vaguely worded agreements that were based on trust rather than sanctions' (O'Shea 1995: 23). The Commerce Department official most directly involved in the HTWG talks concluded subsequently that 'the new "long-term relationships" [with Japanese firms] had lasted less than a year' citing a drop in US sales to Japan of 30 per cent at a time when overall Japanese demand fell 11 per cent (Prestowitz 1988: 54).¹⁶⁹

By February 1985, the SIA's legal advisers had again sounded out trade officials on the US government's reaction to a Section 301 unfair trade case. This time they received encouragement in this direction from USTR William Brock prior to his leaving that post

¹⁶⁸ *Inside US Trade*, 3(35) 30 August 1985, p. 11.

¹⁶⁹ Similarly, SIA trade adviser Alan Wolff would later describe the HTWG process as 'a complete waste of time other than as a learning process ... It was hortatory — "We really ought to open markets" — that sought of thing; zero impact'. Wolff, interview, 1996.

in March. Much of the SIA's case alleging denial of access in Japan at that point was centred on US firms holding over 50 per cent of the European market for semiconductors, but never exceeding around 10 per cent of the Japanese market for any sustained period of time. An insight into the reasoning invoked to support the SIA's demand for affirmative action from Japan comes from a reported exchange between SIA legal adviser Alan Wolff and the former chief trade official in the Reagan Administration. Wolff maintains that:

We went and said to Bill Brock: "We can't sell in the Japanese market; we only have circumstantial evidence though". ... And Brock said: "Look in the southern universities in the 1950s there were no minority students. You don't have to show denial of access to an individual minority applicant to say that there was a problem of access to the southern university system on the part of minorities. Similarly, we have enough to go on here".¹⁷⁰

The SIA also set about mobilising an influential group of legislators from both political parties to support any trade action. The newly-formed Semiconductor Congressional Support Group (SCSG) was made up of 20 members of Congress in both houses with heavyweight representation beyond the key semiconductor producing states such as Texas and California. The SCSG included senior legislators with positions of trade leadership, some with strong free trade credentials and others known as hardliners and sponsors of tough trade legislation. With a mounting trade deficit and Japan the target of increasingly vitriolic criticism on Capitol Hill, 'the SCSG became a popular caucus and many lawmakers sought to join. A decision was made, however, to keep the SCSG "lean and mean" — a small group of well-led committed activists' (O'Shea 1995: 24).

Before the SIA could proceed to tap this political support base, it had to blunt potential opposition from major chip users in the United States, as well as resolve divisions within the trade association itself over any trade policy action. The SIA avoided a confrontation with the American Electronics Association (AEA), the largest group of semiconductor users, by muting calls for trade restrictions and emphasising the market access demands. If a company or industry group had opposed SIA initiatives in the past, new attempts were made to persuade them at least not to undermine the SIA's case.¹⁷¹ Within the SIA, opposition to import restrictions came from large captive producers such as IBM, and

¹⁷⁰ Wolff, interview, 1996. Dryden (1995: 313) also draws attention to this exchange.

¹⁷¹ In fact, the AEA later issued a letter supporting the objectives of the Section 301 case (Yoffie 1988: 86).

companies such as Texas Instruments that manufactured semiconductors in Japan. Concerned about possible implications of a Section 301 case, especially the prospect of future retaliation against Japan, these firms hoped to avoid an escalation in trade friction.

Two factors appear to have tipped the balance towards the SIA securing the necessary support for a trade remedies case in the (northern) summer of 1985. First, complaints about Japanese chip pricing reached a new pitch in June 1985 after Undersecretary of Commerce Lionel Olmer publicised a memo from Hitachi America to its distributors in the market for leading-edge 256K EPROMs. The memo urged them to continue to undercut rivals (Intel, Advanced Micro Devices and Fujitsu) by 10 per cent price cuts in order to build market share, at the same time guaranteeing a 25 per cent profit margin. A wave of adverse publicity about Japanese business practices was generated in an already a frayed political environment.¹⁷² Second, US merchant firms found a more receptive audience to their argument that the weakening of the semiconductor industry would ultimately rebound on US chip users should they find themselves dependent on Japanese suppliers that were also their main competitors in downstream markets such as computer systems. The capacity of the large Japanese electronics firms to sustain high investment in a depressed semiconductor market added to concerns prompted by the movement of US firms out of DRAM production. Superior investment rates were demonstrated through the previous industry slowdown in 1981-82 and, although the 1985 slump would see producers in both countries scale back investment plans, fears about the impact of new Japanese capacity in a depressed global market exercised the minds of American chip producers, users and trade officials by the middle of 1985 (Table 5.1). In May 1985, Commerce Department officials reportedly warned their MITI counterparts that a major bilateral dispute would erupt unless Japanese firms cut capacity and increased chip prices, but without the desired reaction in Tokyo (Flamm 1996: 163).

¹⁷² *International Trade Reporter*, 2(24), 12 June 1985, pp. 780-781. Hitachi officials acknowledged that the memo had been sent to its distributors, but said that it was the product of an overzealous employee and was not company policy. See O'Shea (1995: 24) for a discussion of the impact of the memo, including its text.

Table 5.1 Semiconductor Capital Spending in North America and Japan

| | North America | | Japan | |
|------|---------------|---------|------------|---------|
| | \$ billion | % sales | \$ billion | % sales |
| 1980 | 1.37 | 6.0 | 0.63 | 17.0 |
| 1981 | 1.35 | 16.6 | 0.83 | 16.4 |
| 1982 | 1.21 | 15.4 | 0.92 | 17.1 |
| 1983 | 1.45 | 15.0 | 1.70 | 22.3 |
| 1984 | 3.05 | 21.6 | 3.58 | 31.0 |
| 1985 | 2.07 | 18.4 | 3.23 | 31.5 |

Source: Dataquest in Dohlman (1993: D2).

The SIA filed its Section 301 petition with USTR on 14 June 1985. The trade association alleged that the Japanese government had actively created an anti-competitive, discriminatory market structure in Japan that blocked American suppliers gaining market access commensurate with their competitive position internationally. Amendments to Section 301 as part of the Trade and Tariff Act of 1984 had facilitated the unfair trade action by broadening the statute's definition of an 'unreasonable' foreign barrier to any policy or practice which 'denies fair and equitable market opportunities' — a reflection of hardline demands for sectoral reciprocity. Again, much was made of the circumstantial evidence that US sales rarely exceeded 10 per cent in Japan despite US firms holding around 55 per cent of the European market.¹⁷³ Structural barriers and Buy Japan attitudes were deemed the result of an oligopolistic structure where the leading producers of Japanese semiconductors were also the largest consumers. The petition specifically alleged that in taking liberalisation countermeasures the Japanese government had violated GATT Article XI on the transparency of trade barriers as well as the 1983 HTWG agreement. The petition also focused on Japanese government policies that it was claimed reduced investment risk in Japan and created the capacity for unfair export

¹⁷³ Notably, the SIA's own calculation at the time based on 1984 data put Japanese import penetration of the American semiconductor market at 14 per cent (SIA 1985).

pricing. The SIA proposed that unless US sales in Japan improved rapidly, the Reagan Administration should pursue an unfair trade action under the GATT. It also requested that a monitoring framework be established which could trigger anti-dumping investigations and that the Justice Department investigate possible antimonopoly violations by Japanese firms which resulted in predatory pricing behaviour. In framing the case for maximum support, an SIA spokesman stated at the time that the trade association did not 'seek protection, but rather access to other markets. That is in keeping with what we have always believed'.¹⁷⁴

The SIA's petition was accepted by the US Trade Representative's office and newly confirmed USTR Clayton Yeutter announced a Section 301 investigation on 11 July 1985. This was a victory for the hardliners and pragmatists within the trade policy process against the free trade leanings of the Reagan Administration. Not surprisingly, key congressional supporters of the SIA weighed in with concerted efforts to convince the executive of the merits of the petition.¹⁷⁵ More broadly, the SIA persuaded 180 representatives and senators to send letters (drafted by the SIA's legal team) to the administration (Yoffie 1988: 87). The usual divisions within the inter-agency process were apparent once again. Economists at CEA, OMB and the Justice Department found the SIA's evidence of Japanese barriers less than compelling. The President's National Security Adviser and other custodians of good relations with Japan were also inclined to oppose the petition. But importantly, divisions emerged over the potential danger of American dependence on foreign semiconductors to the point where the Defense Department's Defense Science Board and the Central Intelligence Agency (CIA) supported the industry's case (Prestowitz 1988: 56). Some uncertainty surrounded how the key player in the decision, new USTR Clayton Yeutter, would approach the issue. His predecessor William Brock had encouraged the SIA to pursue its case shortly before he was moved to become Secretary of Labor in March 1985. At least initially, Yeutter (a trained economist) was reportedly less swayed by the industry's pitch for aggressive

¹⁷⁴ *International Trade Reporter*, 2(25), 19 June 1985, p. 807.

¹⁷⁵ Senator Alan Cranston (D, CA) played a lead role within the SCSG facilitating meetings between industry leaders and key administration figures, including possible sceptics such as Secretary of State George Shultz. *Inside US Trade*, 3(27), 5 July 1985, p. 7. That the industry reportedly gained a sympathetic hearing from Secretary Shultz has been highlighted by some observers as an important break from past State Department attitudes (Dryden 1995: 430, Irwin 1996: 43-44).

policy action.¹⁷⁶ He recalls that ‘this was a new issue for me. ... We had some discussions on this shortly after I became USTR and this was the first time I’d paid any attention to this industry because my background was agriculture. Nobody had anything to say about semiconductors in the 1970s; they were hardly a factor at that time’.¹⁷⁷

In the event, the new USTR and his staff became active proponents of the semiconductor industry’s critical economic and national security importance. Another unfair trade petition lodged soon after the Section 301 petition was filed, the first of a series of dumping cases launched against Japanese semiconductor producers, dramatised the state of the industry for US officials. On 24 June, US chip maker Micron Technology filed an antidumping suit with the Commerce Department against seven Japanese producers of 64K DRAMs.¹⁷⁸ At the time, Micron was not a member of the SIA; hence the dumping action was a departure from the strategy of focusing on the market access complaint. Within the trade agencies forced to respond to the two unfair trade petitions, the semiconductor industry’s problems now became the subject of a new degree of scrutiny. Then Deputy USTR Michael Smith recalls that:

When the [Micron] dumping case was filed we [Yeutter and Smith] were in a Quad meeting in Canada. As soon as we could discreetly leave we came back to the US and looked at this dumping case. We quickly realised that we had a bigger case than a dumping case. We had a case of access into the Japanese market, we had a case of dumping in third-markets, and we had a case of dumping in the US market. ...

It was clear that our technology and our quality were no better than the Japanese; could have been worse. But we had briefings from the CIA, DIA [Defense Intelligence Agency] and the Defense Department that this was a pretty big issue. They couldn’t afford to lose capacity in semiconductors. So, to make a long story short, we decided to go and have major negotiations. ...

We felt rightly or wrongly — we may have overreacted — but we felt in a way the crown jewels of the United States were at stake. ... We were being told by very reputable people that semiconductors were the keys to the future. If you lose that capacity then you’re

¹⁷⁶ According to SIA adviser, Alan Wolff, ‘We filed [the Section 301 petition] and Clayton Yeutter became USTR. He said: “You guys, I don’t know what you think you’re doing here. You’re no better than the textile guys — carving up markets”’. Wolff, interview, 1996. Based on Wolff’s account, Dryden (1995: 313-314) concluded that ‘it wasn’t clear at all Yeutter would go along with the SIA plan’.

¹⁷⁷ Yeutter, interview, 1996. Yeutter served as Deputy Special Trade Representative from 1975 to 1977 and prior to that as Assistant Secretary of Agriculture for International Affairs and Commodity Programs.

¹⁷⁸ *International Trade Reporter*, 2(27), 3 July 1985, p. 865.

dependent. Now could the United States as the leader of the free world do that? We judged no.¹⁷⁹

With the president's National Security Adviser adopting a stance in line with foreign policy concerns not to offend a major ally, USTR Yeutter became a strong proponent of the semiconductor industry's case on national security grounds (Irwin 1996: 38). Indeed, he argued later that the 1986 semiconductor deal:

may have been the most important single negotiation we did in my tenure looking back now in retrospect. What was not known publicly at the time, or if known not fully appreciated, was how close we were to losing the entire American semiconductor industry. It was down and almost out with only a couple of independent companies still in business, along with IBM and others making semiconductors for their own use. The industry was in deep trouble because of the Japanese competition and what I felt was clearly predatory dumping in the US market on the part of the Japanese firms. I was persuaded, and I suppose the Japanese would argue to the contrary, that the Japanese firms were determined to put the American semiconductor firms out of business. ...

I will never forget that one of the people supposed to be an expert in this business said: "Don't even waste your time with semiconductors; it's gone. You've got to devote your attention to saving the computer industry because that's going to be next". Well finally I decided that I wasn't ready to draw that conclusion that there really was no opportunity to save the semiconductor industry. And I felt there were major national security issues at stake and that these overwhelmed the economics of the situation. And that's something that I could never talk about publicly because a lot of that was classified in terms of just how vulnerable we might be in the defense industry and elsewhere if the US as a nation became dependent on Japan as its source of semiconductors.¹⁸⁰

While broad strategic industry arguments were used to justify the protection of the semiconductor industry, the SIA's claims of illiberal Japanese government and industry practices also clearly carried weight with US officials. Flamm (1996: 164) draws attention to one particular behind-the-scenes factor which may have emboldened US trade officials to pursue the semiconductor industry's complaints aggressively.

Reports gleaned from a variety of sources in Japan spoke of the existence of a shadowy Council of Nine consisting of sales representatives of Japanese producers of discrete semiconductors who met periodically in a social setting to set prices, agree on market shares, and allocate sales to individual customers. At least some elements of the Japanese

¹⁷⁹ Michael Smith, interview, 1996. The dumping allegations were described as a 'crystallising moment' by then Japan Office Director at the Commerce Department, Maureen Smith. 'It got the inter-agency process mobilised because of the fact that MITI consistently denied that there was any dumping going on. Every agency was looking at the intelligence and USTR and Commerce did everything possible to get MITI to come to grips. We said: "We've got the data, you know it, you know we know it, cut the crap and let's solve this short of a dumping action". And despite that, MITI consistently denied it and I think that brought all of the agencies to a common perception of what was really going on'. Maureen Smith, interview, 1996.

¹⁸⁰ Yeutter, interview, 1996.

government apparently knew of these activities, and MITI representatives were reported to have observed or attended some of the meetings. Knowledge of the Council of Nine was closely held within both US government and industry, but senior American officials were well aware of it by 1985, and satisfied that it existed.

Because the group was never openly investigated, the extent to which it actually succeeded in affecting competition in the Japanese market for discrete semiconductors will probably never be known. Never issued publicly, the reports circulating behind the scenes nonetheless had an important impact. The SIA was reinforced in its determination to file an official Section 301 trade action. When the government received this complaint, awareness of the existence of the council played some role in hardening its resolve to support and pursue the 301 case. And one can only speculate that the Japanese government may have felt some vulnerability on these issues and been more willing to negotiate the agreement eventually signed.¹⁸¹

Dumping actions strengthen US leverage

Official bilateral consultations on semiconductors commenced in August 1985, but the atmosphere of crisis surrounding the US semiconductor industry only deepened in coming months. In the Micron dumping case, the ITC on 8 August announced a preliminary determination that Japanese imports of 64K DRAMs were injuring domestic producers. Around the same time, it was disclosed that the Justice Department, under considerable pressure from Congress, had begun an anti-trust inquiry into possible predatory pricing of EPROMs in the aftermath of the now infamous “Hitachi memo”. In early September, Micron Technology filed a private anti-trust suit against Japanese DRAM producers and later that month three US merchant producers — Intel, Advanced Micro Devices and National Semiconductor — filed a dumping petition against eight Japanese EPROM producers. By October, Intel, Mostek and National Semiconductor had announced plans to close down facilities and phase out production of DRAMs (Flamm 1996: 167).

Cut backs in Japanese production of 64K DRAMs saw prices recover from their lowpoint of June 1985. But in the process, production and consumption accelerated in the next-generation 256K DRAMs in which Japanese producers were dominant. Concerned that neither the US industry nor the bilateral government negotiations were positioned to meet this challenge, Commerce Department officials moved to increase the stakes in the

¹⁸¹ Flamm (1996: 165 fn 6) notes that his account ‘draws on confidential letters and drafts from US sources that I was permitted to review and interviews with former US government officials. Sources of information about the activities of the Council of Nine, and its very existence, were considered extremely sensitive by both American government and industry’.

dispute and arm the US government with new leverage in the form of an official, self-initiated dumping case. In October, officials in the Commerce Department had compiled what they referred to as 'irrefutable, detailed evidence' of Japanese dumping of 256K DRAMs in the United States (O'Shea 1995: 27). J. Michael Farren, then Deputy Undersecretary of Commerce for International Trade, maintains that the government took the lead:

really because the industry could not move fast enough. Because of the generational cycle for semiconductors, the industry was always a year behind where it should have been in terms of a dumping case in order to have an impact on Japanese dumping practices. That's where [Commerce Secretary] Mac Baldrige decided to use the authority which had only been used once before. ... One of the things that persuaded Baldrige to go ahead on the semiconductor dumping case was that Clyde Prestowitz had brought in the latest estimates of Japanese investment in semiconductor manufacturing which showed that by 1986 Japan would have added the productive capacity to swamp the global market with product.¹⁸²

The US government dumping action formulated in the Commerce Department was extraordinary not only because the self-initiation authority was rarely invoked, but also because it was designed to cover not only current-generation 256K DRAMs, but also any higher density products not yet on the market. For President Reagan to approve such a controversial action required an abnormal measure of high-level consensus about officially labelling Japan as unfair. The conditioning role of the trade regime crisis was significant in tipping the balance in the executive branch towards the hardliners. As well as self-initiating a series of Section 301 actions in September 1985 to defuse congressional trade action, President Reagan also established a special "strike force" to identify and combat unfair trade practices.

Commerce Secretary Malcolm Baldrige, a noted hardliner, was put in charge of the strike force creating an opening for the dumping action. The dumping proposal was presented at the first meeting of the strike force in late October 1985. As framed by Baldrige, the issue became whether any agency opposed enforcement of US dumping laws. While officials from the CEA, OMB, the Justice Department, Treasury and the State Department raised concerns, the legitimacy which President Reagan had bestowed on the strike force tended

¹⁸² J. Michael Farren, interview with author, 18 July 1996, Washington DC. The only previous case of a self-initiated antidumping case was during the Carter Administration within the framework of the steel trigger price mechanism (Japan Economic Institute of America 1986: 88).

to mute formal dissent from the Baldrige proposal (Prestowitz 1988: 60).¹⁸³ The body tentatively approved the recommended action in the absence of major concessions from Japan in the bilateral talks. Although the decision was set aside through November as Japanese officials sought to avoid an official US government finding of unfairness, the strike force recommendation was eventually forwarded to President Reagan who signed the order to proceed with the dumping case on 6 December 1985.¹⁸⁴ By year's end, official talks were taking place under the shadow of no less than three semiconductor dumping actions as well as the Section 301 case.

In an attempt to hold back the tide of American trade actions, MITI negotiators in late 1985 and early 1986 proposed a package settlement which included a system of price floors for Japanese imports to the United States and a general commitment to help increase US semiconductor sales to Japan's large electronics firms by 25 per cent — but without a specific guarantee (O'Shea 1995: 28). Their US counterparts rejected this offer. American trade officials wanted to ensure that, as well as countering low chip prices in the US market, any agreement covered Japanese exports to third markets. This would avoid the United States becoming a "high-price island" for chips forcing American semiconductor users, especially the computer industry, to locate offshore. The Commerce Department announced preliminary dumping margins against four Japanese producers in the Micron 64K DRAM case in December.¹⁸⁵ And although signs emerged of recovery in the semiconductor market by early 1986, the investigative lags in the dumping cases ensured no relief from future adverse determinations. In March 1986, the Commerce Department announced preliminary dumping findings in the EPROM action and the government-initiated 256K+ DRAM case. Margins against Japanese producers of EPROMs ranged from 21.7 per cent to 188 per cent and from 19.8 per cent to 108 per cent on US imports of 256K DRAMs.¹⁸⁶ The following month, final dumping margins ranging from 11.9 per cent to 35.3 per cent were posted against four Japanese producers

¹⁸³ USTR also reportedly had reservations about the official dumping action lest it hamper progress on the bilateral negotiations then under way (Dryden 1995: 314). Note that the strike force was an anomaly in that standard practice usually saw a USTR official chair any inter-agency decision-making body on trade policy.

¹⁸⁴ In the context of the semiconductor trade dispute, Prestowitz (1988: 56) describes the establishment of the strike force as 'a fluke'. It nonetheless forms part of the policy sequence linking the domestic regime crisis to new policy thresholds via the enhanced policy authority of the hardliners.

¹⁸⁵ The preliminary margins ranged from 8.9 per cent to 94 per cent. *International Trade Reporter*, 2(49), 11 December 1985, p. 1543.

¹⁸⁶ *International Trade Reporter*, 3(11), 12 March 1986, p. 329. *International Trade Reporter*, 3(12) 19 March 1986, p. 372.

of 64K DRAMs.¹⁸⁷ Facing end June deadlines for final determination in the other two dumping cases and a 1 July deadline on the Section 301 case, Japanese negotiators were under pressure to stave off the full impact of US trade remedies.

In the early months of 1986, negotiations deadlocked over a system to control chip prices in third-country markets and the SIA's demand for a specific market access commitment. On the latter, the SIA's starting point was a figure of 30 per cent market share, roughly equivalent to its share of international markets outside the United States, including Japan (SIA 1985: 14).¹⁸⁸ Initially, US negotiators were guarded, pressing their Japanese counterparts for a substantial market access commitment while stopping short of specifying a specific number. But by March, reports claimed that US officials had floated the idea of a 30 per cent US market share in Japan.¹⁸⁹ Shortly thereafter, a proposal from five major Japanese semiconductor companies to source 20 per cent of their semiconductors from US firms by 1990 was being widely reported.¹⁹⁰ Importantly, as the time frame for resolving the dispute prior to statutory deadlines shortened, negotiations took place away from the scrutiny of the US inter-agency process. The dual objectives for US officials were to placate the semiconductor industry while avoiding an open confrontation with the free trade agencies in the Reagan Administration. An official from the State Department was part of the small negotiating team headed by Deputy USTR Smith, but he was reportedly kept at arms-length from the market access negotiations to avoid his superiors at the State Department intervening in the negotiations (Dryden 1995: 319).

The (ambiguous) deal, the 20 per cent target, and the drive to retaliation

After meetings between USTR Yeutter and MITI Minister Watanabe in May, the outline of an agreement was reported in the media (Flamm 1996: 172).¹⁹¹ Further details were ironed out over following months with agreement on the scope of the proposed system

¹⁸⁷ *International Trade Reporter*, 3(18) 30 April 1986, p. 577.

¹⁸⁸ Prestowitz cites a SIA-commissioned report as setting the ambit for US market access demands. Finan, William F. and Chris B. Amundsen, 'Report on Estimating US Market Share in Japan', a report to the SIA, Washington, DC: Quick Finan & Associates, 8 November 1985.

¹⁸⁹ *International Trade Reporter*, 3(11) 12 March 1986, p. 330.

¹⁹⁰ *Inside US Trade*, 4(13), 28 March 1986, p. 2. See also Flamm (1996: 170).

¹⁹¹ Earlier in May, the House of Representatives voted 408-5 on a resolution that President Reagan retaliate if Japan did not sign an agreement in the near future (Irwin 1996: 48).

for monitoring chip prices in third-country markets proving especially difficult. A deal was reached after a rescheduled deadline of end July. Officially signed on 2 September 1986, the semiconductor agreement stipulated that in return for the United States suspending both the anti-dumping and Section 301 cases, the Japanese government agreed to establish a system to monitor Japanese export prices (both to the United States and to third-country markets) and to promote a 'gradual and steady' increase in foreign access to Japan's semiconductor market. In terms of trade policy intervention, the most dramatic element of the agreement was the export pricing regime. But the most controversial feature was a secret "side letter" exchanged concurrently with the text of the main agreement that cited a specific figure of 20 per cent as an objective for foreign access in the Japanese semiconductor market in five years. Later revealed, the side letter's rather vague undertaking was as follows:

the Government of Japan recognizes the US semiconductor industry's expectation that semiconductor sales in Japan of foreign capital-affiliated companies will grow to at least slightly above 20 per cent of the Japanese market in five years. The Government of Japan considers that this can be realized and welcomes its realization. The attainment of such an expectation depends on competitive factors, the sales efforts of the foreign-capital affiliated companies, the purchasing efforts of the semiconductor users in Japan and the efforts of both Governments.¹⁹²

The exact origins of the 20 per cent figure and its interpretation remain contested issues. When the US industry sought enforcement based on a linear increase in market access towards the 20 per cent goal, MITI officials denied the existence of the side letter. When it was publicly confirmed by former US trade official Clyde Prestowitz in his 1988 book *Trading Places*, the Japanese government maintained that no official commitment attached to what was simply a statement of industry expectation.¹⁹³ It would appear that officials on both sides had an interest in using the side letter to guard against international and domestic scrutiny by opponents of the agreement. At the same time, US government

¹⁹² *Inside US Trade*, 6(45), 18 November 1988, p. 1. Although the details of the side letter were not disclosed at the time the agreement was announced, Flamm (1996: 174) points out that the exact wording of the relevant sections on market access were reported in the *Financial Times* around the time of the agreement.

¹⁹³ Writing in *Bungei Shunju* in May 1988, an anonymous Japanese semiconductor executive put an interpretation from the perspective of Japanese producers: 'I imagine that MITI was in a considerable dilemma. It knew well that the Japanese industry was in great reaction against the "20 per cent market share in five years rule", while it must save the honor of the US side. Then MITI got the US side to agree by putting the specific figures in the side letter, while it throttled the resistance of the Japanese manufacturers by using a delicate expression in the side letter. I think that was the background of that side letter' (Howell, Bartlett and Davis 1992: 81-82).

officials acted on what they took to be a Japanese government commitment. As to the 20 per cent figure itself, clearly by 1985-86, and in light of the HTWG negotiations, the US industry's objective was to secure a very specific undertaking as part of its standing request for a Japanese affirmative action program. A number of analysts point to the US government simply following the demands of the SIA (Prestowitz 1988, Irwin 1996). USTR Clayton Yeutter confirms that the US government reached a point of demanding a specific number, but looks to downplay the industry's role. He argues that:

The industry demands really weren't all that relevant at that time. We were clearly getting input from the industry, but the 20 per cent number was essentially a USTR-developed number.

The US market share in Japan was 8 per cent or thereabouts when we negotiated that agreement whereas our market share elsewhere in the world was something above 40 per cent as I recall. And the point I kept making to the Japanese in the negotiations was that something is wrong here: "If we had a free and open market in semiconductors in Japan, I don't know what our market share would be, but it wouldn't be 8 per cent. Maybe it wouldn't be 40 per cent either, but it is going to be somewhere between 8 and 40". And that's kind of where the 20 per cent number came up. ...

So I said: "Well let's at least get to 20, and if you want to argue that 20 would not be a legitimate share of the Japanese market by foreign firms under free and open market conditions then make that argument". But they weren't willing to make that argument. So I said that in my view we would not in any way distort the market. We would improve the reflection of market conditions.¹⁹⁴

Deputy USTR Michael Smith similarly rejects the notion that the 20 per cent figure simply reflected SIA demands. And while he concedes that a specific market share was a necessary part of any final agreement from an American standpoint, Smith maintains that the Japanese government proposed the 20 per cent figure in order to reach a settlement. He maintains that:

We knew their market was closed and what drove us in this case was that the industry had come to the US government and said: "We're going to have to go offshore. If we don't have greater market share, we can't export more". So it was a market share issue from the start and people have lost sight of this. It was a market share issue because the only way US producers could stay in the United States was if they could export more and you had to increase their market share overseas. ... Now people say that's not fair. You should adjust the price and let the market decide. But with semiconductors we didn't know whether we could do that; whether we could dare risk that. ...

On the access thing, that was an accident; the original figure was 30 per cent. And for a variety of reasons it got knocked down and they said they'd in essence guarantee better

¹⁹⁴ Yeutter, interview, 1996. Irwin (1996: 50) asserts that 'USTR Yeutter explicitly asked for 20 per cent in a Tokyo meeting with Minister Watanabe on May 28, 1986'. Dryden (1995: 319) also maintains that by May 1986, Yeutter 'had become an enthusiastic advocate of an enforceable market-share goal'.

than 20 per cent. ... It had nothing to do with size of market etc. We both realised it was unrealistic to come up with a number that was too big. And [Japanese negotiator] Kuroda and I talked about it for hours and there was never any question about a number; it was just a question of what the number was going to be. And yet, I'm not kidding you, it came up at the last moment — 90 yards down the road. Admittedly it pulled us out of a very difficult situation because we didn't have any other mechanism. And it was a Japanese idea. Now SIA say it was their idea — nonsense.¹⁹⁵

Some support for Smith's assertion that Japanese officials were key actors in the process, at the very least in conditioning their domestic constituency for a market share outcome, is found in Flamm's analysis of the September 1986 semiconductor agreement. In particular, he pinpoints a speech in March 1986 by MITI Deputy Director General Tanahashi of the Machinery and Information Industries Bureau at an industry summit between US and Japanese semiconductor manufacturers. According to Flamm (1996: 170), this speech 'was believed to have been the origin of the 20 per cent market share target for foreign semiconductors later included in a side letter' to the 1986 agreement.

In that speech Tanahashi reportedly stated that "it was expected that the total share of US-made semiconductors used by five large Japanese manufacturers will account for 19.5 to 20 per cent in 1990." This was interpreted in the Japanese press as a proposal from the Japanese side. See "How Should We Settle Japan-US Semiconductor Friction?" *Nihon Keizai Shimbun*, April 2, 1986, p. 2. It was precisely at this point that reports of a 20 percent market share target by 1990 began to circulate within the Japanese semiconductor industry (Flamm 1996: 170, fn 30).

Makoto Kuroda, the former MITI Vice Minister and Michael Smith's counterpart in the 1986 semiconductor negotiations, rejects any notion that the market share figure was a Japanese idea or that any official commitment or guarantee was part of the agreement. He recalls that:

In the chip agreement we never negotiated: "30 [per cent] too high, why not 20?" That was not coming from Japan. We would say 30 is impossible and that even 20 may be reached in five years time, but nobody can commit. ...

The [US] industry considered 30 per cent of the share should be theirs if Japan was not taking any special measures protecting Japanese industry. So 30 per cent market share type of concept was lingering all through the discussions. And to that we said: "Access is opportunity, we can't commit to results. We are not buying; the private sector is buying".

But at the same time we said that we would encourage Japanese [firms] to purchase if the quality is good and specifications meet their desires. Because at that time facing an increasing trade imbalance, the Japanese government, especially MITI, was urging Japanese consumers to import. And there was the famous TV appearance of [Prime Minister] Nakasone asking the Japanese people to buy at least \$100 of imports to reduce

¹⁹⁵ Michael Smith, interview, 1996.

our growing imbalance. This was the type of argument that was prevailing at that time. So it was not really unnatural to say that: “OK, we will commit ourselves to encourage and facilitate imports, but we are not in a position to make any commitment to results”.

But to this argument Clayton Yeutter said that, without some number, the SIA will not be satisfied. So he made a very strong appeal that without a number no agreement can be reached. So then it was a compromise: “You say this is the expectation of the American industry — 30 is too high; 20 per cent, OK”. And we accepted; if this is the expectation on the part of the American industry, we are ready to recognise and we even said that if it is achievable we welcome it. That type of statement should be understood by the atmosphere I described — that we are trying to promote our imports. ... And I suspect that those Japanese producers selling part of their chips [to the US market] considered at the time that if they wanted to sell to the US market, they had to accept something.¹⁹⁶

The signing of the 1986 semiconductor trade agreement did not herald an end to the semiconductor dispute. Indeed, the agreement’s ambiguity regarding the specific actions required of the Japanese government guaranteed further conflict as trade in semiconductors became ‘no longer simply manipulated’ but ‘actively managed’ (Tyson 1992: 107). The US government’s interpretation of the 20 per cent market share expectation provided one aspect of continued conflict. But, at least through the second Reagan Administration, the market access issue was regularly overshadowed by the fallout from the effective cartelisation of the world market for DRAMs due to the agreement’s anti-dumping provisions. This generated renewed opposition to the agreement from US semiconductor users, as well as a GATT complaint by the EC.¹⁹⁷

The Commerce Department’s new “foreign market value” floor price system for Japanese exports came under criticism from US chip users following an immediate rise in the price of US imports of DRAMs in September 1986.¹⁹⁸ And as early as October, US merchant producers began lobbying the US government to retaliate against Japan’s alleged

¹⁹⁶ Makoto Kuroda, interview with author, 20 February 1997, Tokyo. Yoshihiro Sakamoto, another former MITI Vice Minister and an official in the Machinery and Information Industries Bureau during the 1986 negotiations, makes the additional point that at the time ‘there was not so much sensitivity [in Japan] about government intervention into the market so judging from the overall political importance of the US-Japan relationship the Japanese government accepted the market share target in exchange for the suspension agreement on dumping’. Yoshihiro Sakamoto, interview with author, 19 February 1997, Tokyo.

¹⁹⁷ The EC initiated a GATT case in September 1986 and formally requested a GATT panel under Article XXIII in February 1987. In March 1988, the GATT panel concluded that the Japanese export monitoring mechanism was inconsistent with the Article XI prohibition against quantitative restrictions. The panel did not find evidence of discrimination on market access in favour of the United States as the relevant provisions, excluding the then secret side letter, were deemed too ambiguous (Ryan 1995: 7).

¹⁹⁸ See Flamm (1996: 266-72) for details on the US Commerce Department’s firm-specific floor price system on US imports of Japanese DRAMs and EPROMs from late 1986 through mid 1991.

violation of the agreement's third-country dumping and market access provisions.¹⁹⁹ In late January 1987, US trade officials set short deadlines for a halt in dumping and increased market access as MITI attempted to bring Japanese firms' production and exports under tighter control.²⁰⁰ Unsatisfied with Japan's response, on 26 March 1987 the cabinet-level EPC recommended that President Reagan impose 100 per cent tariffs on \$300 million of Japanese exports of computers, machine tools and colour televisions — the first major sanctions against Japan since World War II.

With US government credibility seen to be at stake, and with Congress contemplating legislation to further restrict executive branch trade policy discretion, even agencies opposed to the agreement felt compelled to support swift enforcement measures.²⁰¹ Coming less than six months after the agreement was signed, the sanctions decision displayed an unprecedented determination to use access to the American market as leverage in bilateral negotiations with Japan. The chorus of support for retaliation echoed the hardline view that Japan in the past had played the United States as a sucker in trade negotiations and that process-oriented agreements offered no discernible results. Rationalising the sanctions decision in this case, administration officials argued that 'for the first time Japan had been caught out of compliance with an easily verifiable agreement'.²⁰²

On Capitol Hill, hardliners painted the sanctions decision as an overdue response to a history of "bad faith" agreements. Releasing a GAO report on the semiconductor agreement on 15 April 1987, Senate Finance Committee Chairman Lloyd Bentsen maintained that retaliation would not have been necessary if stronger action had been taken in the past. 'If we had such a policy, the Japanese and others would have learned long ago not to sign trade agreements with us unless they intended to live up to them'.²⁰³ Reflecting later on the merits of the sanctions decision, then USTR Clayton Yeutter maintained that, 'This was the first time Japan got caught with a definitive commitment.

¹⁹⁹ *Inside US Trade*, 4(41), 17 October 1986, p. 13.

²⁰⁰ *Inside US Trade*, 5(6), 6 February 1987, p. 1.

²⁰¹ *International Trade Reporter*, 4(5), 4 February 1987, p. 141. *International Trade Reporter*, 4(13), 1 April 1987, p. 423. The tariffs came into effect on 17 April 1987. Based on US government figuring, \$135 million in sanctions were directed against alleged third-country dumping violations while \$165 million in sanctions related to alleged market access violations.

²⁰² 'Strong evidence led US to set Japan sanctions' by Stuart Auerbach, *Washington Post*, 5 April 1987, p. H01.

²⁰³ *International Trade Reporter*, 4(16), 22 April 1987, p. 538.

Prior to that time they were always able to keep their commitment fuzzy enough that nothing much ever happened and this was the first time that they discovered they had to deliver in a negotiation'.²⁰⁴ A new policy threshold had been established with the 1986 semiconductor agreement in terms of US demands for specific results and swift retaliation to secure those results.

The first semiconductor agreement in perspective

The results-oriented semiconductor agreement of 1986 and the retaliatory sanctions geared to its enforcement were landmarks in US-Japan trade conflict. At one level, they symbolised the scale of Japan's emergence as a high-technology economic power and the pressures this generated on a once-dominant American industry. One measure of this ascendancy is that the Japanese semiconductor market accounted for around 47 per cent of global merchant sales in 1986, up from less than 25 per cent in 1977. Meanwhile, sales in the North American market in 1986 had fallen to around 40 per cent of the world market compared with a figure of over 60 per cent in 1977 (Dohlman 1993: D1). Beneath this transformation in global market positions, an important theme of this study relates to the proximity of the semiconductor agreement, with its radical dumping and market access provisions, to the trade policy regime crisis in the United States. The American merchant semiconductor firms were positioned to take advantage in 1985-86 of a resurgent Congress looking to reclaim trade policy authority and an executive branch intent on more aggressive pursuit of sectoral reciprocity and fair trade. In this context, the semiconductor agreement was a major breakthrough for the policy network of Japan hardliners in the American trade policy community in their political contest to assert authority over the alliance of free traders and national security officials which in the past had restrained results-oriented trade demands and threats of retaliation.

With its protection to provide breathing-space for an American industry, the agreement shared characteristics with a long line of past arrangements driven by Japan's export competitiveness. But its primary significance relates to the market access precedent — a specific share of the Japanese market for foreign semiconductors identified (at least obliquely) in a formal agreement. The agreement was a new reference point in US market

²⁰⁴ Yeutter, interview, 1996.

access policy towards Japan. Still, its importance remains as part of an incremental process. It did not signify a general change towards demanding specific numbers in market access negotiations. It was, as the next chapter will highlight, at one end of a spectrum of results-oriented market access negotiations with Japan undertaken by the second Reagan Administration and the Bush Administration. In short, the 1986 semiconductor agreement was not a model for other agreements at the time it was negotiated. To put the semiconductor agreement in perspective as part of an incremental process of policy change demands attention to its precedent-setting character, but also its contingent features.

The first contingent factor was the importance US policy-makers attached to the semiconductor industry relative to other sectors subject to negotiations. While debate surrounds the degree to which the US industry was in fact under threat in 1985, the belief that semiconductors were indeed the “keys to the future” or “the crude oil of the 1980s”, and that an American-owned merchant industry was a vital national interest, appears genuinely held. The second aberrant feature was the sheer bargaining power possessed by the United States in the negotiations by virtue of the collective weight of the dumping actions that were the central concern of Japanese semiconductor producers and their representatives in 1985-86. On rare occasions could US officials maintain such a credible threat of punitive trade remedies that could be leveraged to support a radical policy outcome. Third, the degree to which free traders were excluded from the policy process was a telling aspect of the semiconductor negotiation. Then Deputy USTR Michael Smith has noted that ‘this was so difficult for us that we never told the other agencies’ (Dryden 1995: 319).

We never took it to cabinet — put it that way. We never took it to a lot of people until it was done. ... The nay-sayers — the Attorney General, the Secretary of State, the Secretary of Defense and all that — didn’t like this agreement. George Shultz was a trained economist, he knew what the hell we’d done; we’d rigged the market.²⁰⁵

The eventual presentation of the market access deal as a *fait accompli* confirmed the reach of this agreement beyond the boundaries of inter-agency consensus. Free traders in the White House, the CEA and elsewhere attacked the market access provision revealed by USTR Yeutter at an EPC meeting in late 1986 (Dryden 1995: 320). Moves towards

²⁰⁵ Michael Smith, interview, 1996.

retaliation were also arranged to lock-in high-level State Department officials not apprised of the agreement's secret provisions. Then Undersecretary of State for Economic Affairs, W. Allen Wallis, provides an insight into the carefully staged lead-up to the retaliation decision, even disputing the official interpretation of the agreement by his administration colleagues. Wallis recalls that:

There was duplicity in that [the semiconductor agreement]. There was suddenly a meeting called at the Capitol [in March 1987] which I was asked on very short notice to attend. I had no idea what was coming up. There were a large number of people there including several senators and cabinet ministers, and it turned out the entire meeting was basically focused on me. And the way they put it was: "The Japanese have agreed to this — foreigners should get x per cent of their market. Would the State Department go along with insisting that they carry through with what they agreed to?" And I remember the way I put it was: "If they agreed to it well of course the State Department will go along with trying to enforce it". So they took that as a commitment from the State Department. Subsequently I found out that the Japanese adamantly refused to make any commitment or even to say it was a target. From my point of view, there was clearly duplicity and trickery within the US government to get the State Department to appear to go along with that. Shultz didn't hear about it until later and he was absolutely flabbergasted.²⁰⁶

Finally, there is an important sense in which the 1986 semiconductor agreement was viewed as an anomaly by those officials most directly involved in its negotiation. This underscores the success of the US semiconductor industry in selling its special case to USTR. While USTR often found itself in alliance with Commerce Department hardliners, it was also in the role of an institutional broker. Hence, it often sought to chart a course between the Commerce Department hardliners and the free traders in the US policy process; to fashion a trade policy that was sensitive to industry demands and politically sustainable, but also tilted towards maintaining an open American market and broad policy coherence (Destler 1995). Again, former Deputy USTR Michael Smith offers an insight into why the semiconductor agreement may be viewed as *sui generis*, rather than part of a general results-oriented strategy by the second Reagan Administration.

In my view, the semiconductor agreement was a special, one-time, never-to-be-repeated negotiation. ... I never viewed this as the proudest moment in USTR history. Not because it was an evil deal, but because it violated the principles USTR was in favour of. We had been battling against the Europeans and the less developed countries for years on domestic content and export performance requirements and that sort of stuff and here we were, in a way, part of that managed trade ethos.²⁰⁷

²⁰⁶ W. Allen Wallis, interview with author, 15 August 1996, Washington DC.

²⁰⁷ Michael Smith, interview, 1996.

Conclusion

The September 1986 semiconductor trade agreement was an extreme policy reaction to support an industry seen as critical to America's high-technology base. It was also an important landmark in the shift by the United States towards a results-oriented market access policy towards Japan. The setting of a numerical target of 20 per cent foreign sales in the Japanese market and the subsequent move towards sanctions established a new threshold in terms of demands for specific market access results and swift retaliation to secure those results. But rather than heralding a general shift towards a results-oriented policy, it should be seen as part of a policy sequence and at one end of a spectrum of agreements. The following chapter examines other examples of the selective results-oriented policy of the second Reagan Administration and the Bush Administration.

6 Reagan, Bush and *Selective* Demands for Results

Introduction

The 20 per cent market share target in the 1986 US-Japan semiconductor agreement would remain a unique case in US market access policy towards Japan (with the Bush Administration opting to recognise the figure explicitly in a renegotiated agreement in 1991). More generally, however, the line between process and results-oriented policy became blurred across a range of bilateral sectoral negotiations in the aftermath of US trade regime crisis. A more structured American focus on Japanese domestic practices was institutionalised with the MOSS process begun in 1985. Subsequently, a number of grey area market access negotiations in such sectors as auto parts, telecommunications, supercomputer and computer procurement, glass and paper products suggested an identifiable move towards a selective, results-oriented policy towards Japan.

By 1992, a number of sectoral negotiations appeared closer to the results-oriented rather than process-oriented end of a policy spectrum. The semiconductor agreement was part of a policy record that included Japanese “voluntary” import expansion measures (VIEs), actions designed to accommodate particular US companies in the Japanese market and progressively more detailed market access agreements, in some cases with quantitative criteria to assess the agreement’s performance. This chapter examines a series of bilateral negotiations through the second Reagan and Bush Administrations to support the argument that the trend towards a results-oriented market access policy went beyond the semiconductor case.

Auto parts: Domestic content with a VIE component

As noted in chapter 4, the MOSS talks bridged the trade regime crisis. They began in January 1985 as an attempt to tackle the peeling onion phenomenon, while steering away from an explicitly results-oriented policy. But by the end of 1985, MOSS was central to the Reagan Administration’s attempts to demonstrate a tougher market access approach towards Japan. The key addition to the MOSS process in 1986 was the automotive parts sector. Whereas MOSS was premised on dismantling barriers to internationally

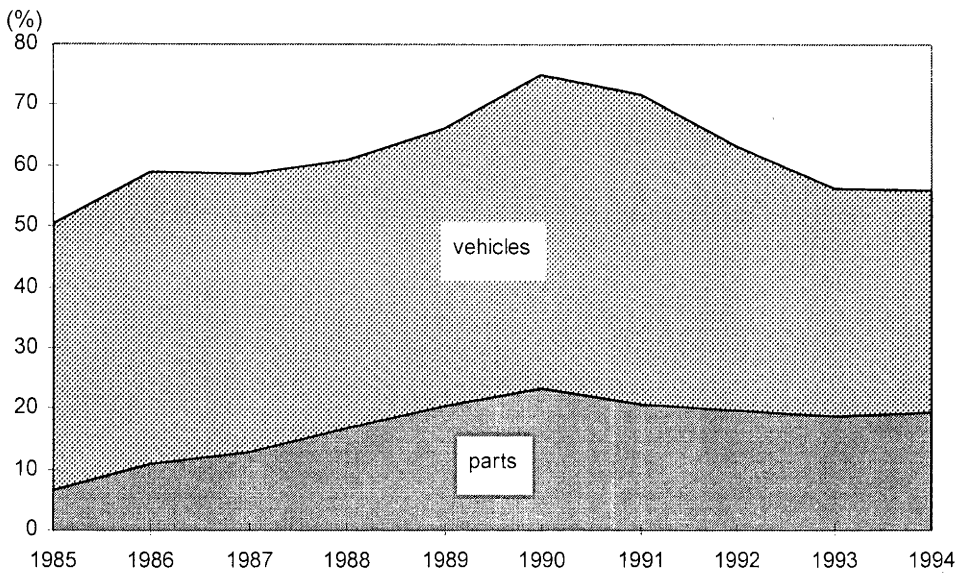
competitive US products in the Japanese market, the Reagan Administration's decision to pursue auto parts negotiations was essentially a case of pragmatic trade politics; a response to a large industry with a significant sectoral trade deficit with Japan. The trade problems of the US auto parts industry related overwhelmingly to Japanese competition in the *American* automotive market. American auto parts production and employment in the mid 1980s remained well below peak 1978 levels despite a recovery in profitability of the Big Three American car manufacturers — General Motors (GM), Ford and Chrysler — boosted by the VER on Japanese vehicles secured in 1981 (OECD 1992: 35-6). Having unsuccessfully pursued domestic content legislation during the first Reagan Administration, the US auto parts industry, the UAW and their allies in Congress identified MOSS as the best available policy option for externalising adjustment pressure.²⁰⁸

The automotive sector's large (and growing) share of the US-Japan trade deficit was at the heart of the Reagan Administration's calculation to target auto parts (Figure 6.1). The March 1985 decision not to request an extension of the VER on Japanese vehicle imports only strengthened pressure on the executive branch for a new sectoral policy initiative.²⁰⁹ By 1985, the bilateral deficit in auto parts had reached \$3 billion, up from \$1 billion in 1980, while new factors associated with the industry's internationalisation dictated a trend of increasing deficits and a higher share of parts in the bilateral automotive imbalance (US ITC 1987). First, as part of their drive to catch up with the Japanese competition, American auto manufacturers sourced production parts increasingly from offshore affiliates, including in Japan. Second, Japanese firms had established a strong presence as suppliers of the large and growing replacement parts market for the nearly 20 million Japanese vehicles sold in the United States between 1978 and 1985 (Japan Economic Institute of America 1986: 109). And third, rising "transplant" production following direct investment by Japanese vehicle producers in the US had emerged both

²⁰⁸ Before targeting MOSS, the US industry attempted unsuccessfully to revive a 1980 TFC initiative to boost sales of US parts to Japanese vehicle manufacturers. This plan was shelved after the auto VER was established in May 1981. *International Trade Reporter*, 2(36), 11 September 1985, p. 1110.

²⁰⁹ A day after President Reagan announced the removal of the VER, Japan announced that it would extend the restraint on vehicle exports, but with the level increased from 1.85 million to 2.3 million units. The limit was no longer binding after 1987 although the Japanese government again lowered the export quota in March 1992. The VER was finally removed in March 1994. See Bass (1992) and Smitka (1997).

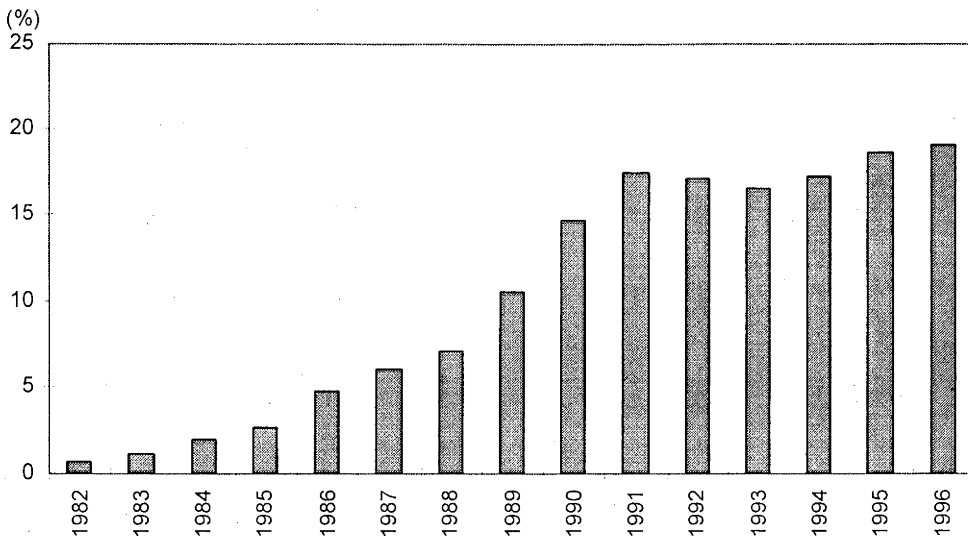
Figure 6.1: Automotive Sector's Share in US-Japan Merchandise Trade Imbalance



Source: US Bureau of Census. Figures cited in Nanto, Cooper and Bass (1995).

as a significant source of rising parts imports from Japan and a highly-visible focal point for US auto parts interests subject to structural change (Figure 6.2).²¹⁰

Figure 6.2: Share in North American Vehicle Production of Japanese-owned Vehicle Manufacturers



Source: *Automotive News*. Figures cited in Fuss and Waverman (1992: 226), MacKnight (1993: 4) and *JEI Report 28B*, 24 July 1998.

²¹⁰ Honda was the first Japanese manufacturer to begin production in the United States in 1982. By the end of the 1980s, seven Japanese vehicle manufacturers had production facilities in the United States with total car and truck capacity of around 1.7 million units (Wong 1989, MacKnight 1993).

The United States nominated auto parts as the fifth candidate for MOSS talks in early 1986, despite concerns in sections of the Reagan Administration that a *de facto* domestic content policy would be the likely outcome.²¹¹ At the time, the prospect of Congress forcing a more protectionist trade policy on the executive was seen as a real possibility with the Democrat-controlled House of Representatives moving towards passage of a trade bill (H.R. 4800) the White House would label as ‘pure protectionism’ (Destler 1995: 91). Passed by the House in May 1986 by a vote of 295-115, H.R. 4800 included the infamous Gephardt amendment, demanding that Japan and other high trade surpluses countries reduce bilateral imbalances with the United States by 10 per cent per year.²¹² That same month, after direct representations from President Reagan to Prime Minister Nakasone, the Japanese government reluctantly agreed to auto parts negotiations.²¹³

The stated goal of US officials in MOSS was ‘to eliminate impediments to US companies from becoming full suppliers to Japanese vehicle manufacturers in Japan, the United States and third markets’ (USTR 1986: 160). In practice, the auto parts negotiations had a dual focus. In keeping with the original MOSS premise, US trade officials targeted process-oriented changes in Japanese government regulations and certification standards in the so-called “after-market” for repairs and accessories in Japan. The larger focus, however, was on pressuring Japanese manufacturers, in particular their US affiliates, to source original equipment (OE) parts from US suppliers. The vertical buyer-supplier *keiretsu* relationships of Japanese vehicle manufacturers were identified as unfairly excluding US firms from component supply relationships.²¹⁴ This focus on private-sector business practices exploited similar themes to the US semiconductor industry’s allegations of informal Buy Japan practices and exclusive corporate structures. Subsequently auto parts access became a key sectoral lightning rod for bilateral conflict over *keiretsu* relationships and their alleged role as Japanese structural impediments.²¹⁵ That Japanese manufacturers were in important respects *less*

²¹¹ One US official lamented at the time that, ‘The purpose of MOSS is to open Japanese markets, not to restrict Japanese exports to the US. ... In theory it [Japanese exports] should not be part of the MOSS negotiations but as a practical matter, it may be impossible to exclude it’. *Inside US Trade*, 4(14), 18 April 1986, p. 11.

²¹² *International Trade Reporter*, 3(22), 28 May 1986, p. 706.

²¹³ ‘Japan to take up auto parts’, *Japan Times*, 5 May 1986, p. 11. *International Trade Reporter*, 3(20), 14 May 1986, p. 648.

²¹⁴ ‘American auto parts makers fight against cultural barriers’ by Susan Frankel, *Japan Economic Journal*, 12 July 1986, p. 19.

²¹⁵ Chapter 8 elaborates on the intensive academic debate that accompanied the emergence of *keiretsu* ties as an issue in US-Japan trade conflict.

vertically-integrated than the Big Three American firms was highlighted by the fact that the American manufacturers were in the process of reducing their heavy reliance on in-house parts facilities (OECD 1992: 43).²¹⁶ Lower production costs, greater automation, better employment relations and higher quality control appeared the more fundamental sources of Japanese competitive advantage in the automotive industry, only partially offset by a weaker exchange rate after 1985.²¹⁷

Through 1986-87, Commerce Department and MITI officials adopted a gradualist approach to expanding US parts sales looking to facilitate contacts between Japanese manufacturers and the larger, more internationalised US suppliers of OE parts. While warning their Japanese counterparts of protectionist pressures in Congress, Reagan Administration officials rejected calls for formal targets for Japanese purchases and opposed sectoral reciprocity bills threatening closure of the US market.²¹⁸ In August 1987, the two governments agreed on a series of initiatives designed to ameliorate auto parts conflict.²¹⁹ The main outcome was the establishment of a data collection system for monitoring purchases of American-made parts by Japanese manufacturers and their US subsidiaries. The Japanese government also indicated its preparedness to promote contact points for American suppliers in Japanese firms and to ensure that the Ministry of Transport's regular vehicle inspection system did not discriminate against installation of foreign-made parts. On the issue of buyer-supplier relationships, the 1987 MOSS report concluded that 'there is no evidence given the severe competition among parts suppliers that "affiliated suppliers" are being accorded a special position over other suppliers by their parent automakers' (Duncan 1995). The report's positive tone drew a strong attack from smaller American parts suppliers (and their allies in Congress) hardest hit by structural change in the auto parts industry. The hardliners' criticism centred on the lack of a specific Japanese commitment to future sales and the failure of the new statistical

²¹⁶ During the 1980s, GM, the largest American manufacturer, was also the world's most integrated automaker with about 70 per cent of parts supplied by in-house parts divisions. By contrast, major Japanese manufacturers tended to source less than 30 per cent of parts in-house (US ITC 1994). For a detailed study of the role of supplier networks in the Japanese automotive industry, see Smitka (1991).

²¹⁷ As one example of the so-called "lean production" techniques developed by Japanese manufacturers, a typical Japanese automaker in the 1980s maintained links with around 200-300 production suppliers whereas GM dealt with approximately 3500 (US ITC 1987: 4-13). On the broader dimensions of the challenge Japanese competition posed to the US automotive industry, see Womack, Jones and Roos (1990), Fuss and Waverman (1992) and Nelson (1996).

²¹⁸ *Inside US Trade*, 5(1), 2 January 1987, p. 1. *Inside US Trade*, 5(6), 6 February 1987, p. 5.

²¹⁹ *International Trade Reporter*, 4(33), 19 August 1987, p. 130. 'Final report for MOSS talks on transportation machinery', *Japan Economic Journal*, 29 August 1987, p. 4.

monitoring system to distinguish between sales to Japanese manufacturers by so-called “traditional” (American-owned) parts makers and by the increasing number of Japanese-owned parts suppliers located in the United States.²²⁰

The Bush Administration extended the Reagan Administration’s low-key approach with an emphasis on building industry-to-industry links. Regular conferences brought together Japanese purchasing teams and executives from US parts companies and “design-in” programs were geared towards building relationships between US parts makers and Japanese vehicle producers at an early stage of the manufacturing process.²²¹ Increasing purchases of US parts and materials by the transplants and an increase in US auto parts exports to Japan from \$200 million in 1985 to \$450 million in 1988 reinforced the Bush Administration’s inclination to avoid a confrontational auto parts strategy. But such trends failed to quell the clamour by the hardliners for stronger trade action, especially given the rise in the bilateral auto parts deficit from \$3.1 billion in 1985 to \$8.8 billion in 1988. By the late 1980s, auto parts accounted for around one third of the bilateral automotive sectoral deficit and 20 per cent of the total US-Japan trade imbalance (MacKnight 1993: 6-8).

The Super 301 actions mandated by the 1988 Omnibus Trade and Competitiveness Act (hereafter the 1988 Trade Act) provided a ready target for auto parts grievances in 1989 and 1990.²²² Bush Administration officials were able to deflect demands for a more confrontational policy by taking advantage of divisions within the US industry between the larger manufacturers of high-value components (engines, transmissions, etc) and the smaller firms specialising in accessories and replacement parts and more reliant on the Big Three American manufacturers. The larger firms represented by the US Motor and Equipment Manufacturers Association were the main beneficiaries of the MOSS initiatives. By the end of the 1980s, they were accruing increased sales from some combination of government activity and enhanced commercial advantages due to increased quality, a lower exchange rate and proximity to the Japanese transplants. The more hardline APAA campaigned for relief on behalf of smaller parts suppliers faced

²²⁰ *Inside US Trade*, 5(34), 21 August 1987, p. 7. *Inside US Trade*, 6(7), 19 February 1988, p. 5.

²²¹ See Duncan (1995) on the intensified bilateral business linkages promoted by the MOSS talks.

²²² The Congressional Taskforce on Auto Parts, the UAW and the Automotive Parts and Accessories Association (APAA) all recommended Super 301 action against Japan targeting auto parts sales (MacKnight 1993: 8).

with ongoing rationalisation in the largely saturated North American automotive market.²²³ S. Linn Williams, Deputy USTR in the Bush Administration, identifies industry division as an important element providing officials with room to avoid a hardline Super 301 strategy on auto parts in 1989 and 1990. He recalls that:

The auto parts industry was badly split — there were the big guys and the little guys. The little guys — doing spark plugs, wipers and those things — took a very hard line on Japan. What they were fighting for was the domestic market. They wanted us to go and scare the Japanese so they'd sell their spark plugs; that was that. Then there were the big guys — TRW, Allied-Signals, Borg Warner etc. They were interested in the Japanese market and they had a much softer line. They had their tie-in arrangements with the Japanese and they didn't want to upset that applecart. They were much more go-slow. So the parts industry was zeroed out.²²⁴

As a follow-up to the MOSS process, the Commerce Department and MITI announced an eight-point Market-Oriented Cooperation Plan (MOCP) in June 1990.²²⁵ The MOCP built on industry-to-industry initiatives and provided an umbrella for the development of voluntary company purchasing plans of US-made parts by the five major Japanese automakers — Honda, Mazda, Mitsubishi, Nissan and Toyota. Other initiatives included support for greater purchasing autonomy and design responsibility for the American production facilities of Japanese manufacturers and the commissioning of a joint price survey of OE and replacement parts in the Japanese market (Tamada 1993). But by 1991, the Bush Administration's gradualist approach on auto parts was in the process of unravelling. With the American automotive industry entering its third consecutive year of declining vehicle production, Congress began a new cycle of legislative activity aimed at mandating reductions in the US-Japan trade deficit starting with the auto and auto parts industries.²²⁶

Japanese transplant operations and the roughly 300 Japanese-affiliated auto parts plants in the United States received unprecedented official attention in 1991 with *keiretsu* ties at

²²³ An APAA spokesman underlined the organisation's domestic focus in his 1990 statement that the 'gravest threat to our industry' is posed by 'hundreds of Japanese suppliers moving on shore to replicate exclusionary ties to Japanese car makers, and more importantly, to crack the Big Three markets and lucrative after-market for US nameplates'. *Inside US Trade*, 8(9), 2 March 1990, p. 9.

²²⁴ S. Linn Williams, interview with author, 24 September 1996, Irvine CA.

²²⁵ 'Accord reached in auto parts talks', *Japan Times*, 16 June 1990.

²²⁶ Congressional representatives of the auto parts industry introduced companion bills in the House of Representatives (H.R. 787) and the Senate (S. 301) in early 1991 aimed at reviving Super 301 and targeting countries whose bilateral deficits accounted for 15 per cent or more of the total US trade deficit and sectoral deficits of five per cent or more of bilateral imbalances. *International Trade Reporter*, 8(6), 6 February 1991, p. 199. *Inside US Trade*, 9(6), 8 February 1991, p. 4.

the centre of the bilateral Structural Impediments Initiative and the auto parts industry's problems the subject of hearings by numerous congressional committees.²²⁷ June 1991 witnessed an important turning point in sectoral politics when for the first time the Auto Parts Advisory Committee (APAC), an industry body set up to advise the Commerce Department on Japan auto parts trade, presented the Bush Administration with a consensus, hardline recommendation for a dumping investigation and a Section 301 case against the Japanese auto parts industry.²²⁸ The Bush Administration rejected the APAC proposal, but Commerce Department officials launched renewed demands for increased US sales on the back of the MOCP price study which identified cases of "comparable" parts costing up to three times more in Japan than in the United States.²²⁹

The inclusion on the bilateral auto agenda in 1991 of American grievances concerning low vehicle sales in Japan further strained the pattern of low-key follow up to the MOSS process. The Japanese government reluctantly agreed to examine the statutory motor vehicle inspection and distribution systems and to participate in a joint study of the problems foreign automakers faced in the Japanese market.²³⁰ At the time, imports made up around four per cent of the Japanese automobile market with American cars accounting for less than one per cent of sales in Japan (Bass 1992). Explanations for low sales by the Big Three invariably pointed to their low export orientation, failure to develop right-hand-drive vehicle models, reluctance to invest in marketing and distribution relationships and perceptions of poor quality relative to Japanese vehicle producers. According to Mike Farren, the Bush Administration's Undersecretary of Commerce and chief automotive sector negotiator, 'up until 1990 the US auto

²²⁷ The potential anticompetitive effects of *keiretsu* relationships being replicated in the United States was the subject of no less than three official inquiries by the Department of Justice, the Federal Trade Commission and the GAO in 1991. See 'Honda: Is it an American car?' by Paul Magnusson et al., *Business Week*, 18 November 1991, p. 39.

²²⁸ *International Trade Reporter*, 8(26), 26 June 1991, p. 978. APAC also released a controversial University of Michigan study which projected a bilateral auto parts trade deficit of \$22 billion in 1994 and a significant further decline in US automotive parts suppliers unless action was taken against Japanese procurement practices.

²²⁹ *International Trade Reporter*, 8(27), 3 July 1991, p. 1013. 'Factors explain US-Japan auto parts price discrepancy: MITI', *Nikkei News Bulletin*, 27 June 1991. The Department of Commerce/MITI study found that of 68 uninstalled after-market parts surveyed, 87 per cent were priced higher in Japan than in the United States, and that of 65 installed parts surveyed, 80 per cent were priced higher in Japan than the same or comparable US parts. MITI argued that price discrepancies reflected a complex mix of factors including ancillary services provided by Japanese auto parts firms and the larger role of discount stores in the United States.

²³⁰ *Inside US Trade*, 9(31), 2 August 1991, p. 18. 'Trade talks to include US car sales' by Nobuyuki Oishi and Thomas P. O'Toole, *Nikkei Weekly*, 3 August 1991, p. 8.

manufacturers had steadfastly refused to allow the US government to become engaged in negotiations on the question of market access to Japan. They only wanted the US government engaged on Japanese import penetration'.²³¹ Again, contrary to the basic MOSS premise, the proximate causes of this latest episode of bilateral auto trade politics were the large sectoral deficit in vehicles (\$21.3 billion in 1990), strong competitive pressures from the Japanese transplants and record Big Three losses totalling \$7.5 billion in 1991 (Nanto and Bass 1992).

By November 1991, economic recession, a hostile Congress disenchanted with the Bush Administration's trade policy and a looming presidential election year combined to place automotive issues at the forefront of a new round of bilateral trade tensions. American officials launched renewed criticism of the announced voluntary purchasing plans of the major Japanese vehicle producers.²³² Having previously cancelled a planned trip to Japan and other Asia Pacific countries, President Bush rescheduled the visit as a trade mission complete with a delegation of American business executives, including auto industry executives. In the subsequent flurry of activity geared towards making the Bush visit a success, US officials demanded concrete sales results in the auto parts and vehicles sectors.²³³ Under duress, the Japanese government corralled the five major Japanese automakers into twice expanding their voluntary auto parts purchasing plans and extracted additional measures to assist Big Three vehicle sales in Japan.²³⁴

January 1992 saw the culmination of this scramble for results with a series of announcements orchestrated by MITI as part of an "Automotive Action Plan" (White House 1992).²³⁵ Japan's auto manufacturers announced plans to increase purchases of

²³¹ Farren, interview, 1996. Reflecting on the Big Three's commitment to the Japanese market, another Bush Administration official noted wryly that 'my personal experience with the Big Three was that they could barely find Japan on a map'. Not-for-attribution interview. See also Armacost (1996: 36).

²³² *International Trade Reporter*, 8(45), 13 November 1991, p. 1643. *Inside US Trade*, 8(47), 22 November 1991, p. 1.

²³³ 'Car issues said vital to Bush visit' by Akinori Uchida, *Daily Yomuri*, 24 December 1991, p. 1. 'US calls for "visible" results on trade issues', *Mainichi Daily News*, 26 December 1991. Not-for-attribution interviews with former Japanese officials.

²³⁴ 'PM urges automakers to help US car industry', *Mainichi Daily News*, 1 January 1992. 'Japan automakers willing to expand US auto imports', *Nikkei Top Articles*, 1 January 1992.

²³⁵ See also *JEI Report 2B*, 17 January 1992, *JEI Report 3B*, 24 January 1992.

US parts from \$9 billion in Japanese fiscal year (JFY) 1991 to \$19 billion by the end of JFY 1994. Of this total, \$15 billion was marked as procurement of US parts by Japanese affiliates in the United States. As in the semiconductor negotiations, capital-affiliation rather than production location became a critical element of US demands with the Automotive Action Plan stating that 'special consideration' would be given to American-owned suppliers in meeting the purchasing plans. Japanese producers also announced new investments in R&D operations in the United States as a signal of their commitment to future auto parts sales. The market access-VIE component of the action plan remained relatively less significant with US exports to Japan slated to rise from \$2 billion to \$4 billion in JFY 1994. In relation to vehicles, Japan's major manufacturers undertook to increase opportunities for Big Three models to be handled by their dealer networks in Japan and to set informal sales targets for foreign nameplates. The Japanese government rejected American demands for a specific sales commitment, but pledged to speed up resolution of outstanding standards and certification issues.

In the event, American and Japanese officials received little credit for the automotive measures despite the affirmative action plans announced during President Bush's Japan visit.²³⁶ With the House of Representatives again moving towards passing a protectionist omnibus trade bill (H.R. 5100), Bush Administration officials walked a fine line between asserting that the Japanese undertakings were voluntary plans rather than official commitments while at the same time holding out the prospect of more formal 'benchmarks' in future auto negotiations.²³⁷ Even so, the inevitable scrutiny attending the Japanese automakers' procurement plans and VIE implied that the new goals were voluntary in name only. As one Bush Administration trade official noted later, the company plans 'occurred in the important political context of a presidential visit, and the pledges were announced at the same time as the official communique' (Janow 1994: 66). And according to the official most directly involved in securing the January 1992 auto commitments, 'we knew the political reality would be that the Japanese would try to move heaven and earth to meet the goals'.²³⁸

²³⁶ '\$10 billion trade goal: But executives sceptical of import pledges' by Paul Blustein and Stuart Auerbach, *Washington Post*, 10 January 1992, p. A01. 'US Democrats decry summit, seek retaliation' by Hisashi Kitahara, *Daily Yomuri*, 11 January 1992, p. 1.

²³⁷ *International Trade Reporter*, 9(16), 15 April 1992, p. 685. Passed by the House on 8 July 1992, H.R. 5100 included a mandatory Section 301 investigation of unfair Japanese trade practices in autos and auto parts. A companion bill was introduced in the Senate (S. 3019), but received no action (Bass 1992).

²³⁸ Zoellick, interview, 1996.

Results for Motorola and Cray

The Reagan and Bush Administrations' efforts in Japan on behalf of telecommunications firm Motorola Inc. and supercomputer manufacturer Cray Research Inc. yielded very specific actions making room for particular American companies in sectors characterised by heavy Japanese government discretion. The cellular telephone and third-party radio negotiations highlighted the grey area between process and results-oriented policy where new technologies expose the limits of existing regulatory structures and where technical constraints (such as a radio wave spectrum) dictate close government oversight of limited market opportunities.²³⁹ The supercomputer case pointed to the greater political scope for results-oriented market access demands where the Japanese government had direct or indirect leverage over purchasing decisions. No overt numerical goals were established in these negotiations, but the multiple iterations implied progressive movement beyond process-oriented negotiations through the Reagan and Bush Administrations. A familiar pattern emerged whereby an initial American complaint was followed by a process-oriented agreement centred on general norms of transparency and non-discrimination. Unmet American expectations and continued allegations of Japanese government management of internal market outcomes usually resulted in a new cycle of negotiations, more explicit threats of retaliation, a more detailed market access agreement and ultimately more concerted pressure for concrete results.

The original MOSS telecommunications negotiations covered an extensive set of issues related to standards, testing and certification of telecommunications equipment and the terms of foreign entry for the provision of telecommunications services in Japan. Reagan Administration officials demanded significant policy harmonisation so that US companies could offer the same type of telecommunications products and services in Japan that Japanese companies offered in the United States (Prestowitz 1988: 297). Begun in June 1985, negotiations on radio system licensing and equipment approval constituted the second and most difficult phase of the MOSS negotiations (Mikanagi 1996: 67-9). The January 1986 telecommunications agreement secured broad agreement on liberalisation of foreign access to cellular telephone and third-party radio services in Japan with measures designed to make standard setting and allocation of frequency more

²³⁹ Third-party radio systems are mobile communications networks of the type used by taxis, towing and delivery services.

transparent and to reduce licensing and foreign ownership restrictions. American trade officials gave the agreement high marks, but made final judgement on market access conditional on MPT's implementation.²⁴⁰

Japan was an early mover into cellular telephony in 1979, but NTT (the former monopoly provider) was slow to encourage market growth and penetration rates lagged far behind other industrial countries well into the 1980s.²⁴¹ With reform of the world's second largest telecommunications market in prospect, Motorola, the largest American telecommunications equipment manufacturer, looked to establish a presence in a cellular phone market valued at \$400 million in 1986 and expected to grow by 40 to 50 per cent a year during the next five years (Tyson 1992: 68). Under the MOSS agreement, MPT appointed representatives from foreign firms (including Motorola) to the Telecommunications Deliberation Council, the new body charged with setting technical standards. In March 1986, the council recommended that any of three cellular phone standards, including Motorola's Total Access Communications System (TACS), could be adopted for cellular service in Japan.²⁴² MPT decided in turn that the Japanese market should be divided into geographic regions with a now privatised NTT allowed to operate a nation-wide cellular system based on its proprietary system with one additional service to be licensed in each region. Some observers have suggested that MPT actively sought to delay applications by foreign companies keen to enter the Japanese cellular market while it assembled alternative domestic consortia of companies (Prestowitz 1988: 299, Steven K. Vogel 1996: 163).

Japan's Daini Denden Corporation (DDI) proposed to establish a cellular system based on Motorola's TACS standard and cellular equipment. Nippon Idou Tsushin Corporation (IDO), a consortium with strong industry and government connections as a subsidiary of Teleway Japan Corporation, came forward with a rival offer based on the NTT standard.²⁴³ In January 1987, MPT announced the new license allocations after the two

²⁴⁰ *International Trade Reporter*, 3(3), 15 January 1986, p. 82.

²⁴¹ The following discussion draws on Tyson (1992: 66-75) and Johnson (1993: 37-41).

²⁴² TACS had been adopted as an international standard in a number of countries in contrast with NTT's proprietary system that was not used outside Japan (Johnson 1993: 37).

²⁴³ The Telway Japan consortium included such partners as Toyota Motor Corporation, Japan Highway Public Corporation and Tokyo Electric Power Company (Johnson 1993: 42-3).

potential entrants rejected an initial ministry proposal that they form a joint venture to avoid excess competition with NTT. NTT and IDO were licensed to compete in eastern Japan accounting for between 60 and 70 per cent of the Japanese market while the Motorola-DDI partnership was licensed to compete with NTT in the remainder of the country centred on the Kansai and Hokuriku regions (Johnson 1993: 44). Reagan Administration officials immediately complained about the exclusion of the Motorola-based service from the largest and most lucrative segment of the Japanese market, disputing MPT's claims about insufficient radio capacity and the dangers of excess competition.²⁴⁴ This renewed campaign resulted in the Motorola-DDI service being granted an expanded license for all of Japan except the Tokyo-Nagoya corridor. Motorola appeared grudgingly to accept the MPT decision, but in mid 1988 the cellular phone dispute was rekindled after MPT allocated new frequency bandwidth for a new mobile communications service (Convenience Radio Phone) in the Tokyo-Nagoya region. The American telecommunications firm again complained to the US government arguing that this action belied MPT's assertions about insufficient radio frequencies (Tyson 1992: 69).

Motorola's second grievance arising from the 1986 MOSS agreement was that MPT continued to discriminate against new entrants in third-party radio spectrum allocation and license approval. Mobile Radio Center (MRC), the former government-run monopoly affiliated with MPT, was the sole provider of such services in Japan until Motorola, in partnership with Shikoku Tsuhan, launched its Japan Shared Mobile Radio (JSMR) system in 1987.²⁴⁵ Again the commercial focus of the dispute was the lucrative Tokyo area where the Motorola-Shikoku Tsuhan joint venture sought to expand its market reach after an initially successful entry in regional Japanese markets.²⁴⁶ Motorola alleged that MPT restricted frequency allocation and managed competition in the Tokyo market to the advantage of MRC. Also subject to complaint was the practice whereby MRC could obtain radio licenses from MPT based on forecasts of future customers while the new foreign affiliated entrant was required to pre-sign customers prior to license approval (Tyson 1992: 72).

²⁴⁴ 'US getting bad connection to Japanese mobile phone market', *Japan Times*, 27 February 1987.

²⁴⁵ 'Motorola 1st foreign company to enter Japan wireless phone market', *Japan Economic Journal*, 12 September 1987, p. 13.

²⁴⁶ 'Nippon Motorola applies for Tokyo mobile radio service approval', *Japan Times*, 3 March 1988.

In both cases, Motorola alleged that the Japanese government applied bogus technical arguments to limit competition faced by powerful Japanese corporate interests. In early 1989, the company filed a formal complaint with the US government charging that MPT had violated the 1986 MOSS agreement by failing to grant US companies comparable access to Japan's markets for cellular phone services and third-party radio systems.²⁴⁷ The unfair trade petition was primed to take advantage of the 1988 Trade Act and a special reciprocity provision (Section 1377) that mandated that USTR conduct an annual review of telecommunications agreements. The crux of the complaint was the cellular phone issue, specifically the denial of radio frequency that would allow users of Motorola phones to "roam" in the Tokyo area. Motorola had recently released a new extra compact phone (MicroTac), but the incompatibility of DDI's Motorola system with the NTT standard required the incorporation of bulky roaming requirements that posed a particular handicap in the cellular phone market.²⁴⁸ In April 1989, US Trade Representative Carla Hills announced that the United States would retaliate against Japan for violating commitments under the 1986 MOSS telecommunications agreements unless Japan acted immediately to remedy the alleged discriminatory practices.²⁴⁹ A deadline of 10 July 1989 was set before the customary Section 301 remedy of 100 per cent tariff retaliation would come into effect on a range of Japanese product lines. Japanese officials denied any agreement violation arguing that the dispute reflected new demands by Motorola unrelated to the original MOSS agreement. They maintained that no additional frequencies were available for cellular phones in the Tokyo-Nagoya region and also that the complaint would be immaterial within two years when digital cellular technology superseded Motorola's analog system.²⁵⁰

A new telecommunications agreement was signed on 28 June 1989 after several rounds of negotiations between US trade officials and their Japanese counterparts led by Ichiro Ozawa, an influential member of the ruling LDP.²⁵¹ The agreement included very

²⁴⁷ *Inside US Trade*, 8(23), 31 March 1989, p. 4. The company estimated that alleged Japanese barriers in these markets would cost it more than \$2 billion in lost sales over ten years.

²⁴⁸ 'Time's a wasting for Motorola telecom entry' by Hisao Takagi, *Japan Economic Journal*, 1 July 1989, p. 28.

²⁴⁹ 'Administration orders trade sanctions against Japan' by Stuart Auerbach, *Washington Post*, 29 April 1989, p. D11. Under Section 1377, a determination of non-compliance was equivalent to a final, affirmative finding of a trade agreement violation under Section 301.

²⁵⁰ *International Trade Reporter*, 6(20), 17 May 1989, p. 615. American officials were sceptical of claims about technical spectrum limits because of similar MPT arguments in the lead-up to the 1986 agreement.

²⁵¹ 'Hills announces telecommunications agreement', Office of the US Trade Representative, 28 June 1989.

specific Japanese undertakings reallocating a one-fifth of IDO's radio spectrum in the Tokyo region to accommodate users of Motorola's cellular system and providing for increased spectrum allocation if this proved insufficient to satisfy future demand. The third-party radio provisions reflected even stronger results-oriented characteristics. As well as streamlining licensing procedures, the agreement set out specific quantitative guidelines for future sequencing of Japanese and foreign access to radio licenses. Former Deputy USTR and chief negotiator of the agreement, Linn Williams, describes the US government's intent to ensure the negotiations secured commercial room for Motorola products in the Japanese market: 'I went back twice to Ozawa on a little war path on telecoms. And the message was: "You guys have messed this up; we have to fix it or we're going to come with sanctions". And we could deliver sanctions. And they came around. So we wanted results'.²⁵²

The 1989 agreement designated IDO (rather than DDI) as the operating company for Motorola's TACS standard in the Tokyo-Nagoya region with an initial infrastructure investment for the new service estimated at nearly 10 billion yen (almost \$70 million).²⁵³ In 1990, Motorola was awarded the relevant IDO contract to supply relay stations and exchange systems for the first instalment of a new TACS service in Tokyo from 1 October 1991.²⁵⁴ The Clinton Administration would later revisit cellular phone market access complaining of delays in IDO's infrastructure program, but the 1989 agreement had nevertheless given the US firm a demonstrably "managed" foothold in the Japanese market. Meanwhile, American commercial interests would herald the new arrangements for third-party radio access as an unqualified results-oriented success (ACCJ 1997: 29). Under quantitative guidelines in place until new bandwidth was made available in November 1990, MPT allocated new licences in Tokyo on a one-for-one basis between Motorola's JSRM system and the MRC system. By August 1991, US officials could claim that American firms (i.e. Motorola) held more than half of the Japanese market in third-party radios.²⁵⁵ Within a relatively short period of time, the Bush Administration

²⁵² Williams, interview, 1996. At the agreement's signing ceremony, Williams' Japanese counterpart Ichiro Ozawa remarked: 'This morning I have back pains and even walking is difficult to me, which shows how strongly I was whipped by the US side'. 'Japan agrees to open cellular phone, radio markets' by Stuart Auerbach, *Washington Post*, 29 June 1989, p. E01.

²⁵³ 'Telecom agreement leaves Japan uneasy', *Japan Economic Journal*, 8 July 1989, p. 1.

²⁵⁴ 'US-Japan trade friction pays off for Motorola' by Yasushi Takano, *Japan Economic Journal*, 17 February 1990, p. 14.

²⁵⁵ US Congress, Senate Committee on Finance (1991: 7).

could point to tangible market access improvement under a telecommunications sectoral policy that tended more towards market sharing than arms-length market competition. Or as one prominent supporter of a results-oriented Japan policy concluded about the 1989 telecommunications agreement, 'on a continuum between trade management through better rules and managed trade through quantitative targets, these negotiations were clearly closer to the latter' (Tyson 1992: 74).

Cases where the Japanese government had either a direct or indirect role as purchasing agent represented the line of least resistance for a selective, results-oriented US sectoral policy through the second Reagan and Bush Administrations. There is no simple metric to identify policy change over time or across industries, but such cases as Japanese procurement of supercomputers and satellites (two of the three Super 301 cases against Japan in 1989) and US efforts from 1986 to open the Japanese public sector construction market have been identified with movement away from process-oriented demands (Brainard 1995: 338).²⁵⁶ While bilateral agreements remained consistent with norms of transparency and non-discrimination, the market access barometer of concrete results (sales or contracts to US firms) can be seen as part of the logic in deciding sectors to target based on scope for Japanese official "guidance".

The negotiations over Japanese public sector purchases of supercomputers illustrated the particular procurement dimension and the purposefulness of US market access policy where American high-technology supremacy was seen as at stake.²⁵⁷ Allegations of Japanese government targeting were at the core of the market access complaint from American corporate interests keen to preserve international market dominance.²⁵⁸ As in other high-technology disputes, it was equally possible to point to the important role the US government had played in supporting the American supercomputer industry through military procurement and R&D funding.²⁵⁹ Two American firms (Cray Research Inc. and

²⁵⁶ Brainard, a staff member of the CEA in the Bush Administration, nominates Reagan/Bush agreements on auto parts, cellular phones, supercomputers, construction and wood products as having results-oriented aspects.

²⁵⁷ Supercomputers are commonly identified based on their mathematical processing capacity and multi-million dollar cost. Examples of their application are found in such areas as weather forecasting, aerospace design and automobile crash analysis.

²⁵⁸ For more detailed discussion of public policy issues raised by the supercomputer dispute, see Office of Technology Assessment (1991), Tyson (1992) and Bayard and Elliott (1994).

²⁵⁹ Critics of Japanese procurement policies nonetheless concede that 'defense-based industrial policy has played an essential nurturing role in the supercomputer industry' (Tyson 1992: 82).

Control Data Corporation) first marketed supercomputers in the mid 1970s and their multi-million dollar cost ensured public sector applications remained a major source of demand. Access to the potentially large Japanese procurement market first attracted the attention of the US government in the early 1980s when Japanese industrial policy became a high-profile bilateral issue.²⁶⁰ That the Japanese government began an aggressive program of acquisitions only when the first Japanese-made supercomputers became available in 1983 fuelled American suspicions about the intent of targeting policies (Prestowitz 1988: 135-136). As the acknowledged industry leader, Cray Research assumed the role as the central US complainant arguing that its superior performance machines were being discriminated against by the Japanese government given Cray held sizeable shares of US and European markets and had successfully penetrated the private sector market in Japan.²⁶¹

Between 1983 and 1986, Cray sold three of the 22 supercomputers installed by Japanese public agencies.²⁶² American claims of Japanese targeting echoed themes well established since the NTT procurement negotiations — closed bidding procedures due to the absence of public notices by Japanese public agencies of their intention to buy supercomputers, a lack of clear performance criteria in tender documents and an unstated Buy Japan bias. Again the Japan market access issue was entangled with the strategic threat which new Japanese supercomputer makers (Fujitsu, Hitachi, and NEC) posed to the market dominance of US firms in the American market. One aspect of Cray's market access complaint concerned aggressive discounting of up to 80 per cent on Japanese public procurement bids by the large Japanese electronics groups. The American supercomputer manufacturer linked this to artificially low procurement budgets set by Japanese agencies, but it also signalled concern about Japanese capacity to penetrate the US market. Indeed, it was the prospect of NEC moving aggressively into the US market that was an important catalyst for increased sectoral conflict after 1985-86.²⁶³

²⁶⁰ The VLSI cooperative research programs of MITI and NTT are credited by some analysts as critical to Japan's entry into supercomputers in the 1980s (Office of Technology Assessment 1991).

²⁶¹ The fact that only US and Japanese firms produced supercomputers contributed to the narrow commercial focus of the supercomputer dispute. The US government's identification with Cray's interests was even more pronounced from 1989 after Control Data Corporation's supercomputer subsidiary (ETA Systems) was forced to close (Bayard and Elliott 1994: 103).

²⁶² *JEI* Report 46B, 19 December 1986.

²⁶³ 'Accord will let Honeywell sell NEC supercomputers', *Japan Economic Journal*, 12 July 1986, p. 12.

In December 1986, USTR launched a Section 305 investigation of Japan's supercomputer trade practices that led to bilateral market access talks under the MOSS electronics framework.²⁶⁴ Bilateral friction quickly escalated following initial talks in January 1987 in which MITI Vice Minister Makoto Kuroda allegedly told US negotiators that the United States could not expect to sell supercomputers to Japanese government agencies and that if Cray was to survive it might have to be nationalised.²⁶⁵ Intensified negotiations under threat of a Section 301 action led to a bilateral agreement in August 1987 as well as emergency funding by the Japanese government for two supercomputer purchases.²⁶⁶ This process-oriented agreement was geared towards non-discrimination and transparency with the goal of bringing Japanese supercomputer procurement practices in line with the GATT Government Procurement Code. It included provisions for advance notice of purchasing decisions, greater reliance on performance specifications, longer time periods in which companies could prepare bids, and procedures for monitoring and registering complaints. At the time, USTR Clayton Yeutter noted that 'the proof of the pudding will come in sales' given that 'there have been many market-opening announcements by the government of Japan that have not been meaningful'.²⁶⁷

The Japanese government's emergency budget provisions saw two purchases of American machines announced in October 1987.²⁶⁸ Yet the lack of further public sector sales under the 1987 agreement led US industry and government officials to view it as a failure. By 1989, US machines accounted for five of 51 public sector supercomputers installed in Japan and three of these (including the two announced in October 1987) were

²⁶⁴ *International Trade Reporter*, 3(50) 17 December 1986, p. 1520.

²⁶⁵ The exchange reported in a leaked State Department cable from Tokyo became one of the periodic rallying points for hardliners seeking more aggressive trade action against Japan. See 'Remark fires US campaign to retaliate against Japan' by Stuart Auerbach, *Washington Post*, 26 March 1987, p. A1. Kuroda later denied the widely publicised interpretation of his remarks. Kuroda, interview, 1997.

²⁶⁶ 'Japan to ease way for US computers' by Todd J. Gillman, *Washington Post*, 8 August 1987, p. C01. Through the course of the 1986-87 negotiations, NTT announced two orders for Cray supercomputers, but neither was counted as public procurement by the US government as both were resold to the Recruit Corporation (Bayard and Elliott 1994: 108).

²⁶⁷ *International Trade Reporter*, 4(32), 12 August 1987, p. 1008. Cray's complaints about Japanese discounting practices were not dealt with in the 1987 agreement in part because US agencies could not agree on their legitimacy. And as Bayard and Elliott (1994: 107) point out, discounts were well-established in the United States based on commercial considerations such as improving the possibility of future sales and the existence of software design externalities.

²⁶⁸ A Cray computer was sold to MITI's Agency of Industrial Science and Technology while the Tokyo Institute of Technology purchased an ETA machine. 'US makers seek supercomputer buyers' by Takayuki Kamada, *Japan Economic Journal*, 9 July 1988, p. 1.

considered 'managed' by the Japanese government to defuse trade tensions (Tyson 1992: 78). Cray representatives maintained that the vague language of the 1987 pact meant US firms were still disadvantaged by such practices as reliance on "theoretical" peak performance evaluations and the tailoring of specifications to disqualify or discourage foreign vendors from making bids.²⁶⁹ They further criticised the 1987 agreement for doing nothing to rectify low procurement budgets and large discounting by the Japanese computer manufacturers.

As evidence of informal barriers, Cray cited the sort of circumstantial evidence that the semiconductor industry had used to good effect. Low sales in the Japanese procurement market up to 1989 were contrasted with shares of over 21 per cent of installed machines in the Japanese private sector, 84 per cent of the total European market and 81 per cent of the North American market.²⁷⁰ Former USTR official Glen Fukushima notes that frustration with the process-oriented 1987 supercomputer agreement led to renewed market access demands by the Bush Administration. He recalls how:

Those of us at the working level were saying that the August 1987 supercomputer agreement was a failure in that it was a procedurally-oriented agreement that had no indication whatsoever of progress or results. John Rollwagen, then Chairman of Cray Research, said his company was worse off after the agreement than before the agreement.

Before the agreement, Cray wouldn't know when certain government entities were buying supercomputers. But as a result of the 1987 procurement agreement the Japanese government was obligated to publish in the government gazette when Japanese government agencies were going to buy supercomputers. That meant that Cray would know when purchases were going to be made and therefore expended the time, effort and money to translate documents and go to information sessions; and yet end up with zero procurements. ... It was as a consequence of that that the Super 301 case on supercomputers was initiated in the summer of 1989.²⁷¹

The Bush Administration took up the complaint and in May 1989 USTR Carla Hills named Japanese supercomputer procurement as one of three targets for Super 301 action. The fact that supercomputer purchases fell directly under the purview of the Japanese government was an important factor behind the action in conjunction with the strong support which the case received across the executive, Congress and industry

²⁶⁹ US Congress, Senate Committee on Finance (1990).

²⁷⁰ US Congress, Senate Committee on Finance (1990).

²⁷¹ Glen Fukushima, interview with author, 16 May 1996, Tokyo.

(Mastanduno 1992a).²⁷² The closure of ETA Systems, Control Data's supercomputer subsidiary and Cray's only American-owned competitor, only heightened American concern about the potential loss of technological leadership to Japan in an important industry.²⁷³ During the 1989-90 negotiations, the Japanese government again took a series of actions which supporters of the US industry would cast as 'leaning on Japanese companies and public agencies to make room for foreign suppliers' (Tyson 1992: 80). The outline of a new supercomputer procurement pact was announced in March 1990.²⁷⁴

Finalised in May, the degree of detail in the agreement set a new standard for future US-Japan procurement negotiations.²⁷⁵ On the issue of performance standards, Japanese government entities were required to draw up their specifications in terms of 'actual minimum needs' based on 'minimally acceptable benchmark results that demonstrated the operational performance of the supercomputers'. The agreement also tackled the more controversial US industry demands about heavy discounting by encouraging budget allocations and contract bids to be based on market prices and urging stronger enforcement of Japan's Anti-Monopoly law. In addition, extensive procedures were agreed for a more formal Procurement Review Board mechanism to hear complaints about procurement decisions. Bush Administration negotiators stopped short of explicit sales goals. But echoing former USTR Yeutter's remarks in 1987, one US official noted more obliquely that 'the real test will be when the cash register rings'.²⁷⁶ According to one senior Bush Administration trade official, a more outcome-oriented follow-up process buttressed the process-oriented formal agreement.

In many ways the supercomputer negotiations we did were rule changes but with a political understanding — never articulated in the way the 20 per cent in semiconductors was — that they would start buying supercomputers which they did. We set that up as a measuring device. We'd go back to revisit these understandings. And in supercomputers

²⁷² Congress had inserted Section 1307 in the 1988 Trade Act expressing concern about alleged Japanese targeting of supercomputers and about lack of adherence to the 1987 agreement. Industry support for a Super 301 designation came from Cray, IBM and the AEA (Mastanduno 1992a: 744).

²⁷³ 'Can US protect lead in supercomputers? Control Data's pullout, Japan's aggressiveness raise stakes' by John Burgess and Evelyn Richards, *Washington Post*, 7 May 1989, p. H01.

²⁷⁴ 'US, Japan reach supercomputer agreement' by Stuart Auerbach, *Washington Post*, 24 March 1990, p. D12.

²⁷⁵ 'Procedures to introduce supercomputers', attachment to letter from USTR Carla Hills to His Excellency Ryohei Murata Ambassador of Japan, Office of the US Trade Representative, 15 June 1990.

²⁷⁶ *International Trade Reporter*, 7(13), 28 March 1990, p. 427.

really it was not the rule changes; when we'd go back to talk to them it was: "How many have you bought? how many are our firms?"²⁷⁷

Former MITI official Makoto Kuroda has identified the results-oriented dimension of the supercomputer case as part of the broader class of procurement negotiations. He maintains that there was 'some impression that in a government procurement type [of issue] a target could easily be converted into a commitment because the government buys. And I think MITI may have worked in favour of Cray in certain circumstances'.²⁷⁸ In the first two years of the 1990 agreement's operation, Cray won three of the 11 recorded supercomputer contracts awarded by Japanese government institutions.²⁷⁹ Dispute surrounds the exact dimensions and interpretation of any Japanese government guidance in these cases. Ironically, actions portrayed from a Japanese perspective as favouring Cray have been interpreted by analysts sympathetic to American commercial interests as 'orchestrated sales [which] ... simply confirm Cray's contention that public procurement decisions in Japan were not the outcome of market competition' (Tyson 1992: 80). And even to the extent that the Reagan and Bush Administrations established results as an implicit 'measuring device', this failed to prevent the reemergence of supercomputer market access complaints. In July 1992, Cray initiated the first test of the 1990 agreement's review mechanism complaining that inadequate information and slanted specifications had seen a contract awarded unfairly to NEC.²⁸⁰ Echoing the familiar grievance of unmet American expectations, Cray Chairman John Rollwagen maintained at the time that 'the agreement is fine, it's just not being followed'.²⁸¹

Renewing the semiconductor agreement and securing 20 per cent

The Reagan Administration's March 1987 decision to impose \$300 million in punitive sanctions against Japanese exports was a dramatic response to the alleged violation of the 1986 semiconductor agreement's market access and third-country dumping provisions. Dumping charges subsided through 1987 as Japanese chip producers were forced to conform to MITI's comprehensive export and production control regime, but a recovery in global semiconductor demand also opened up new tensions in semiconductor trade

²⁷⁷ Williams, interview, 1996.

²⁷⁸ Kuroda, interview, 1997.

²⁷⁹ *JEI Report* 17B, 7 May 1992, p. 9.

²⁸⁰ 'Cray cries foul over lost contract' by Edmund Klamann, *The Nikkei Weekly*, 25 July 1992, p. 8.

²⁸¹ 'Cray chief protests', *Japan Times*, 10 October 1992.

politics. Within weeks of the US government's retaliation coming into effect, major American computer manufacturers were complaining not only of high prices but also of serious shortages of Japanese DRAMs.²⁸² With rising chip prices worldwide, the Reagan Administration removed the last of the third-country dumping sanctions in November 1987.²⁸³ At the time, both the American and Japanese governments also publicly disavowed production and investment controls on the Japanese industry.²⁸⁴ An electronics industry boom in 1988 resulted in substantial price increases for the first time in the history of the semiconductor industry and unprecedented differentials between DRAM prices in Japan and in other markets (Flamm 1996: 201-216). This drove a much deeper wedge into domestic industry politics in the United States as semiconductor users opposed to the hardline approach of the SIA organised against the supply-side impact of the semiconductor agreement.²⁸⁵

Not surprisingly, the 20 per cent foreign market access 'expectation' remained a constant source of dispute between the United States and Japan after September 1986. Japanese officials and chip producers rejected outright the US position embodied in the sanctions decision that the figure amounted to a government commitment and that a 'gradual and steady' improvement required something akin to a linear increase in market share. Dispute also surrounded how to measure foreign market access in Japan with the US government-favoured statistic consistently lower than the MITI-endorsed figure.²⁸⁶ The former indicated a rise in foreign share from 8.6 per cent at the time the agreement was signed to just over nine per cent by the second half of 1987 following a jump in purchases by the large vertically-integrated Japanese electronics firms targeted by tariff

²⁸² *Inside US Trade*, 5(22), 29 May 1987, p. 12.

²⁸³ *International Trade Reporter*, 4(44), 11 November 1987, p. 1382.

²⁸⁴ However, Flamm (1996: 272) concludes from Japanese press reports that investment "guidance" continued through at least early 1988 and hence probably affected supply through 1989.

²⁸⁵ An analysis of the economic impact of the original semiconductor agreement's production and price control system is beyond the scope of this study. Other research has identified the windfall profits Japanese firms received under the arrangement as well as evidence that the agreement facilitated, at least for a time, a *de facto* cartel among Japanese DRAM producers after MITI production and investment guidance was halted. The main US beneficiaries of the pact were the remaining DRAM producers — Texas Instruments, Micron Technology and Motorola. The major losers were global semiconductor users, especially computer manufacturers dependent on DRAMs. For more detailed analyses of these aspects of the semiconductor agreement, see Flamm (1996), Irwin (1996) and Dohman (1993).

²⁸⁶ One reason was that the MITI calculation included captive shipments by IBM Japan to its Japanese subsidiaries (Flamm 1996: 280).

retaliation.²⁸⁷ But with Japanese imports still short of American expectations, \$165 million in market access sanctions were kept in place when the dumping-related tariffs were lifted in November 1987.²⁸⁸ One provision of the 1986 agreement was fulfilled in 1987 with the establishment by MITI of the International Semiconductor Cooperation Center (INSEC) to promote purchases of foreign chips in Japan, but its initial aspirations were modest.²⁸⁹

The Reagan Administration's strategy for reaching the 20 per cent market share objective was based on two assumptions. The first was the need to target Japanese chips users beyond the major electronics groups. The second was that foreign chips would need to be "designed-in" at an early stage of product development in a number of product lines. A US government proposal in January 1988 sought to enlist MITI leverage in extracting firm-specific import plans, including 'expected' levels of foreign purchases. This was aimed at a wide group of users including small and medium-sized firms in the automotive and consumer electronics industries where customised devices were widely used.²⁹⁰ Early 1988 also saw the first signs of joint industry initiatives between the SIA and the EIAJ designed to promote imports.²⁹¹ While both industry groups remained far apart on the issue of a market share target, in June the EIAJ moved to establish a Users Committee of Foreign Semiconductors (UCOM) comprising 56 companies and accounting for roughly three-quarters of all semiconductor purchases in Japan.²⁹² By the end of the year, this expanded group of Japanese users was targeted for regular visits by MITI officials acting as 'salesmen for foreign companies'.²⁹³

The US government's pressure for design-in arrangements reflected the structural differences in semiconductor demand and production in the two economies. Reduced American capacity in DRAM production was one factor highlighting the difficulties Japanese producers faced in switching easily to foreign products. American producers were estimated as capable of supplying only around six per cent of the semiconductor

²⁸⁷ 'IC makers move to ease dispute', *Japan Times*, 6 August 1987.

²⁸⁸ 'US remains unhappy with chip share', *Japan Economic Journal*, 14 November 1987, p. 11.

²⁸⁹ 'Sales of foreign semiconductors to be promoted', *Nikkei News Bulletin*, 3 March 1987. 'INSEC to issue foreign semiconductor catalogue', *Nikkei News Bulletin*, 7 December 1987.

²⁹⁰ *Inside US Trade*, 6(4), 29 January 1988, p. 1.

²⁹¹ 'Japan, US groups to promote chip access', *Japan Economic Journal*, 9 April 1988, p. 18.

²⁹² 'Coming to terms on semiconductors', *Japan Times*, 7 June 1988.

²⁹³ *Inside US Trade*, 6(46), 18 November 1988, p. 17.

devices purchased by Japan's consumer electronics sector which represented over one-third of total Japanese semiconductor sales (Dohlman 1993: 88). As one US trade official noted later, 'it was the "design-ins" that made the difference because the semiconductor mismatch was awful'.²⁹⁴

The foreign share of the Japanese semiconductor market remained below 11 per cent through 1988. The Reagan Administration kept market access sanctions in place despite Japanese government efforts, supported by free traders in the Council of Economic Advisers and the State Department, to have them lifted before President Reagan left office.²⁹⁵ For its part, the SIA was anxious to keep alive the prospect of increased retaliation if sales failed to improve substantially, but American chip users continued to oppose further retaliation. In the 1988 election campaign, Vice President George Bush supported the existing market access sanctions, but stopped short of endorsing stronger actions to pursue the market share goal.²⁹⁶ Meanwhile, the Japanese government continued to proclaim its efforts to boost foreign sales while simultaneously drawing attention to US firms' shortcomings in quality and commitment to the Japanese market. With the formerly secret 20 per cent figure in the public domain, the official Japanese position nonetheless remained that the semiconductor agreement 'does not guarantee any specific share or share increase, and it is clear that no one can make a commitment on a market share under free competition in a free economy'.²⁹⁷

The mandates of the 1988 Trade Act provided an early test of the Bush Administration's approach on semiconductors. The SIA and its supporters in Congress urged USTR Carla Hills to identify Japanese non-compliance with a 'gradual and steady' increase in market access as a 'priority' practice under the Super 301 provision.²⁹⁸ But the Bush Administration rejected a hardline stance given opposition from major US chip users and their concern that a Super 301 designation might only provide Japan with justification to abandon or reconsider the 1986 agreement (Mastanduno 1992a: 738). American trade

²⁹⁴ Not-for-attribution interview.

²⁹⁵ *Inside US Trade*, 6(35), 2 September 1988, p. 12.

²⁹⁶ *Inside US Trade*, 6(38), 23 September 1988, p. 3.

²⁹⁷ 'Hidden deal with US draws criticism' by Satoshi Takeuchi, *Japan Economic Journal*, p. 2. *Inside US Trade*, 6(46), 18 November 1988, p. 17.

²⁹⁸ *International Trade Reporter*, 6(10), 8 March 1989, p. 290.

officials continued the path of cajoling the Japanese government and semiconductor users in Japan to announce more specific purchasing plans while supporting the private sector measures coordinated by the peak trade associations. Through 1989 an array of officially-endorsed taskforces, seminars and trade missions targeted the full range of Japanese chip users. American officials prevailed upon MITI to secure Market Access Plans (MAPs) from over 50 Japanese companies to be updated and forwarded to the US government semi-annually.²⁹⁹ The MAPs included explicit preferences for foreign products and company-wide sales targets (SIA 1990: 18). In December 1989, the EIAJ released a new program aimed at boosting foreign sales in the final 18 months of the semiconductor arrangement, especially from smaller US chip suppliers. Japanese firms undertook to release more detailed commercial information on semiconductor requirements, to schedule special purchasing missions to the United States and to further encourage alliances in manufacturing, technology and distribution.³⁰⁰

The open conflict between the SIA and the major US computer manufacturers underpinned the Bush Administration's reluctance to escalate the semiconductor dispute. In June 1989, IBM, Hewlett-Packard and Tandem launched the Computer Systems Policy Project (CSPP) designed to ensure their interests found greater voice in US-Japan semiconductor trade.³⁰¹ While complaining that measured foreign access failed to exceed 13 per cent of the Japanese market, the SIA again failed in its attempt to have Japan cited under Super 301 in 1990.³⁰² But with the semiconductor agreement approaching its end-July 1991 deadline well short of the 20 per cent foreign share figure, the trade pragmatists in the Bush Administration developed a stronger interest in seeing US chip producers and users reach an accommodation. In October 1990, the SIA and the CSPP agreed on terms to promote a second semiconductor pact critically shaping the US government's next move in the semiconductor dispute.³⁰³ The deal saw US chip producers exchange weaker dumping provisions for a unified position with computer manufacturers supporting the market access provision of the original agreement. The two trade associations called for a new five-year agreement in which the 20 per cent foreign

²⁹⁹ *Inside US Trade*, 7(35), 1 September 1989, p. 1.

³⁰⁰ *Inside US Trade*, 7(50), 15 December 1989, p. 7.

³⁰¹ *Inside US Trade*, 7(24), 16 June 1989, p. 3.

³⁰² 'Japan ready to say "no" to US chip accord renewal' by Tsuyoshi Sunohara, *Japan Economic Journal*, 31 March 1990, p. 1.

³⁰³ See Computer Systems Policy Project and Semiconductor Industry Association, 'Semiconductor and Computer Industry Executives Release Joint Trade Policy Recommendations', 4 October 1990.

share objective would be recognised explicitly, but with the deadline on Japanese compliance extended to the end of 1992.³⁰⁴

The pragmatists in the Bush Administration had to shepherd the renegotiation of the semiconductor agreement past a significant free trade-oriented wing of the administration with a decidedly negative view of market share arrangements. A number of senior officials including CEA Chairman Michael Boskin, OMB Director Richard Darman, White House chief-of-staff John Sununu and Housing and Urban Development Secretary Jack Kemp carried reputations as unvarnished free traders strongly opposed to interventionist trade and industrial policies (Fratantuono 1993). As the administration's senior trade official, USTR Carla Hills' public position was that the agreement was 'on the books' and hence she would 'seek to enforce it.'³⁰⁵ But unlike her predecessor Clayton Yeutter, Hills (an anti-trust lawyer) held little enthusiasm for the results-oriented market share target. Still, her reservations were outweighed by the imperatives of retaining industry support and negotiating credibility. She stated later that:

The industry, and hence their elected representatives, felt very keenly that that number was significant. And I said: "Look, I think you're going down the wrong road for three reasons. I don't like numerical targets, but particularly with Japan. One, it is going to cause MITI to be more involved because they'll have to monitor. In my opinion we want to get MITI out of the picture and get industry in. Second, if ever there was a country which did not need encouragement to cartelisation it is Japan. Once you say you have to share this percentage opening you get yourself backed into a non-defensible economic position. And third, it sells us short". I asked: "Why in the world are you people willing to settle for 20 per cent when you have a 56 per cent market share in head-to-head competition in Europe?" But they wanted the 20 per cent so in negotiating the agreement we put the 20 per cent in, but with the words that this 20 per cent is neither a floor nor a ceiling nor a guaranteed share, which was not in the other agreement. ... Anyway, I recoiled from it, but politically I put it in with that proviso.³⁰⁶

The lead negotiator of the 1991 agreement offers a further view of the prevailing argument leading up to the Bush Administration's decision to maintain the market share target at the centre of a new agreement. According to Deputy USTR Linn Williams, 'There was strong sentiment for letting it die in the American government. I would guess

³⁰⁴ The importance of the truce between the SIA and the computer manufacturers is highlighted by Linn Williams, the lead negotiator of the second semiconductor agreement. 'The SIA wanted us to use 301. And we said: "No, you already have the agreement". ... They said: "What do you think about it?" I said I like it, but if it is you guys versus the computer people you're dead. So Alan Wolff and the semiconductor people made their peace with the computer people'. Williams, interview, 1996.

³⁰⁵ *Inside US Trade*, 7(42), 20 October 1989, p. 1.

³⁰⁶ Carla Hills, interview with author, 30 August 1996, Washington DC.

half — sub-cabinet and cabinet — didn't want it. Carla Hills didn't want it; Boskin, Kemp, a lot of opposition. But institutionally we took the view that there was a role for the government encouraging market forces and that was particularly important in Japan. ... And I would not underestimate the appeal of "a deal is a deal" within the administration. Frankly, I think that was the biggest appeal to President Bush'.³⁰⁷

The US proposal for a new semiconductor accord was presented to Japanese officials in January 1991.³⁰⁸ It basically mirrored the deal struck between US producer and user groups the previous year — a watering down of the original agreement's dumping provisions along with an explicit recognition of the 20 per cent market access goal, but with the deadline extended to the end of 1992.³⁰⁹ The Japanese government, after initially opposing any new agreement, eventually agreed to a second semiconductor pact in June 1991 on the condition that the 20 per cent figure not be cast as a guaranteed share and that the remaining sanctions against Japanese exports be lifted.³¹⁰ The main text of the agreement included the statement that 'the Government of Japan recognizes that the US semiconductor industry expects that the foreign market share will grow to more than 20 per cent of the Japanese market by the end of 1992 and considers that this can be realized. The Government of Japan welcomes the realization of this expectation. The two governments agree that the above statements constitute neither a guarantee, a ceiling nor a floor on the foreign market share' (Flamm 1996: 281). Japanese officials had attempted to elevate other market access indicators (such as the number of design-in relationships) to equal status with the 20 per cent figure, but US officials successfully secured language that identified market share as the key indicator of progress.³¹¹ The agreement again called for 'gradual and steady' improvement in access over the five-year life of the agreement, but no market share target was set for the post-1992 period.

³⁰⁷ Williams, interview, 1996. *A Deal is a Deal* was the title of a major SIA (1990) report setting out the case for a new semiconductor agreement.

³⁰⁸ *Inside US Trade*, 9(2), 11 January 1991, p. 1.

³⁰⁹ In a related development, at the beginning of 1991 US officials initiated bilateral talks on Japanese government procurement practices in the computer industry. *Inside US Trade*, 9(5), 1 February, p. 14.

³¹⁰ *International Trade Reporter*, 8(23), 5 June 1991, p. 845. The 1991 agreement replaced the Commerce Department-administered floor prices with a fast-track anti-dumping procedure based on expedited delivery of data collected by Japanese companies.

³¹¹ Sect. II, para. 7 of the agreement stated that: 'In making an overall assessment of progress achieved under the Arrangement, particular attention should be given to market share. The two Governments should also take into specific consideration other important quantitative and qualitative factors, including the development of foreign semiconductor design-ins and other long-term relationships between Japanese semiconductor purchasers and suppliers, and foreign capital-affiliated semiconductor suppliers'.

President Bush's January 1992 visit to Japan saw renewed US government pressure to secure the 20 per cent goal. MITI announced an expansion from 60 to 226 in the number of companies targeted to buy more foreign semiconductors while US trade officials directed a new campaign at loosening ties between Japan's electronics manufacturers and their affiliates.³¹² By March 1992, the SIA pronounced the 1991 agreement 'on the verge of failure' with foreign market share measured at 14.4 per cent in the last quarter of 1991.³¹³ And despite an emergency purchasing program announced by the EIAJ, USTR Hills foreshadowed in August 1992 the likelihood of new sanctions 'if substantial improvement is not achieved'.³¹⁴

The fruits of the Reagan-Bush results-oriented policy on semiconductors only materialised in early 1993 after the Republican Party's defeat at the November 1992 election (Figure 6.3). Contrary to expectations, foreign market share in Japan jumped from below 16 per cent to 20.2 per cent in the final quarter of 1992, the deadline under the 1991 agreement.³¹⁵ The 4.3 percentage point increase from the third quarter of 1992 was three times the next largest single period rise in market share. After years of wrangling over semiconductors and increasing calls for a results-oriented Japan policy, hardliners and pragmatists could proclaim an identifiably successful agreement.

It is impossible to identify precisely the respective roles of government action and commercial forces in securing the increased foreign market share in Japan by the end of the Bush Administration. Observers who emphasised the role of market forces pointed to both the large depreciation of the US dollar vis-à-vis the yen after 1985 and the competitive strength of US producers in microprocessors and other semiconductor devices as the key determinants of increased Japanese imports.³¹⁶ But there is strong evidence to suggest that overt government pressure played more than a marginal role in

³¹² *Inside US Trade*, 10(4), 24 January 1992, p. 8.

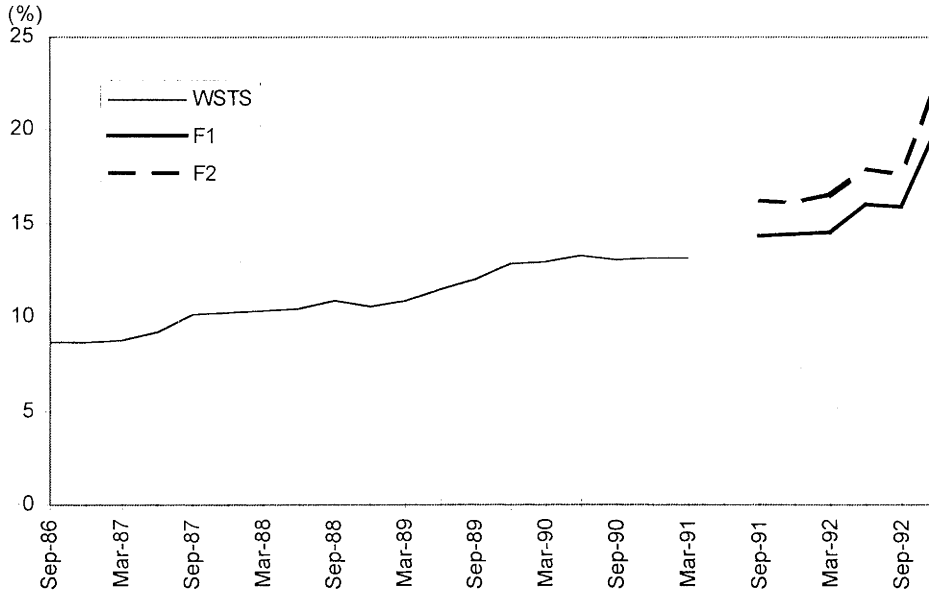
³¹³ *JEI Report* 11B, 20 March 1992, p. 9. The 14.4 per cent figure was based on the new US-favoured market access formula (F1) calculated following the 1991 agreement.

³¹⁴ *Inside US Trade*, 10(32), 7 August 1992, p. 5.

³¹⁵ *International Trade Reporter*, 10(12), 24 March 1993, p. 487.

³¹⁶ 'Yen appreciation does reduce Japan's surplus' by William R. Cline, *Wall Street Journal*, 20 May 1993, p. A16.

Figure 6.3 Foreign Share of Japanese Semiconductor Market



Sources: SIA (1990), *Inside US Trade* (various issues), *JEI Report No. 11B*, 26 March 1993 p. 5.

Note: The World Semiconductor Trade Statistics (WSTS) market share figure was the indicator favoured by the US government and semiconductor industry during the life of the 1986 semiconductor agreement. The 1991 agreement led to the establishment of two official indicators of market access. Formula 1 (F1) favoured by the US government identified foreign semiconductors based on ‘final assembly’ and excluded ‘captive’ production (e.g. IBM Japan) not sold in the merchant market. Formula 2 (F2) favoured by the Japanese government identified foreign semiconductors by ‘brand’ and included ‘captives’.

the rise in foreign market share by the end of 1992. Then Deputy USTR Linn Williams provides an insider’s perspective on the impact of the government-to-government agreement in Japanese commercial decisions. Describing the government action as ‘riding a market wave’, Williams maintains that:

The value of the agreement was that it did focus the attention of the [Japanese] government and Japanese private industry on doing more outsourcing. If you were inside a Japanese company and you were looking at outsourcing, you could do it in Milwaukee or you could do it in Yokohama. It’s close and you have got people saying do it in Japan. And you have this other voice which says that there is this agreement; you have got the MITI guy coming in on Thursday and he is going to be asking how many foreign semiconductors have you bought. ... The [US] price is a little lower and the problem is the reject rate and you can get the reject rate down — let’s take Milwaukee. And that happened. And the agreement did that. If the market forces weren’t there it would not have happened, but the agreement gave voice to foreign production.³¹⁷

³¹⁷ Williams, interview, 1996.

More tangible evidence suggesting a critical role for government intervention and guidance comes from Flamm's (1996) careful study of the semiconductor agreement. In particular, he singles out the 'sharp declines in Japanese EPROM production and soaring imports of EPROMs into the Japanese market' as likely outcomes of the agreement's market share target.

The circumstances of this decline are consistent with the suggestion that the Japanese retreat in EPROMs may have been a deliberate political decision. ... The analysis of available data on the growth of foreign companies' share of the Japanese semiconductor market supports the notion that pressures associated with the STA [Semiconductor Trade Agreement] may have played an important role in increasing foreign sales. Only a small part of the increase in foreign market share could be attributed to shifts in the composition of Japanese demand toward products in which foreign firms already had a greater presence; most of the increase is clearly due to greater foreign penetration into individual product niches. Furthermore, a large part of the growth in foreign market share was associated with ASICs [Applied Specific Integrated Circuits] and memory chips, where foreign firms enjoyed no huge technical advantage relative to Japanese firms (Flamm 1996: 293).

Whatever the precise breakdown in contributing factors, the demonstration effect from the semiconductor agreement only reinforced the policy authority of the hardliners within the US trade policy community. The element of ambivalence and, in certain areas, active opposition to the agreement within the US government largely dissipated once an identifiable market access improvement materialised. In key sections of the US trade policy process, the semiconductor agreement acquired a special status. According to Joseph Massey, an Assistant USTR for Japan and China during the Reagan and Bush Administrations, at least the line officials in the chief trade policy agency were 'very pleased and proud about the success of the semiconductor negotiations; of the demonstrated cause-effect relationship of using leverage of access to the US market to generate action by the Japanese government'.³¹⁸ Michael Armacost, a career State Department official and the Bush Administration's Ambassador to Japan, also highlights the demonstration effect while alluding to the wider debate on policy options that the semiconductor agreement touched off.

If you look at the chart on improving market share, it tended to go up as the deadlines approached so the agreement had some effect. So I was somewhere between the negative to agnostic at the outset when I wasn't involved, but my experience out in Tokyo led me to be quite a supporter of the agreement. I don't think our market share would have increased nearly to the extent it did without it; certainly not in that time frame. I thought

³¹⁸ Joseph P. Massey, telephone interview with author, 18 September 1996.

the semiconductor agreement proved its worth. Where I fell off was in regarding this as some principle that could be replicated in every other sector.³¹⁹

The Reagan-Bush Legacy

By the presidential election year of 1992, US market access policy towards Japan was results-oriented to the extent that in a number of areas steady increases in US sales was something more than an implicit benchmark for successful market access negotiations with Japan. Explicit demands for enforceable quantitative targets (ala the semiconductor agreement) remained exceptional and anathema to the free trade wing of the Bush Administration. But the pattern of grey area negotiations suggested demonstrably fewer reservations among trade officials about VIE-type arrangements or very specific results-oriented demands in politically-sensitive sectors at politically-sensitive times. In the often ambiguous world of negotiating strategy and tactics, results-oriented policy could turn less on the formal wording of market access agreements than on the configuration of monitoring, measurement, follow-up threats and occasional retaliatory actions — all stronger facets of American aggressive bilateralism after 1985. Leaving aside the automotive case that centred largely on purchases by Japanese companies located in the United States, other agreements negotiated in the context of President Bush's January 1992 visit to Japan capture the degree to which US market access policy had moved beyond process-oriented negotiations.

The January 1992 agreement on Japanese government procurement of computer hardware and services reflected the cumulative experience of over a decade of US-Japan procurement negotiations dating back to the Tokyo Round and the 1980 NTT agreement. The general charge was familiar with American companies claiming that Japanese bidding processes and procurement specifications discriminated against foreign firms. Informing the US case were data putting the foreign share of the Japanese public sector market for mainframe computers at six per cent in 1990 while the equivalent share in the private sector was around 40 per cent.³²⁰ Championing principles of 'non-discrimination, transparency, and fair and open competition', the procurement agreement nonetheless highlighted the range and specificity of American demands where the Japanese public

³¹⁹ Michael Armacost, interview with author, 5 July 1996, Washington DC.

³²⁰ *Inside US Trade – Special Report*, 10 January 1992.

sector assumed the role of purchasing agent.³²¹ The Japanese government agreed to improve access to pre-bid information, reduce the practice of single (sole-source) tendering, include foreign participation in study groups on product specifications, rely less on price and more on 'overall best value' (performance and price) in evaluating bids, establish a bid protest mechanism, facilitate stronger enforcement of Japan's Anti-Monopoly law, promote multi-vendor distribution of computer products and conduct periodic bilateral consultations to assess progress. No numerical benchmarks were established, but the agreement identified 'relevant information' (including purchasing data broken down by foreign and domestic categories) to be used to assess market access trends.³²² Bush trade official Merit Janow (1994: 62) has drawn attention to the fact that 'unlike other procurement agreements, the computer accord stated explicitly that its objective was to expand Japan's procurements of competitive foreign computer products and services, and it included various quantitative criteria to be used to assess implementation of the agreement'.

The bilateral market access agreements on flat-glass and paper products in early 1992 linked the type of structural issues US trade officials were pursuing on a broader front (close relationships between Japanese manufacturers and distributors) with more specific sectoral demands.³²³ Japanese glass distributors, it was claimed, would not carry foreign glass for fear of upsetting relationships with the three dominant Japanese glass producers — Asahi Glass, Nippon Sheet Glass Company, and Central Glass Company. As part of the January 1992 glass agreement, the Japan Fair Trade Commission (JFTC) agreed to launch a study of competition in the Japanese glass market and to encourage Japanese glass manufacturers to adopt stronger anti-trust compliance procedures. MITI began a campaign to encourage large glass users to increase imports, while the Ministry of Construction agreed to facilitate efforts by foreign firms to meet Japan's building standards for glass materials.³²⁴ The paper products negotiations had a stronger results-oriented dimension with Japan committing to 'substantially increase market access for

³²¹ 'Measures related to Japanese public sector procurement of computer products and services', Office of the US Trade Representative, 22 January 1992.

³²² The definition of "foreign" was based on capital affiliation rather than production location, an extension of US policy approaches in semiconductor and automotive talks. Thus hardware and software produced by foreign subsidiaries of Japanese companies and shipped to Japan were excluded from the measure of foreign market access.

³²³ 'Glass, paper: new sources of friction', *Daily Yomuri*, 17 December 1991, p. 9.

³²⁴ *Inside US Trade*, 10(3), 17 January 1992, p. 1.

foreign firms exporting paper products to Japan'. At the time of the Bush visit, MITI orchestrated pledges from more than 100 paper distribution and processing companies to increase purchases of foreign paper products, again in conjunction with a JFTC study of competitive conditions in the Japanese paper market.³²⁵ Signed in April 1992, the paper accord cited Japanese government measures to encourage long-term relationships between Japanese users and foreign producers, non-discriminatory purchasing practices, and a range of process-oriented changes. The agreement also identified seven qualitative and quantitative factors as indicators of the agreement's performance, including change in the level of import penetration (Janow 1994: 65).

Conclusion

The semiconductor agreement was not the only bilateral agreement with a strong results-oriented character in the wake of the trade regime crisis. Emerging from the MOSS process, a number of negotiations blurred the line between process and results-oriented policy with VIEs, company-specific sectoral deals, and increasingly detailed agreements which, in some cases, included quantitative criteria. The selective results-oriented policy of the second Reagan and Bush Administrations can be discerned in agreements struck on auto parts, telecommunications, supercomputer and computer procurement, glass and paper products. Notwithstanding its strong free trade disposition, the Bush Administration's decision to recognise explicitly the semiconductor agreement's 20 per cent target in a new agreement in 1991 highlighted the steady shift towards support for a results-oriented approach in the American trade policy community. The next chapter describes the larger backdrop to this shift based on the progressive ascendancy of the hardliners over the free traders.

³²⁵ *JEI Report* 3B, 24 January 1992, p. 7.

7 The Hardliners Advance

Introduction

The crafting by Congress of a vehicle for a results-oriented Japan policy in the form of the Super 301 provision of the 1988 Trade Act established a clear congressional intent that the Bush Administration declare Japan a bad trading actor. The progressive shift of internationally-oriented American firms into the hardline coalition in the second half of the 1980s also placed a results-oriented Japan policy firmly on the official trade policy agenda. In particular, the February 1989 report on the Japan problem by the US Trade Representative's Advisory Committee on Trade Policy and Negotiations (ACTPN) signalled the hardline ascendancy across a heavyweight business coalition. Chapter 4 examined the rather loose hardline coalition of actors in the American trade policy community taking shape in the late 1970s and early 1980s associated with the idea that Japan was a fundamentally different type of capitalist economic actor. This chapter traces the main strands of the ascendancy of the hardliners over the free traders in the wake of the mid 1980s trade regime crisis.

One dimension of the way in which the regime crisis left the power of the hardliners enhanced can be seen in the imprint of an inter-temporal cognitive process: a process of *learning* in the American trade policy community that Japan plays by different rules economically. The coupling of learning about the Japan problem with politically "fertile soil" of US-Japan disputation helps in understanding the content and timing of change in US market access policy towards Japan. The rise of the so-called *revisionists* as a knowledge-based network directly challenged the orthodox, free trade view of the Japan problem. Revisionism crystallised the otherwise loose collection of hardline experiences and beliefs into a tighter paradigm from which to argue the case for a results-oriented Japan policy. The fertile soil revisionist ideas found in the second half of the 1980s paved the way for the hardliners to frame the case against Japan in a way that put the free traders increasingly on the defensive. An important element of this fertile soil was a notable deterioration in American elite attitudes towards Japan through this period.

Congress, Japan and Super 301

A Congress intent on reasserting its constitutional role in US trade policy remained a major driving force of hardline trade advocacy after 1985. The Reagan Administration's new trade strategy of aggressive bilateralism announced in September 1985 could not derail overwhelming bipartisan momentum in Congress towards an omnibus trade bill. This would culminate in the Omnibus Trade and Competitiveness Act of 1988, the first major trade law since 1930 to be drafted by Congress rather than the executive. Two major themes ran through this legislation: (1) US commercial interests, perceived by Congress as subordinated to national security concerns, needed to be more forcefully pursued; and (2) Congress needed to be afforded equal partnership in US trade policy as befitting its constitutional authority. More specifically, Congress sought to increase the tools for the executive to target foreign trade barriers and to limit the president's discretion to waive aggressive enforcement actions. Amendments to Section 301 and a series of new action-forcing statutory triggers as part of the Section-301 family were the principal instruments of congressional demands. Of these, the Super 301 provision was aimed principally at securing measurable trade results from Japan (Schwab 1994, Bhagwati 1990, Kuroda 1990). The crafting of Super 301 simultaneously highlights a number of features of American trade policy in the wake of the trade regime crisis: a new balance of institutional initiative and control between a resurgent Congress and a defensive executive branch, the salience of the Japan problem for a bipartisan, hardline congressional leadership, and the pressures on a free trade-oriented executive to secure tangible results from Japan in market access negotiations.³²⁶

Congressional parameters for the 1988 Trade Act were set by those who wanted 'to be tough on trade and those who claimed to be tougher' (Schwab 1994: 111). In effect, two wings of the hardline coalition set the direction for a post-1985 trade bill: "protectionist hardliners" and "reciprocity hardliners". This distinction can be thought of in terms of relative interest in seeing potentially trade-restrictive laws (including retaliatory actions) implemented. Protectionist hardliners appear motivated by an underlying preference for protection so that, for example, trade retaliation would be considered a successful policy

³²⁶ As the multiple references imply, this section draws heavily on Susan Schwab's comprehensive, insider's account of the making of the 1988 Trade Act. Schwab was Senator John Danforth's legislative director during this process.

outcome. Although reciprocity hardliners might outwardly appear equally hardline, they would tend to score retaliation leading to increased US protection as a policy failure. Their basic interest lay in putting increased pressure on the executive to use the leverage of the US domestic market more aggressively to level the playing field for American business.

The Japan problem was front and centre for both groups of hardliners in the framing of the 1988 Trade Act. Protectionist hardliners made the initial running in 1986 with the Gephardt amendment which, as the previous chapter noted, was part of a sweepingly protectionist trade bill (H.R. 4800) passed by the House of Representatives in May 1986. The Gephardt amendment, entitled “Mandatory Negotiations and Action Regarding Foreign Countries Having Unwarranted Trade Surpluses with the United States”, provided for the imposition of quotas against large bilateral trade surplus countries — at the time, Japan, West Germany and Taiwan — in the absence of a multiyear rollback of bilateral surpluses by 10 per cent per year.³²⁷ The remarks in opposition to the Gephardt amendment by Daniel Rostenkowski, Chairman of the House Ways and Means Committee, encapsulated the basic difference between the two wings of the hardline coalition, but also their common focus on the Japan problem. Rostenkowski cautioned that foreign countries might be tempted to apply a similar measure to US exports and that inclusion of the Gephardt amendment would guarantee a veto by President Reagan that Congress would be unable to override. Such a result would ‘merely serve to strengthen Japan’s view that Congress is interested in sending unenforceable messages rather than actually enacting a tough trade bill’. Summing up, the Ways and Means chairman argued, ‘The Gephardt amendment is too draconian to be effective’. Instead, he favoured an alternative which ‘changes the current practice of inaction, but ... with a surgical knife, rather than a meat axe. ... I would rather see us pass a bill that is so tough the Japanese can’t ignore it, but so fair the President has no choice but to sign it’ (Schwab 1994: 111-112).

A combination of executive branch opposition and Senate preoccupation with tax reform

³²⁷ Congressman Gephardt received support for his amendment from leading House Democrats including Speaker Jim Wright (D, TX) and Democratic Whip Tony Coelho (D, CA) and a business coalition led by Chrysler’s Lee Iacocca and including steel, textile, and auto parts producers as well as some major multinationals including Motorola and Ford Motor Company (Schwab 1994: 109).

legislation blocked major trade legislation in 1986, but two developments late in the year redrew the legislative boundaries. First, the Democratic Party won control of the Senate at the November 1986 election adding an even more partisan political dynamic to the trade issue. Second, the Reagan Administration decided to become a player in the congressional trade deliberations by indicating a desire for new trade negotiating authority to undertake the recently launched Uruguay Round of multilateral negotiations. In the new Congress, the House again passed a reintroduced trade bill (HR. 3) in April 1987, but the narrow margin of approval for the Gephardt amendment (218-214) signalled a peak in the momentum of the protectionist hardliners` (Destler 1995: 93). Attention shifted to the Senate's trade bill (S. 490) introduced in February 1987 by new Finance Committee Chairman Senator Lloyd Bentsen and the committee's ranking Republican member Senator John Danforth. Senator Bensten's decision to promote a politically viable, bipartisan bill without the protectionist connotation of the Gephardt provision laid the basis for a broader and more durable hardline approach to the Japan problem. The alternative to the Gephardt amendment in the Senate Finance Committee bill was entitled "Negotiations in Response to Adversarial Trade" and was aimed with little subtlety at Japan. It instructed the president to negotiate the elimination of barriers with countries found to be 'maintaining a consistent pattern of barriers and market distorting practices, as in the case of Japan'. It further required the president to report on action taken in response to the barriers or on 'evidence that the level of United States exports ... [was now] commensurate with the level ... reasonably expected to result from the elimination of [such practices]' (Schwab 1994: 123).

In hearings on the Senate Finance bill, Senator Danforth articulated the perceptions and frustrations of the broad hardline coalition in Congress when it came to Japan:

Nothing really works. Take Japan, as obviously everybody's leading example of the trade problem. ... We negotiate, we harangue, we cry, we sob, we plead, and nothing happens.

... you negotiate down one barrier and, as soon as you have gotten that out of the way, you find five more have cropped up to take its place.

... why do I believe in retaliation, mandatory retaliation, almost automatic retaliation? Why? Because I think that a Japan has to feel that it is their choice. ... Let them decide. ... But that decision has to carry with it a down side; that decision has to trigger, automatically, something bad that happens to them. ...

Now, the reason I think we should rewrite the trade laws is not out of joy of retaliation. ... But what I do believe is that there must be penalties which are surely imposed on those who don't want to do business with the United States. And if we don't have such penalties, then I fear that nothing happens (Schwab 1994: 127-128).

The key players in drawing up Super 301 (based on the Adversarial Trade provision) looked to craft a law that would attract overwhelming bipartisan support and that presented legislators with 'a real alternative to the political pariah the Gephardt amendment had become' (Schwab 1994: 151). The original Senate version was drafted by the offices of Senators Danforth, Riegle (D, MI), Dole (R, KN) and Byrd (D, WV) with a supporting cast made up of protectionist hardliners (Chrysler, the UAW and the AFL-CIO) and what could be termed "pragmatic free traders" (the office of Senator Packwood and Reagan Administration trade officials). According to one closely involved in the process, Super 301 was designed 'to be action-forcing, focus on barriers rather than balances, and contain a means of measuring results; and it was to be sufficiently flexible for the president to avoid having to take draconian action' (Schwab 1994: 152). With the reciprocity hardliners as the lead advocates, it passed the full Senate by an overwhelming vote of 87-7 in July 1987.³²⁸

The August 1987 commencement of the conference committee phase designed to reconcile the House bill (HR. 3) and the Senate bill (S. 1420) illustrated the new political salience of trade as well as its increased institutional complexity.³²⁹ Twenty-three congressional committees were represented — 14 from the House and nine from the Senate — and a 199-member conference committee was appointed to reconcile the two bills — 155 representatives and 44 senators (Destler 1995: 94). But in keeping with the tradition of powerful Committee chairmen, Representative Rostenkowski and Senator Bentsen used their authority to strip the two trade bills of virtually all provisions that were directly trade-restrictive. This was critical in signalling congressional intent to present to President Reagan a bill that he could sign, or at least that would make sustaining a veto difficult. For their part, the free traders in the Reagan Administration were presented with the decision of whether to negotiate with Congress to secure a bill the executive could "live with" or to pursue a veto strategy with the risks that would entail. Debate over how broad to make the executive's list of objections to Congress saw

³²⁸ Schwab (1994: 149) records that in the debate, 'the amendment expected to cause the most controversy — the Senate's answer to the Gephardt amendment — ultimately caused little more than a ripple'.

³²⁹ The committee stage saw S. 1420 added to H.R. 3 as a single amendment.

the trade pragmatists line up against the more unvarnished wing of the Free Trade-Good Relations coalition within the Reagan Administration. According to Schwab (1994: 203):

The most important factor was the split between the various agencies, pitting those wanting to work to bring about sufficient change to recommend a presidential signature against those who had already concluded that no amount of work could make the bill salvageable. This divergence of views primarily involved USTR and Commerce on the side of negotiations; OMB, CEA, and the NSC firmly on the other; State generally siding with bill opponents; and Treasury either uncommitted or leaning toward the trade agencies on issues other than its own. Agriculture and Labor generally favored negotiations, but were lesser players in the debate.

The heart of the trade bill centred on the Section 301 provisions, including the Senate's Super 301 that eventually secured endorsement in the conference process at the expense of the Gephardt amendment in the House bill (Bello and Holmer 1990). The general outcome on Section 301 would apply also to the new 301-based provisions applying to intellectual property (Special 301), telecommunications (Section 337), and Super 301. The major issue for the executive was the Senate demand for a retaliatory mechanism in Section 301 that was 'mandatory but waivable'.³³⁰ The reciprocity hardliners 'did not want to create a legal right to retaliation, [but] they felt it necessary to put enough pressure on the executive to force whatever action was most likely to achieve the desired result, that is elimination of the adverse foreign practice' (Schwab 1994: 187).³³¹

With Senators Bentsen and Danforth taking the lead, Japan remained the focus of negotiations over Super 301. The Senate bill targeted those countries that maintained 'a consistent pattern of import barriers and market distorting practices'. Section 301 investigations would then be initiated against that country's 'major barriers ... the elimination of which are likely to have the most significant potential to increase US exports'. In addition, evidence of results was to be reported annually and contrasted with earlier estimates of the increase in US exports that could have occurred had the barriers not existed in the first place (Schwab 1994: 152). In negotiations over the provision, the pragmatic free traders of the Reagan Administration pressed the Senate conferees 'to drop "the name calling" through a shift in focus from "bad actors" to one of "bad

³³⁰ Other changes saw a limited transfer of authority from the president to USTR and an expansion in actionable practices.

³³¹ In the end, conferees agreed to maintain existing discretionary language in Section 301 cases of 'unreasonable' and 'discriminatory' practices, and to add a number of exceptions to mandatory action in case of 'unjustifiable' practices.

actions” (Schwab 1994: 194). A compromise hammered out between USTR Clayton Yeutter and Senator Danforth’s office saw Super 301 cast in terms of ‘trade liberalization priorities’, including both ‘priority practices’ and ‘priority foreign countries’ (Schwab 1994: 196). But there were few illusions as to *the* priority country congressional actors had in mind.

By April 1988, the pragmatists in the Reagan Administration led by Treasury Secretary James Baker and USTR Clayton Yeutter had determined that if the trade bill was stripped of the administration’s two main concerns — a provision mandating notification of plant closings by companies employing 100 or more workers, and the “Bryant amendment” threatening to restrict foreign investment in the United States — there was a real possibility a presidential veto could not be sustained. The decision by Baker and Yeutter not to pursue a broader veto strategy with a longer list of complaints (including Section 301 and Super 301 issues) was informed by the judgement that ‘no matter what they did, State, Defense, OMB, CEA, and the NSC would probably still recommend a veto’ (Schwab 1994: 204, 205). The inability of congressional trade leaders to secure the removal of the plant closing provision from the final legislation left Congress facing a presidential veto. On April 21, the House voted 312-107 in favour of the reworked omnibus trade bill, more than 20 votes clear of the margin needed to override a veto. The Senate also passed the bill on April 27 by 63-36, a margin short of a veto-proof majority. President Reagan exercised his veto power but in very narrow terms, urging Congress to promptly pass a second trade bill stripped of only two offending provisions.³³² This proved forthcoming and on 23 August 1988 President Reagan signed the Omnibus Trade and Competitiveness Act of 1988 into law. Whilst opposing it, the Reagan Administration decided it could live with Super 301, a new hardline tool designed largely as a means of pressuring results from Japan. The choice as to how to implement it would fall to President George Bush in 1989.

³³² The two provisions concerned plant closings and a ban on certain oil exports from Alaska. The State Department and the CEA fought an unsuccessful campaign against Treasury Secretary Baker, USTR Yeutter and White House political advisers for a “long list” version of the President’s veto grievances (Schwab 1994: 215).

American Business and the Japan Problem

Congressional activism on the Japan problem not surprisingly drew support from a cross-section of American corporate and labour interests seeking relief from trade-related structural change and other competitive pressures magnified by the appreciating US dollar through the first Reagan Administration. The private sector free trade coalition of internationally-oriented firms and agricultural interests that had supported past liberal trade initiatives fragmented in the trade regime crisis of the mid 1980s. Increased US trade exposure and the record trade deficits of the early 1980s saw a range of US manufacturing industries granted import relief. Major business lobby groups such as the Business Roundtable, the US Chamber of Commerce and the National Association of Manufacturers (NAM) were subject to more intense cross-pressures within their memberships (Destler 1995: 195). By 1985, the scale of Japan's competitive challenge to American industry was dramatised less by high-profile "Japan-bashing" than by the defection of long-time free traders in support of Japan-specific import relief. For knowledgeable observers, the weakening of the business base of the free trade coalition was underlined when Hewlett-Packard chairman David Packard lent support to demands for temporary quotas against Japan in early 1985.³³³ Declining support for multilateral trade policy approaches and a frustration with GATT was evident in May 1985 when USTR received a distinctly lukewarm response from American corporate interests to its efforts to kick-start a new multilateral round. The trade agency's private sector advisory committees argued that a new round 'might divert attention from other pressing domestic and international economic problems, such as the creation of a tough US trade policy, the value of the dollar, budget deficits, and other financial and monetary issues'.³³⁴

A central theme in the weakening of support for new trade initiatives was 'the growing perception, across pretty much the entire community of US traded-goods producers, that the United States has been asymmetrically the victim of unfair foreign trade practices' (Destler and Odell 1987: 120). Exploring the erosion in 'generic anti-protection activity', Destler and Odell (1987: 121) cited one 'balanced and sophisticated [free trade] coalition member' as complaining that 'the Japan thing is serious in undermining the anti-

³³³ Destler (1995: 192), William Frenzel, interview with author, 17 July 1996, Washington DC. Packard was also co-chair of the bi-national US-Japan Advisory Commission.

³³⁴ *Inside US Trade*, 3(22), 31 May 1985, p. 11.

protection coalition. The Japanese are particularly protectionist' (Destler and Odell 1987: 121). The distinction drawn between protectionist hardliners and reciprocity hardliners seems commensurate with new patterns of corporate trade policy preferences under the umbrella of complaints about unfair trade. Analysts have drawn attention to the emergence in the 1980s of a more complex set of American corporate trade preferences away from the standard poles of free trade and protection (Milner and Yoffie 1989). Milner and Yoffie (1989: 239-240) found that increasing numbers of American multinational firms 'that historically supported unilaterally opening their home market have publicly advocated a third type of policy — a "strategic" trade policy of demanding trade barriers for the home market if foreign markets are protected'. They cite industries such as semiconductors and telecommunications equipment (both facing their stiffest competition from Japan) as moving from preferences for 'unconditional' free trade to demanding 'strategic action' rather than 'unconditional' protectionism. As in Congress, the general trend was towards a strengthening broad coalition of protectionist and reciprocity hardliners at the expense of the postwar free trade coalition.³³⁵

With their diverse memberships, large industry groups such as the US Chamber of Commerce, the Business Roundtable and the NAM tended to distance themselves from protectionist hardliners on Japan (the likes of Chrysler's Lee Iacocca). And while, for example, the NAM strongly supported the Section 301 case against Japan brought by the SIA in 1985-86, at the time it continued to push a moderate trade agenda which stopped short of singling out Japan for special attention.³³⁶ In Congress, the major business groups campaigned actively against the Gephardt amendment, but as the more moderate trade push gathered momentum they progressively developed a brokering role between the reciprocity hardliners in the congressional leadership and the free traders in the Reagan Administration. According to Schwab (1994: 168):

the positions taken by these groups usually placed them somewhere between the adamantly free-trade stance of the administration and the tougher, more activist approach of the congressional trade leaders. ... In essence, there had been an inversion in traditional roles in the development of trade legislation: Instead of the executive branch drafting a bill and rallying the private sector to lobby it on the Hill, in this case Congress drafted the bill and turned to the business community to help with the administration.

³³⁵ 'Free-trade coalition fades' by Hobart Rowan, *Washington Post*, 20 September 1987, p. H01. See Destler and Odell (1987) on some of the new anti-protection groups (e.g. retailers) whose activities sought to balance against protection in the United States.

³³⁶ *International Trade Reporter*, 3(10), 5 March 1986, p. 311. *International Trade Reporter*, 3(47), 26 November 1986, p. 1417.

On Japan trade issues, individual corporate hardliners such as the semiconductor producers, Motorola's chief executive Robert Galvin and Cray Research's John Rollwagen were key actors. Their capacity to enlist support for results-oriented actions, including credible threats of retaliation, was apparent across the trade policy community, not least in USTR and the Commerce Department. Their influence was partly a reflection of the fragmentation of trade policy authority as well as the wider 'advocacy explosion' in Washington DC which tended to undermine the influence of large, broadly-based lobby groups. In this more crowded policy environment, the more that 'member companies have their own expertise and activist presence in Washington, the more their CEOs are likely to take their cues from their on-the-ground staffs rather than those of the umbrella organizations' (Destler and Odell 1987: 122).

An important landmark in terms of business advocacy for a results-oriented Japan policy came with the release in February 1989 of an "Analysis of the US-Japan Trade Problem" by USTR's Advisory Committee on Trade Policy and Negotiations.³³⁷ With a statutory mandate to advise the president on US trade policy, ACTPN drew its heavy-weight representation from across the spectrum of American industrial, agricultural and service sectors.³³⁸ The Japan report was the result of a special ACTPN taskforce formed in November 1987 'to analyze the factors driving the US-Japan trade imbalance and to forge a consensus on a comprehensive approach to trade relations with Japan'.³³⁹ Released to coincide with the newly-elected Bush Administration's deliberations over Super 301, the ACTPN report recommended that given 'the different structures of the two economies, trade policy solutions lie somewhere between free trade and managed trade' (ACTPN 1989: vii). It highlighted 'a growing frustration with what is perceived as an approach to managing the bilateral relationship that is too piecemeal, too confrontational, and too process-oriented' (ACTPN 1989: viii). It called instead for a 'results-oriented trade strategy' geared towards 'concrete evidence that US-Japan

³³⁷ The Advisory Committee for Trade Negotiations was originally established in the Trade Act of 1974 to advise the president on all aspects of the Tokyo Round of multilateral trade negotiations. The 1988 Trade Act expanded the mandate of the group to provide advice to the president on all aspects of US trade policy, hence the renamed ACTPN.

³³⁸ Major multinationals represented within ACPTN at the time included IBM Corporation, General Motors Corporation, General Electric Company, American Express Company, Johnson & Johnson, Philip Morris Inc., and the Boeing Company.

³³⁹ Advisory Committee on Trade Policy and Negotiations, Letter to the Honorable Carla Hills, 10 February 1989.

negotiations are succeeding' and that 'works within Japan's unique economic structure' (ACTPN 1989: xv-xvi).

While stressing the role of macroeconomic policy in explaining the bilateral imbalance, the report maintained that the US-Japan trade deficit was also the result of 'Japanese microeconomic policies which reduce the role of imports substantially below what would normally be expected of an industrial economy with Japan's economic attributes' (ACTPN 1989: x). Emphasis was given to 'Japan's invisible or informal barriers, buying preferences arising from Japan's industrial group structure (*keiretsu*), and attitudes and predispositions against imports' (ACTPN 1989: xiv). Such barriers, the report argued, did not 'lend themselves to discipline through a rules-based system' (ACTPN 1989: xxii). Hence the US government was called on to: (1) establish sectoral priorities; (2) define 'successful outcomes'; and (3) negotiate 'successful outcomes' using US trade laws (in particular the Super 301 provision) as a lever.³⁴⁰

For hardliners across the American trade policy community, the ACTPN report was seen as offering unprecedented legitimacy to their claims about the Japan problem and to demands for policies that focused on results rather than processes or rules. Its support from an activist Congress was a given. But equally, hardliners in the executive branch embraced the report with the Commerce Department's Maureen Smith proclaiming it as 'a landmark. Those are mainstream, Establishment business people'.³⁴¹ Echoing the view that a new threshold in hardline advocacy had been crossed, one former US trade official has suggested that 'the ACTPN report of early 1989 was I think the first indication that this [a results-oriented Japan policy] was something to be considered seriously on a government level'.³⁴²

Revisionism: Hardliners learn to paradigm

The capacity of hardliners in politics and business to credibly place a results-oriented Japan policy on the official policy-making agenda by the end of the 1980s cannot be

³⁴⁰ The report recommended that the United States offer to delay Super 301 procedures against Japan for one year while an effort be made to negotiate new agreements (ACTPN 1989: xvii).

³⁴¹ 'Rethinking Japan', *Business Week*, 7 August 1989, p. 20.

³⁴² Not-for-attribution interview.

understood simply in terms of their institutional position or material interests. It was bound up with a process of learning about the Japan problem within the American trade policy community. In this connection, cognitive factors (shared beliefs/ideas) do not determine outcomes independently, but they play an important role in framing policy debate — what does and does not count as an object of contestation — and in delimiting boundaries for policy innovation. The rise to prominence of a more codified set of ideas about the Japan problem that attracted the label *revisionism* was part of this learning process, especially relevant *within* the hardline advocacy coalition. The core revisionist proposition that Japan plays by different rules economically became the dominant cognitive prism through which the American trade policy community debated the Japan problem by the second half of the 1980s. For hardliners in the American policy community, revisionism helped crystallise, strengthen and legitimate core beliefs and arguments for a results-oriented Japan policy, in the process directly challenging the credibility of *traditionalist* views of the Japan problem within the free trade coalition. At the same time, revisionism's persuasive capacities can be detected *across* the policy community, especially in areas less directly involved in advocacy roles — researchers, analysts, journalists etc. — where it posed as a source of new information and enlightenment about the way Japan works. Finally, the political power of revisionism can be seen in its fit with beliefs among “latent” hardliners in the wider American community (outside the trade policy elite) anxious about Japan's growing economic power and American decline.

A 1989 cover story in *Business Week* magazine attached the label revisionism to a set of ideas directly challenging the traditionalist, free traders' view that Japan's political-economic system was fundamentally similar to, or at least converging with, other Western capitalist democracies.³⁴³ The main revisionist arguments were distilled and generalised from the writings of a small group individuals tagged subsequently as the Gang of Four — political science professor Chalmers Johnson, former Reagan Administration trade official Clyde Prestowitz, and journalists James Fallows and Karel van Wolferen. The revisionist paradigm centred on four interrelated propositions: (1) that Japanese capitalism represented a fundamentally different political-economic model

³⁴³ 'Rethinking Japan', *Business Week*, 7 August 1989. The article drew attention to 'a radical shift in US thinking' around the view that 'Japan really is different — and that conventional free-trade policies won't work'.

when compared with Anglo-American, consumer-oriented capitalism; (2) that the model's success at some level posed a threat to American wealth and power; (3) that strong continuity characterised the Japanese system contrary to claims of convergence with Anglo-American capitalism; and (4) that a drastic change in US policies towards Japan was required, including some form of managed trade or results-oriented market access trade policy. Revisionism's claims to displace a traditionalist interpretation of Japan were made very directly on the grounds of superior knowledge about Japan. Hence, the acknowledged dean of the revisionists asserted that it constituted 'merely the intellectual recognition that Japan's alleged fundamental similarity to the Western capitalist democracies was always based on ignorance of Japan itself' (Johnson 1990: 107). Notwithstanding differences in emphasis among the revisionists, the core ideas are embedded in the following statement by Johnson.

The Japanese economy is the product of a different history of industrialization from that of the United States, of a different role for the state in economic affairs, of a different role for the economy in the overall scheme of things and of a different kind of economics; American economic policy toward Japan should be premised on these differences. ... In order to maintain our economic independence, we have no alternative than to manage our trade with Japan — as the Japanese have always managed their trade with us to their advantage — and to implement an industrial policy to ensure that US manufactured goods are attractive to American consumers.³⁴⁴

Similarly, Prestowitz (1993: 75, 81, 95) maintained that revisionists:

see the Japanese economy as being based on principles and having objectives, structures, and operating practices that deviate very substantially from the neoclassical Western model. In this view, the [economic] frictions arise not from the poor performance of the Americans or the cheating of the Japanese, but from a clash of two very different systems that is unlikely to be ameliorated by the application of general rules on which the two countries do not agree. ... negotiations always lead to agreements, but the agreements never produce the anticipated results. ... [This calls for] negotiating specific measures to overcome or offset the impact of structural or policy differences.

Revisionism offered a form of paradigmatic wrapping for the core hardline proposition that Japan was different. This encompassed codification and legitimation of core beliefs, the refinement of causal relationships and interpretive strategies internal to a belief system, and the logical extension to policy proposals for attaining core values/interests. As a binding element, revisionism connected in its cognitive web salient events, shared

³⁴⁴ 'The "revisionist" stance on trade with Japan' by Chalmers Johnson, Letter to the editor, *Washington Post*, 11 August 1992, p. A16.

experiences and perceived anomalies into a set of ideas akin to a “paradigm”.³⁴⁵ In the words of one US trade official, revisionism was ‘the textbook written of this learning experience. ... In terms of the view of Japan and an understanding of Japan it was definitely influential’.³⁴⁶

It is impossible to trace a singular path for the emergence and dissemination of revisionist ideas. Focusing simply on the rise to prominence of the Gang of Four offers a distorted picture of the intellectual pedigree of revisionism and the wider reservoir of hardline-friendly analysis of the Japan problem. Indeed, as others have noted, an emphasis on Japan as different is not especially revisionist in light of the intellectual tradition surrounding study of Japanese uniqueness (*Nihonjinron*) in Japan itself (Samuels 1992). Nor could such an emphasis be considered especially new in relation to the history of US-Japan relations (Benedict 1972, Johnson 1988). Moreover, discussion of peculiar features of Japanese capitalism was hardly alien to orthodox economists in the United States prior to the 1980s (Patrick and Rosovsky (eds.) 1976). In terms of what Kingdon (1984: 134) calls the ‘softening up’ process for ideas, Japanese industrial policy had already been subject to intense criticism in the US policy process in the early 1980s that made the path for revisionism in the late 1980s all the smoother. The trade crisis of the mid 1980s was a catalyst creating demand for new views on the Japan problem. Still, with its distinctive paradigmatic packaging, revisionism left an imprint on how the American trade policy community debated the Japan problem, including policy options.³⁴⁷ The words of one former USTR official through the Reagan and Bush Administrations are suggestive of this distinctive element within the hardline coalition:

By the time I joined USTR in 1985, those people who were dealing with Japan on trade negotiations — at least in Commerce, USTR, and probably Agriculture as well — by that time knew that dealing with Japan was different from dealing with other advanced, industrial trading partners.

But I think until Clyde Prestowitz wrote *Trading Places* and Karel van Wolferen came out with his book and Jim Fallows wrote those articles and Chalmers Johnson’s MITI

³⁴⁵ In the learning literature, Hall (1993) relies most explicitly on the Kuhnian idea of paradigm shifts in exploring the shift from Keynesianism to monetarism in economic policy making in Britain.

³⁴⁶ Maureen Smith, interview, 1996.

³⁴⁷ Kingdon (1984: 131) makes a strong case for thinking in terms of an evolutionary process where ‘origins become less important than the processes of mutation and recombination that occur as ideas continuously confront one another and are refined until they are ready to enter a serious decision stage. ... evolution proceeds not so much by mutation, or the sudden appearance of a wholly new structure, as by recombination, or the new packaging of already familiar elements’.

book was taken more seriously, I think there was really not much codification or crystallising of those experiences.³⁴⁸

The revisionist challenge to traditionalist conceptions of the Japan problem associated with the Free Trade-Good Relations coalition can be dissected across three dimensions characteristic of beliefs about a policy problem: (1) the stakes involved; (2) causal relationships; and (3) policy implications. The starting point for revisionism was the size of the political-economic stakes for the United States seen as arising from differences between American and Japanese political-economic systems. In general, traditionalists saw the Japan problem in much narrower and secondary terms (for example, as economic problems which should not be allowed to undermine more important security objectives, or as reflecting largely *domestic* problems such as the US budget deficit or protectionist pressures). By contrast, revisionists saw a primary threat to American interests in 'the persistently unbalanced economic and industrial relationship between Japan and the rest of the world, including the continued displacement of industrial sectors and the shift of technological capability toward Japan. ... If today's trade and industrial patterns continue, we contend, their natural result will be a substantial decrease in the Western, and especially American capacity for independent economic and political action'.³⁴⁹

The revisionists viewed the success of Japan's economic system as a wholesale challenge to traditionalist conceptions of American foreign policy priorities based on containment of communism as an overriding Cold War national security objective. The prospect of Japanese economic dominance and declining American wealth, power and independence was such as to warrant an American strategy of 'Containing Japan' (Fallows 1989a).³⁵⁰ Johnson (1990: 135) warned that the United States 'must either begin to compete with Japan or go the way of the USSR' (Johnson 1990: 135). Prestowitz (1988: 22) similarly intoned that, 'Today the real challenge to American power is not the sinister one from the Eastern bloc, but the friendly one from the Far East' (Prestowitz 1988: 22). Indeed, the former US trade official's seemingly more fatalistic view had the battle already lost with the United States and Japan *Trading Places*, and the latter

³⁴⁸ Not-for-attribution interview.

³⁴⁹ 'Beyond Japan-bashing: The "Gang of Four" defends the revisionist line' by James Fallows et al., *US News & World Report*, 7 May 1990, pp. 54-55.

³⁵⁰ Fallows' (1989a: 42) famous article was premised on the claim that 'the major external threat to America's ability to pay the costs of leadership is Japan's uncontrolled, unbalanced economic growth'.

economically victorious. Only magnifying the stakes was the spectre of other states in East Asia emulating the Japanese model and threatening 'to turn West Coast high-tech areas such as Silicon Valley into electronic rust belts' (Johnson 1987a: 71). 'The major threat to the free-trade system does not come from American protection. It comes from the example set by Japan. Japan and its acolytes, such as Taiwan and Korea, have demonstrated that in head-on industrial competition between free-trading societies and "capitalist development states", the free traders will eventually lose' (Fallows 1989a: 54).

Going beyond the litany of complaints about Japanese unfairness, the revisionists articulated a more holistic view of Japan as a 'mercantile power' with a state-guided strategy to dominate the global economy.³⁵¹ Again, the Gang of Four was part of a larger analytic enterprise focusing on Japan's trade and industrial strategies that included researchers, analysts and industrial policy advocates from such centres as Harvard Business School (Bruce Scott and George Lodge) and the Berkeley Roundtable on the International Economy (John Zysman, Michael Borrus, Stephen Cohen and Laura Tyson). Perhaps the most influential packaging of the Japan problem in the wake of the trade crisis came from management expert Peter Drucker.³⁵² Writing in the *Wall Street Journal* in April 1986, Drucker singled out Japan as an exponent of 'adversarial trade' (as distinct from 'competitive trade') whose significance went beyond such statistics as the US-Japan trade imbalance. According to Drucker, Japan's adversarial trade 'creates serious social dislocation in the importing country and is seen as a hostile act rather than as fair competition. ... [it] threatens to drive out and to destroy an already weak industry and thus to create major *economic* damage. But above all, it creates massive unemployment and *social* dislocation'.³⁵³ Revisionists simply magnified this picture of a deindustrialising America infusing it with claims to expertise on the underpinnings of Japan's deliberate *political* strategy of economic domination.³⁵⁴ 'International domination in as many industrial areas as possible is part of an uncoordinated and never

³⁵¹ Johnson's (1990: 108) conception of Japan as a mercantile power was of 'a nation that uses state action to export the utmost possible quantity of a nation's own manufactures and to import as little as possible of those made in other countries'.

³⁵² 'Japan and adversarial trade' by Peter F. Drucker, *Wall Street Journal*, 1 April, 1986. See also Drucker (1986-87).

³⁵³ As noted earlier, the term adversarial trade found its way into the original Senate alternative to the Gephardt amendment, the forerunner to the Super 301 provision.

³⁵⁴ For the more sophisticated groundings of revisionist economics, see Johnson, Tyson and Zysman (eds.) (1989).

delineated yet powerful campaign to make the world safe for Japan' (van Wolferen 1990: 48).

The spectre of American high-tech de-industrialisation at the hands of Japan (and its Asian 'acolytes') was at the core of revisionist arguments for going beyond Japan-bashing over unfairness to focusing on a Japan playing by different rules and winning the commanding heights of the international economy (Fallows 1987). Of the episodes that the revisionists and other hardline analysts sought to illuminate and dramatise, none was more central than the story of America's loss of DRAM capacity and market share in the global semiconductor industry (chapter 5). The case of America 'losing the chips' to Japan, with the US semiconductor industry threatened with a similar fate to television and automobile manufacturers in the United States, remained a signature of revisionist analysis of the Japan problem.³⁵⁵ The eventual acclaim associated with the outcome of America's results-oriented market share deal on semiconductors only reinforced the general policy stance of the revisionists that such outcomes were both desirable and obtainable. Again, the revisionists were part of a larger chorus bemoaning the decline of American manufacturing and the loss of high-technology leadership and hence connecting with the beliefs and interests of hardliners throughout the US trade policy community.³⁵⁶ It is impossible to separate the revisionist quest to illuminate Japan's success from the mirror image painted of American failure with the US government cast as unwilling or unable to come to grips with Japan. A theme of all the revisionist writers, it proved especially potent in the case of Clyde Prestowitz, a former "insider" in the Reagan Administration determined to expose the Reagan Administration's 'intellectual and bureaucratic blunders' in its dealings with Japan.³⁵⁷

Beneath the high-stakes Japan problem lay the causal relationships of revisionism and the means by which Japan was seen as having rewritten the rules of international economic relations. Fundamental and enduring differences in institutions, in the role of

³⁵⁵ Prestowitz (1988: chapter 2) introduces his larger thesis with the 'losing the chips' story, as does Fallows (1994: chapter 1) in his later tract on the economic rise of East Asia.

³⁵⁶ See, for example, Cohen and Zysman (1987), Dornbusch, Poterba and Summers (1987), Dertouzos, Lester and Solow (1989), and Ferguson (1989).

³⁵⁷ Quoted from Chalmers Johnson's endorsement of *Trading Places*. The list of endorsements for Prestowitz's 1988 book reads like a who's who of a high-level coalition of hardliners: Senators Robert Dole, John Danforth, Robert Byrd, Paul Simon (D-IL), businessmen David Packard (Hewlett-Packard), Robert Galvin (Motorola) and Lee Iacocca (Chrysler), and union leader Lynn Williams (United Steel Workers Union).

the state in economic affairs, and in economic doctrines provided the causal mechanisms by which the revisionists sought to explain outcomes and perceived anomalies. Analysis of the new institutions of capitalism developed by Japan was designed to displace the traditionalist emphasis on private sector economic activity and orthodox macroeconomic policy in understanding Japan's rapid postwar development and patterns of international economic interaction.³⁵⁸ Johnson's (1982) historical-political study of Japan as a 'capitalist development state' provided the intellectual anchor for the larger revisionist paradigm that took shape in the second half of the 1980s.³⁵⁹ Japan's rise as a global economic power was seen as the result principally of a successful industrial policy in which MITI pursued developmental state goals by directing resources, structuring markets and influencing enterprise decisions. Johnson's capitalist analytic comparator was the United States, a 'capitalist regulatory state' that set rules for economic competition but tended not to concern itself with what industries ought to exist (Johnson 1982: 19).³⁶⁰ Where the 'Anglo-American' system was cast as institutionally oriented towards consumer welfare, Johnson and the other revisionists maintained that the Japanese system actively pursued producer-oriented, economic nationalist goals with the purpose of dominating the key (strategic) industries of the international economy. The result was a 'system whose goals and performance may not be accurately described by the Western model of democratic capitalism'³⁶¹. The way the Japanese system worked, its external economic posture and its postwar economic success were seen as discrediting orthodox, neo-classical economic analysis. Indeed, revisionists went so far as to argue that Japan did not respond to economic forces as conceived by orthodox economics.³⁶²

³⁵⁸ In terms of American literature, Patrick and Rosovsky (eds.) (1976) remains the standard reference for more traditionalist analysis of Japan's postwar economic development.

³⁵⁹ In his survey of Japanese political studies in the United States, Samuel (1992: 32) lauds Johnson's work as 'probably the most widely read and influential scholarly book by a Japan specialist ever' which 'ushered in an era of research by American Japan specialists that addressed the political economy ... a beacon that illuminated equally theory and Japan'.

³⁶⁰ Johnson qualifies his categorisation by noting that 'the role of the US government in economic affairs has never been exclusively regulatory any more than the Japanese government's role has been exclusively developmental. But over the past 125 years each role has been sufficiently salient in one country for economic ideologies to develop asserting or pretending that the American government regulates its economy while the Japanese government develop Japan's' (Johnson 1987a: 78). Johnson and others have drawn attention to industry-specific policies to support agricultural and defense industries in the United States. See, for example, David Vogel (1996).

³⁶¹ 'Beyond Japan-bashing: The "Gang of Four" defends the revisionist line' by James Fallows et al., *US News & World Report*, 7 May 1990, pp. 54-55.

³⁶² In terms of intellectual foes, the revisionists directed much of their attack on 'the influence of a set of theological principles — the doctrine of free trade — serviced by an entrenched priesthood — the professional economists — that is much more interested in defending articles of faith than in understanding what is going on in international economic relations' (Johnson 1990: 107).

The revisionist interpretation of Japan's rapid postwar growth and external trading performance, with causal inferences grounded in different institutions and interventionist industrial and trade strategies, directly challenged the traditionalist thesis emphasising Japan's similarity/convergence with Western capitalism and adherence to basically orthodox economic policies. 'Japan's achievement of the status of the second most productive economy that ever existed is no longer simply an enigma; it is a challenge to the main political and economic doctrines that currently dominate global thinking about human social organization' (Johnson 1987b: 136). 'From the vantage of traditional economics, Japan has made very serious policy errors ... traditional American economic and political conceptions about the dynamics of international trade and domestic development are flawed and must be reconsidered in view of Japan's spectacular development success' (Tyson and Zysman 1989: xiii). Revisionist claims to expert knowledge reflected a capacity to weld institutional detail to a plausible story of Japan's different capitalist system which 'far from "beating the West at its own game", might not be playing the Western "game" at all' (van Wolferen 1989: 406).

In terms of a process of learning internal to the hardline coalition, revisionism can be seen in more-or-less instrumental terms: refining, extending and legitimating the cause-effect relationships embodied loosely in prior images of an omnipotent, impenetrable 'Japan Inc'. That the revisionists assumed a status akin to a knowledge-based network of expertise on Japan was in part a reflection of their claims to uncovering the sort of 'informal' or 'invisible' bases of power in Japan's political-economic system which traditionalists were seen as having ignored or downplayed. Markedly different causal inferences reflected a paradigm in which the sorts of overt, legal bases of power characteristic of Anglo-American capitalism were seen as much more circumscribed in the case of Japan. In this connection, van Wolferen's 1986-87 article on 'The Japan Problem' in *Foreign Affairs* refers to the Japanese System as:

structurally protectionist in the sense that all kinds of informal, if not official, barriers to imports must ensure that foreign competition will not undermine its aims. ... A select few foreign firms receive assistance to serve as fresh examples of Japanese openness. What we should look at, however, are distribution systems in a few controlling hands, regulations dictated by Japanese competitors, new product standards, and other barriers that a potentially powerful foreign competitor faces in the Japanese market. The bureaucrats in Tokyo are extremely inventive when it comes to subtle controls and

euphemisms for rendering them more palatable to foreigners' (van Wolferen 1986-87: 293).

Rather than attacking perceived unfairness, the revisionists stressed that outcomes simply reflected fundamentally different understandings of the purposes and workings of a national economy; an economy where the imperative is 'to resist foreign penetration of their own market, while relentlessly pursuing markets abroad, as the natural course in their scheme of things: natural in respect to their governmental bureaucracy, to their industrial policies, and to the way companies operate in Japan' (Prestowitz 1988: 24). By the late 1980s, the more scholarly godfather of revisionism had sharpened his historically-based concept of a capitalist developmental state into a more enduring closed and collusive system. Where traditionalists saw a scaling back of the role of the state in the Japanese economy, Johnson (1987b: 159) stressed that the 'Japanese economic bureaucracy has long found that its most effective powers are tailor-made, verbal, ad hoc agreements implemented through "administrative guidance"'. The collective weight of administrative guidance, industrial groups (*keiretsu* relationships), and government organisation of R&D created 'competitive conditions in Japan that consistently discriminate against foreigners'. Johnson went so far as to argue that because of administrative guidance 'a foreigner can never master the rules of doing business in Japan' (Johnson 1989: 23).³⁶³

The capacity of revisionists to contrast their institution-centred view of how Japan worked with the more abstract interpretive framework of orthodox economics informed their very direct attack on the intellectual credentials of the free trade-good relations coalition. Thus Johnson argued that 'capitalist economic theory is an utterly abstract and even utopian body of thought until it is translated into action through concrete institutions. ... Macroeconomic theory uninformed by variations in institutions is a fundamental source of error in public policymaking' (Johnson 1987a: 77). Among the exhibits revisionists and other hardliners used as interpretive ammunition against the free traders was the perceived failure of movements in the yen-dollar exchange rate to adjust trade flows and correct trade imbalances (van Wolferen 1986-87: 297, Fallows 1989a: 43-44). At an industry level, the SIA had effectively enlisted support for its claims in the

³⁶³ By way of contrast, Johnson's 1982 work on MITI offered an account of Japanese trade and capital liberalisation up to the 1980s broadly consistent with a traditionalist perspective (Johnson 1982: chapter 8).

mid 1980s with a chart publicising the failure of US industry market share in Japan to rise above about 10 per cent despite upward swings in the yen and formal Japanese trade liberalisation (SIA 1985: 12, Prestowitz 1988: 63). The continued growth of the US-Japan trade imbalance in dollar terms from 1985 through 1988, despite the large fall in the US dollar, was one of the perceived anomalies boosting the credibility of the institution-centred revisionists, not only within the hardline coalition but also across the wider American trade policy community.

This wider influence can be detected in centres of policy expertise not readily aligned with the major advocacy coalitions. Raymond Ahearn, a long-time analyst of US-Japan trade relations in the highly-regarded Congressional Research Service, provides one perspective on revisionism's emergence as an influential dissent from economic orthodoxy:

I started in 1978 at the time of the Strauss-Ushiba agreement not having a clue as to major trade barriers in Japan. But then all the revisionist critique started to come in and it was like a revelation to those of us who knew nothing that this is how Japan actually worked. We felt we'd been fools and ignorant not to have had a better insight into how the economy worked. It doesn't work as all the neoclassical economists have argued in the past. Where the hell have we been? So I think you felt duped, and then you think you've got sort of an insight, and then you overreact. I think that was part of this dynamic that went on with people.³⁶⁴

Edward Lincoln, an economist and Japan scholar who moved from the Japan Economic Institute of America (funded by the Japanese Foreign Ministry) to the prestigious liberal think-tank the Brookings Institution in the mid 1980s, highlights the durable influence of revisionism in terms of its focus on Japanese institutions. 'I would agree with the revisionists that many economists have been reluctant to think about institutions because institutions are hard to put into an econometric model. Economics can contribute useful things, but there is a social and institutional context that economic activity takes place in. The revisionists correctly identified a need to know more about institutional context'.³⁶⁵

A central premise informing the policy implications of revisionism concerned the strong continuities in Japan's political-economic system in terms of economic institutions and state-guided, mercantilist industrial and trade strategies. The Reagan and Bush

³⁶⁴ Raymond Ahearn, interview with author, 22 May 1996, Washington DC.

³⁶⁵ Edward Lincoln, interview with author, 24 January 1997, Washington DC.

Administrations were assailed for their traditionalist naivety in seeking to reshape Japan in the direction of a liberal capitalist economic model. Fallows (1989b: 60-62) asserted that 'the constant expectation that Japan is about to change is the central intellectual flaw in our trading policy ... It is foolish for America to adopt a policy that will fail unless [fundamental changes in Japan] occur — which is what all our market opening strategies boil down to. ... We should base our plans on the assumption that Japan's internal order is not going to change'. In a similar vein, van Wolferen (1989: 17) argued that 'barring some great upheaval unforeseeable at present, it is unlikely that Japanese institutions will come to mesh more smoothly with the outside world, because this would entail the break-up of the bureaucracy-business partnership that forms the heart of the System'.³⁶⁶ Again, the Gang of Four was able to draw strength from other respected analysts arguing for American recognition of the basic continuity of Japan's 'infant industry techniques'.³⁶⁷ The continuity argument comported with an emphasis on informal and invisible mechanisms used to sustain causal relationships despite the outward appearance of change. Those entertaining the traditionalist convergence thesis were cast as simply not understanding how Japan worked given its long history and the particular features of Japanese state-society relations and culture. Thus, for example, Prestowitz (1988: 115) criticised Americans' 'obtuse tendency to interpret Japan in terms of the United States and to assume that if there is not an overt legal basis for power, it does not exist. To accept this fallacy is vastly to overemphasize the actual loss of power and to ignore the subtle, nonlegalistic nature of Japanese society'. The revisionist emphasis on continuity in this high-stakes, institution-centred paradigm took aim not only at American naivety but also at a deliberate Japanese strategy to 'foster the illusion of change' (Johnson 1990: 124).

The logical policy conclusion from revisionist premises was that if Japan was not about to change, the United States needed to take action to reorder the political-economic relationship. The case for an explicitly results-oriented Japan policy carried special force when made by a former US trade negotiator proclaiming past American policy failure based on wrong-headed thinking about Japan. In his 1988 book *Trading Places*, Prestowitz (1988: 322) articulated the revisionist case with particular clarity:

³⁶⁶ van Wolferen referred to this aspect as the 'myth of slipping control' (van Wolferen 1989: 394).

³⁶⁷ See, for example, 'Trade, Japan, and the Year 2000' by Henry Rosovsky, *New York Times*, 6 September 1985.

Our negotiations should always be for results. To negotiate over the procedures of a foreign culture in hopes of obtaining an undefined “open” market is to court failure and frustration. We can negotiate to alter a revision in a law. We can negotiate to prevent a law from passing. We can negotiate a market share or a specific amount of sales or a sliding scale. We can negotiate anything identifiable and concrete. We cannot negotiate philosophy or perception and should not try to do so.³⁶⁸

For revisionists, the rule-oriented multilateral trading system was all but irrelevant to trade with Japan. As such, Johnson (1987a: 75) argued, ‘the GATT rules are fatally flawed because they do not take into account variations in national institutions’. When confronted with the charge that revisionists demanded managed trade, this was countered with the claim that management of trade (via cartels and collusive activity sanctioned by the state) was already endemic to the Japanese system and would encounter no obvious conceptual barrier if the United States accepted the way Japan worked and was clear about what it wanted. Thus, Johnson (1990: 121) maintained, ‘managed trade is already a fact of life ... the issue is not whether managed trade is desirable but the failure of the United States to manage its trade as effectively as Japan does’ (Johnson 1990: 121).³⁶⁹

Fertile soil and the “latent” hardliners

The revisionist paradigm has been explored so far in terms of its core *economic* representation of America’s Japan problem: high-stakes economic rivalry, the causal significance of Japan’s different institutions and doctrines, the strong continuity of Japan’s political-economic system, and the need for radical change of American trade policies. The focus has been on refinement and legitimation of a hardline coalition’s belief system, plus an element of “new information” enlightenment across other parts of the trade policy community. This evolutionary cognitive process would interact with external events outside the trade domain and, in turn, feed back into debates about the Japan problem. In the second half of the 1980s, the most dramatic external change outside the trade policy domain that opened up political space for hardline thinking about Japan was the rapid thaw in US-Soviet relations culminating in the end of the Cold War.

³⁶⁸ Prestowitz nominated the managed system of bilateral airline agreements as a model for the type of results-oriented approach he favoured more generally with Japan. For similar statements recommending the United States adopt some form of results-oriented Japan policy, see Fallows (1989b: 62) and Johnson (1990: 133).

³⁶⁹ For similar statements arguing managed trade sat comfortably with Japan’s political-economic system, see van Wolferen (1986-87: 303) and Fallows (1989a: 51).

Despite the fact that the revisionists focused much of their scorn about ignorance of Japan on professional economists seen as upholding the ideological tenets of the free trade coalition, self-consciously underpinning revisionism was a fundamental *political* assault on traditionalist thinking about Japan through a Cold War foreign policy paradigm. Revisionism posed as a reaction to ‘the ideological redefinition of Japan during the Cold War era in accordance with the interests of the Western alliance and with the role Japan will play now that the Cold War is ending’ (Johnson 1990: 107).³⁷⁰ The reduced relevance of Cold War doctrine as an orienting factor in US-Japan relations by the late 1980s ensured traditionalists were reliant more than ever on debating the Japan problem on narrow economic grounds. Claims of the primacy of economics and that America was fast approaching a new order of “competing capitalisms” further strengthened revisionism’s claims to contest debate on Japan policy, not simply on economic grounds but as part of a post-Cold War reordering of American foreign policy purpose (Islam 1990, Bergsten 1992, Thurow 1992, Garten 1992). Not to be outdone, the dean of the revisionists is reported to have obliged with an epithet for the times: ‘The Cold War is over; and Japan won’.

The Cold War dimension highlights the connection of revisionism to political currents and non-trade events and the “fertile soil” revisionists could exploit to frame debate on the Japan problem in hardline-friendly terms. The rise to prominence of the Gang of Four as carriers of new thinking about Japan was testimony not simply to the content of their ideas, but also to their capacity to fit with prevailing trends in elite and mass opinion in the United States. These included increasingly negative images of Japanese motivations and actions. Kingdon (1984: 76, 81) has argued persuasively that the key to understanding the role of ideas in the policy process ‘is not where the idea came from but what made it take hold and grow. ... the critical thing to understand is not where the seed comes from, but what makes the soil fertile’. Reinforced by mass media coverage of endemic conflict in US-Japan relations, a set of ideas emphasising the economic threat Japan posed to American interests found a favourable political setting in general anxiety

³⁷⁰ Prestowitz (1993: 80) also grounds American misperception in Cold War doctrine and the ‘predisposition in the United States to see postwar Japan as a chip off the US block’.

about Japan's economic power projection and American decline.³⁷¹ Revisionism resonated with "latent" hardliners in the American political system, outside the elite trade policy community. This suggests a dual image of revisionism (both cause and effect) in light of the unprecedented postwar conflict in US-Japan relations through the 1980s.

External factors such as real structural changes in relative economic positions of the two countries and the macroeconomic shocks of the early 1980s remain central to the economic and political salience of America's Japan problem and heightened US-Japan conflict. Moreover, well before terms such as 'capitalist development state' had found a place in elite discourse, perceptions of Japan as an unfair trader were solidly planted in the United States (Angel 1978). The early 1980s witnessed a deterioration in overall public attitudes towards Japan reflective largely of concern about the trade impact on American jobs (Watts 1984). In the shadow of a sharply rising trade deficit and increasing economic friction, Watts reported on a more 'troubled partnership' and a new pattern to the relationship in that what had been 'for many years a subject area reserved for experts and career officials has become daily fare for the American people at large' (Watts 1984: 89). Progressively through the 1980s, American public perceptions of Japan came to be filtered almost solely through the prism of economic interactions (Okimoto and Raphael 1993: 139). Much of the polling data and studies of American public opinion through the 1980s and into the 1990s affirmed that the trade issue provided the catalyst for more negative attitudes towards Japan.³⁷² A consistently negative finding related to the percentage of Americans who deemed Japan's trade behaviour "unfair". As one careful study has noted, the trade problem registered in the minds of many Americans not just as an economic irritant, but also as a moral issue reinforced by negative mass media coverage of US-Japan economic relations. The image portrayed was 'of a liberal economic system (that of the United States), based on principles of equal opportunity, openness, and fair competition, being challenged by a system that is essentially closed, collusive, and unprincipled (or unfair)' (Okimoto and Raphael 1993: 142). To be sure, the American public also retained ambivalent and often

³⁷¹ In their studies of newspaper coverage of three episodes of US-Japan conflict from the late 1980s, Budner and Krauss (1995: 346) found that 'the arguments most frequently cited in American stories seemed to emphasize a concern about Japanese behavior as threatening the economic well-being of the United States combined with a fear of actual or potential American decline'.

³⁷² See, for example, 'American and Japanese polls on the bilateral relationship: Trends and implications', *JEI Report*, 2 March 1990. For an account critical of media use of polling data to emphasise negative attitudes, see Okimoto and Raphael (1993).

schizophrenic attitudes towards the broader US-Japan relationship (for example, Japan as a rival *and* Japan as a partner) that acted as sources of stability and continuity (Johnson 1988, Okimoto and Raphael 1993). Nonetheless, by 1990 one highly-regarded survey found that 60 per cent of the American public saw the 'economic power of Japan' as a 'critical threat' to 'the vital interest of the United States in the next 10 years'. Seventy-one per cent agreed that Japan practiced 'unfair trade with the United States' (Reilly (ed.) 1991: 20, 22).

While public opinion may set broad constraints on political action, it is important not to overstate its impact or portray it as providing overly binding or uniform signals. It is a slippery notion 'partly because there are many publics with many different opinions and partly because opinion on all but relatively simple matters tends to be uninformed, unstable, and sensitive to different ways of asking poll questions' (Wilson and DiIulio 1995: 128). Against this backdrop, a striking observation made by a number of sophisticated observers is that broad public opinion often displayed more balanced and less accusatory views on Japan compared with the hostility among large sections of American *elite* opinion through the 1980s (Watts 1984: 48, Frost 1987: 14, Okimoto and Raphael 1993: 139). The richer, more fertile soil for revisionism after 1985 was found less in mass opinion than in the deterioration of American elite attitudes towards Japan. Samuels (1992: 33) has pointed to two separate Japan booms in the broader American intellectual community in the 1980s:

The first was flattering and Pogo-esque: "We have met the enemy and he is us". The central lesson of this first boom was that the United States could compete successfully with Japan if we fixed what is broken at home, preferably by learning the secrets of Japanese success. The second was a finger pointed across the Pacific. Often it was hostile and accusatory: Japan (indeed, "the Japan problem") was replacing the Soviet Union as America's most pressing foreign policy problem.

Historically, American elites paid only sporadic attention to Japan, except during times of difficulty in the US-Japan relationship (Glazer 1975, Samuels 1992). The bilateral conflict of the 1980s marked it as the most difficult decade in US-Japan relations since World War II. The trade crisis provided the catalyst for American elites to look at Japan in a less than flattering light with one close observer noting an 'eruption of ill will' in the mid 1980s in which not just politicians but 'respected academics and a broad range of private sector spokesmen have been increasingly critical of Japan' (Lincoln 1985: 22).

Esteemed American journalist Theodore H. White's *New York Times* magazine article of July 1985 on 'The danger of Japan' has been cited as a harbinger of more negative American elite opinion.³⁷³ White likened Japan's 1980s drive for markets with the 1930s drive for empire, casting Japan's external economic policies as the equivalent of a counterattack against the United States after World War II.³⁷⁴ The fact that the Gang of Four would themselves eventually wear the tag of "Japan-bashers" (both in Japan and the United States) illustrates the degree to which their ideas were seen to mesh with prior anti-Japan sentiment displayed by high-profile actors in American politics and business. Again, more negative attitudes towards Japan need to be seen alongside mirror images of Japanese success and American decline, the latter theme developing its own intellectual cottage industry in the late 1980s (Kennedy 1988, Schlosstein 1984, Nye 1990).

In the context of this deterioration in American elite attitudes towards Japan, issue-areas beyond the trade domain provided fertile soil for the mobilisation of latent hardliners in the second half of the 1980s. A more politicised and fractious environment surrounded the nexus of American economic and security interests — traditionally policy domains that central decision makers in both countries strived to keep operationally separate. A series of conflicts left a residue of increasingly negative attitudes towards Japan, the most notable being the controversy over Toshiba's violations of the COCOM regime, the saga over Japan's development of the FSX fighter aircraft, and the perceived failure of Japan to adequately support American military operations in the Persian Gulf (Trezise 1989-90, Watanabe and Imperiale 1990, Ortmayer 1992). As outlined in chapter 3, the wave of Japanese foreign investment in the United States in the second half of the 1980s also generated a sharp political response (Burstein 1988, Tolchin and Tolchin 1988, Yamamura (ed.) 1989). And drawing strength directly from these political currents and bringing the revisionists into increasingly bitter disputes with American traditionalists were claims of inordinate Japanese influence in the American political system (Choate 1990, Holstein 1990).³⁷⁵ The result emerging from this broader front of US-Japan conflict was an elite community increasingly polarised over what sort of Japan problem

³⁷³ 'The danger from Japan' by Theodore H. White, *New York Times Magazine*, 28 July 1985, pp 18-23.

³⁷⁴ Samuels (1992: 34) describes White as 'the first policy intellectual to question the benefits to the United States of the postwar alliance with Japan'. Others to identify the White article as symbolic of a sea-change in American elite opinion include Packard (1987-88: 358) and former Japanese Ambassador to the United States Yoshio Okawara, interview with author, 14 February 1997, Tokyo.

³⁷⁵ See also 'The Japan-Bashers are poisoning foreign policy' by George Packard, *Washington Post*, 8 October 1989.

confronted the United States and whether a Japan “threat” was in the process of becoming the basis for far-reaching bilateral rivalry in the wake of the waning military threat of the Soviet bloc.³⁷⁶

Conclusion

By the end of the 1980s, the hardliners had placed demands for a results-oriented Japan policy squarely on the official policy-making agenda. Demands of congressional and business hardliners drew strength from the emergence of revisionism as a coherent hardline paradigm geared around high-stakes economic rivalry between Japan and the United States, the causal significance of Japan’s particular economic institutions and doctrines, the strong continuity of the Japanese system, and the need for radical change in US policy towards Japan. The scaling down of the Cold War and other events outside the trade policy domain created the fertile soil for the revisionists to rise to prominence. While this was aided by more negative attitudes identified in American public opinion, the more telling trend was the sharp deterioration in images of Japan held by elite opinion-makers. This in turn helped to shift the balance of initiative within the American trade policy community further in the direction of the hardliners. The next chapter analyses the reaction of a more defensive free trade coalition to these developments.

³⁷⁶ ‘Washington polarized over Japan policy’ by Peter Ennis, *Tokyo Business Today*, March 1990, pp.16-17. Ennis reports on the debate sparked by a proposal from US State Department official Kevin Kearns for the creation of a “Team B” panel of hardline trade, defense, and foreign policy specialists critical of the Bush Administration’s Japan policy.

8 Free traders and Japan's "structural impediments"

Introduction

The enhanced position and influence of the hardliners in the American trade policy community in the wake of the regime crisis had its corollary in a more fragmented and defensive free trade coalition. As noted in the previous chapter, the easing of Cold War tensions through the second half of the 1980s left traditionalists in the Free Trade-Good Relations coalition reliant more squarely on economic arguments in countering the sort of hardline definition of the Japan problem which the revisionists had articulated forcefully. After 1985, a process of puzzling about Japan by professional economists in the United States lent greater credibility to the notion that the way Japan worked challenged core parts of the traditional free trade paradigm. Pragmatic free traders in the Bush Administration co-opted aspects of this policy learning *across* the American trade policy community in a deliberately process-oriented framework.

This chapter focuses on these two aspects of the free traders' reaction to the hardline challenge in the late 1980s. Greater analysis of the Japan problem saw reputable economists in the American trade policy community draw conclusions about Japan not dissimilar to those of the hardliners. Based on econometric analyses and micro-institutional studies of the Japanese economy, many within the group renowned as the bastion of free trade opinion concluded that Japan was indeed different from other industrialised economies in terms of its international openness. The coupling of this analysis of Japan with new theories of international trade lent weight to arguments that not only might the Japan problem be a source of *political* conflict, it may have far reaching *economic* implications. This process of learning would leave an imprint on policy with the Bush Administration's Structural Impediments Initiative. As the Bush Administration's key innovation in Japan policy, SII was geared both at warding off demands for a results-oriented approach and at dealing with what many free traders saw as the underlying structural sources of bilateral trade tension.

Economists and the Japan Problem

The influence of professional economists in policy-making in the United States remains a curiously under-explored topic of analysis. Even so, a number of studies have pointed to analysis of policy problems by economists playing an important role in framing discussion of issues and influencing policy outcomes. The creation and staffing of specific federal government institutions by economists provides the obvious base for such influence with Kingdon (1984: 144) identifying ‘a long-range trend toward more economists (and people receptive to their thinking) in government’. This is clearest in the executive branch where the Treasury, the President’s CEA, OMB and, more recently, the National Economic Council (NEC) are important sources of economic analysis of US government policies.³⁷⁷ Economists and their language of efficiency and opportunity cost have been seen as influential in steering policy towards more market-oriented regulatory approaches in domestic issue-areas such as aviation, trucking and communications (Kingdon 1984, Derthick and Quirk 1985).

A more qualified picture emerges in the case of US trade policy. Those who note the influence of liberal trade ideas of the sort economists have advocated are also careful to point to the centrality of long-standing fairness and reciprocity norms in US trade policy debate (Destler 1995; Goldstein 1988, 1993; Mucciaroni 1995). Hence, real world circumstances have figured most prominently in explanations of America’s generally liberal postwar trade regime — specifically, the association of the Smoot-Hawley tariff of 1930 with the deepening of the Great Depression, the subsequent record of strong economic growth associated with a more open policy in the postwar years, and the strategic basis for a liberal trade policy during the Cold War. Judith Goldstein has made a particular point of identifying a role for ideas in US trade policy, but she has sought nonetheless to link ideas closely to specific political interests.³⁷⁸ At odds with the more abstract public welfare arguments of economists has been the importance of legal, client-

³⁷⁷ In the mid 1980s, Rhoads (1985: 7) noted that, ‘Increasingly, economists hold important political offices in their own right. Under President Reagan economists have headed the State Department, the Federal Trade Commission, and the White House’s domestic policy council. Under President Carter four PhD economists served as secretaries of cabinet departments, and two others headed the Civil Aeronautics Board and the Interstate Commerce Commission’ (Rhoads 1985: 7-8).

³⁷⁸ Goldstein (1993: 239) maintains, for example, that ‘American commercial policy is not a story of enlightenment in which a progressive idea — liberal free trade — triumphed. Liberal policy gained support in the United States in the 1930s for the same reasons as did protectionism in the 1860s: elected leaders conceived of each policy as the best means to further their interests’.

based norms in the American trade policy process. Tensions created relate not simply to competition for bureaucratic influence but to ‘competing visions, sometimes invested with a good deal of emotion, as to how to discharge a public responsibility’ (Wilson 1989: 61).³⁷⁹ The strong legal orientation of US trade policy can be seen in the institution of the United States Trade Representative’s office, created by Congress under the Trade Expansion Act of 1962 based on concerns that central decision-makers in the executive were less than aggressive in demanding trade “concessions” from America’s trading partners (Destler 1995: 19).³⁸⁰ Still, economists have been active players in the US trade policy process by virtue of their institutional position and presence on such bodies as the inter-agency, sub-cabinet Trade Policy Committee. More broadly, networks of economists (in government, academia, and the think tank community) have been prominent advocates in US trade policy debate, playing something akin to a “gate-keeping” role in trade discourse, differentiating legitimate economic arguments and policy innovations from illegitimate ones. As such, how American economists have puzzled about the Japan problem forms part of the wider process of learning about Japan within the American trade policy community.³⁸¹

Writing in the wake of the trade regime crisis, MIT economics professor Paul Krugman outlined his own and what he saw as the prevailing view of the Japan problem among professional mainstream economists in the United States.³⁸² He argued that in contrast with hardline conventional wisdom, ‘few economists’ would agree with a view of Japan that takes ‘unfair advantage of our open market while closing its own’ (Krugman 1987a: 16). He maintained that ‘US-Japanese trade tension in fact owes little to Japanese trade and business practices’ (1987a: 35). ‘The accusations about these practices in the United States, I argue, are rationalizations for protectionist demands that would be there in any

³⁷⁹ Wilson (1989: 61) highlights these tensions whereby lawyers are prone to refer to economists as ‘dogmatic’ or ‘ideological’. For their part, economists ‘see themselves as social scientists — as “dispassionate searchers for the truth”; lawyers, on the other hand, are seen as people less interested in truth than in finding facts to support a predetermined case’.

³⁸⁰ Four of the six USTRs through the Carter, Reagan, Bush and Clinton Administrations have been lawyers (Robert Strauss, Carla Hills, Mickey Kantor and Charlene Barshefsky). Clayton Yeutter stands out in having a PhD in economics. William Brock was a former Senator and member of the House of Representatives.

³⁸¹ As chapter 7 notes, whatever the actual influence of economists, it is clear from the writings of the revisionists and other hardliners that they certainly *perceived* American mainstream economists as their main intellectual opponents in contesting American policy debate on the Japan problem.

³⁸² In an American context, the term “mainstream” encompasses a clear majority of economists — liberal and conservative, Democrat and Republican but excludes radical, socialist or Marxist economists (Rhoads 1985: 3).

case. If the Ministry for International Trade and Industry (MITI) did not exist, the Americans would have to invent it'. The main analytical and policy problem for economists then was not one of economics but politics: 'How should those who view US-Japanese trade as mutually beneficial protect that trade from the political frictions menacing it?' (Krugman 1987a: 16).

A few years later, Krugman had a somewhat different take on the Japan problem. He described the conventional wisdom in the US policy community whereby:

despite its relative absence of legal barriers to trade, the Japanese market is de facto protected because it is not competitive in the same way as other countries. Collusive behavior involving both firms and a highly cartelized distribution sector effectively shut out many foreign products, even when imports would be cheaper and/or of higher quality than the Japanese version. Foreign direct investment is similarly choked off by an inability to get local business cooperation, and the inability to establish local subsidiaries inhibits exports to Japan. And this more or less conspiratorial system tends particularly to close ranks when a key new technology is at stake, assuring Japanese firms of a chance to capture new markets even when foreign firms have an initial lead (Krugman 1991a: 2-3).

Rather than assailing the conventional wisdom as the creation of protectionists, Krugman (1991a: 3) found that 'on the whole ... the conventional wisdom survives crude empirical testing more or less intact'. Drawing lessons from a 1989 conference of American and Japanese academic specialists hosted by the National Bureau of Economic Research, Krugman (1991a: 8) concluded that 'Japan *is* different. ... [and] in some ways Japanese difference does contribute to trade tensions (which is not the same thing as saying that it is in any sense "unfair"). Japan does appear to be marked by a style of relationships between firms that makes it difficult for outsiders, including foreigners, to break in'. What at face value appears as a case of individual learning about the Japan problem seems to be reflected in a wider pattern of learning within the American economics profession, at least the more "liberal" mainstream. Within a few years, a long list of American economists, including highly reputable figures in international economics, had lent support to the view that Japan was indeed different in terms of its international openness and the pervasiveness of collusive, insider relationships. Among academic economists, this list included *inter alia*: Bela Belassa, Robert Lawrence, Rudiger

Dornbusch, Paul Krugman and Alan Blinder.³⁸³ In the world of policy think tanks, prominent scholars at traditional centres of free trade opinion — the Brookings Institution (Edward Lincoln) and the Institute for International Economics (C. Fred Bergsten and Marcus Noland) — drew similar conclusions about Japan's asymmetrical openness. While the issue of Japan's relative openness remained (and still is) controversial, a reputable wing of American professional economists, the traditional bastion of free trade opinion, added legitimacy and credibility to the core hardline premise that Japan plays by different rules. This in turn weakened and fragmented the free trade coalition in an already hostile political environment.

As with tracing the rise of revisionism, there is no pretence to uncover a specific path by which a number of highly regarded American economists came to learn broadly similar lessons to Paul Krugman. What is suggestive in terms of timing, however, is the sharp increase in economic analysis of Japan's economic openness and its micro-institutional features after 1985. Prior to the mid 1980s, analysis of Japan's impact on the world economy was largely the preserve of a relatively small network of specialists on the Japanese economy. A general view of Japan as on a path of economic liberalisation in conformity with international trade norms found expression in authoritative analysis by mainstream US economists (Patrick and Rosovsky (eds.) 1976). Contrary to pronouncements by hardliners on Japan's closed market, Japan economy specialists stressed the conformity of Japan's trade structure with an orthodox view of international trade based on comparative advantage. As noted in chapter 4, the standard for this analysis was set by Michigan economist Professor Gary Saxonhouse and his widely cited papers of the early 1980s (Saxonhouse 1982, 1983a). Based on a Heckscher-Ohlin empirical model of international trade, Saxonhouse concluded that Japan's trade structure (defined in terms of sectoral net exports) was well explained by factor endowments and distance from trading partners. In effect, Saxonhouse concluded that, based on his sample, Japan was neither more nor less open than other countries. Later work by Saxonhouse, often in reply to analysis reaching contrary conclusions, incorporated alternative trade models into the study of Japan's trade structure but yielded the same basic conclusions (Saxonhouse 1989, Saxonhouse and Stern 1989).

³⁸³ In this group, Dornbusch was undoubtedly the most outspoken advocate of a more aggressive Japan policy. See 'Give Japan a target and say "import"' by Rudiger Dornbusch, *New York Times*, 24 September 1989, Sect. 3, p. 2.

Saxonhouse's contribution to this increasingly controversial area of debate has been summarised as concluding that Japan's informal barriers 'however vexing, are ultimately of little quantitative significance. ... however unusual Japan's trade pattern, it can be explained on the basis of Japan's equally unusual factor endowments, without reference to trade policy, much less trade policy of a *sub rosa* sort' (Bergsten and Noland 1993: 180).

Centres of economic analysis closely involved in free trade advocacy appear broadly to have shared the Saxonhouse perspective in the first half of the 1980s. The central message was that hardliners miscast the Japan trade problem that was basically generated by factors independent of Japanese practices or policies. This view of the Japan problem as largely one of macroeconomic imbalances and politically active *American* protectionists registered in analyses by both conservative and liberal economists. Chapter 4 highlighted the special attention President Reagan's CEA devoted to the Japan problem in its February 1983 annual report.³⁸⁴ While advocating the benefits of further Japanese liberalisation, the CEA was at pains to explain Japan's trade patterns and its bilateral surplus with the United States in terms of its limited natural resources that ensured large deficits in primary products. More liberal mainstream economists at the IIE largely mirrored analysis by conservative Reagan Administration economists. In their 1985 study entitled *The United States-Japan Economic Problem*, Bergsten and Cline (1985) paid particular attention to the macroeconomic factors which underpinned the trade imbalance noting that virtually the entire growth in the bilateral imbalance, from about \$12 billion in 1980 to almost \$40 billion in 1984, could be explained by exchange rate misalignment and differences in economic growth rates. While acknowledging the role of individual barriers as sources of frustration and conflict, they drew attention to Japan's path of liberalisation arguing that the 'explanation for the rapid *escalation* of tensions must lie elsewhere, notably at the macroeconomic level' (Bergsten and Cline 1985: 5). On the issue of Japan's trade structure, Bergsten and Cline found that Japan's import share, although lower than most OECD countries, was basically normal after controlling for economic size, natural resource endowments, and distance from trading partners — conclusions virtually identical to those of Saxonhouse.

³⁸⁴ See CEA (1983: 56-58) on 'The Issue of Trade With Japan'.

The Saxonhouse and Bergsten and Cline studies were among the earliest examples of a chain of puzzling by the economics profession (especially in the United States) aiming to shed light on the same basic question: Does Japan import less than it should? By the end of the 1980s, one survey reported an 'astonishing diversity' of conclusions (Takeuchi 1989: 144).³⁸⁵ At the very least, this diversity pointed to a more fragmented set of views on the Japan problem within the traditional free trade coalition. A significant wing of mainstream economic opinion sided with the view that Japan was different in terms of abnormally low foreign penetration of its economy (both trade and investment) and that micro-institutional features amounted to plausible evidence of collusive insider relationships.³⁸⁶ One class of studies in the tradition of Saxonhouse and Bergsten and Cline applied empirical models of trade, but concluded that Japan was indeed an outlier in terms of abnormally low imports. The diverse findings of these studies relate in part to significant differences in underlying trade models and in the measured variables.³⁸⁷ For example, Balassa (1986a) and Balassa and Noland (1988) used a similar regression technique to Bergsten and Cline, but with slightly different variables, and found that Japan was an under-importer among industrial countries in terms of imports to GDP. Balassa (1986b) undertook a similar exercise focused narrowly on manufactured imports reaching the same conclusion.

Arguably the most influential of the studies concluding Japan to be an outlier in terms of low imports was by Robert Lawrence (1987), an associate at the Brookings Institution and subsequently a professor at Harvard University. From his analysis grounded in a theoretical model of trade (the Krugman-Helpman model of intra-industry trade in differentiated products), Lawrence concluded that Japan's manufactured imports were about 40 per cent lower than one would expect of a typical industrial economy. He did not, however, draw specific conclusions as to causal factors (officially-sanctioned barriers, market structures, or unusual preferences).³⁸⁸ And while Lawrence's study not

³⁸⁵ See Golub (1994: 11) for a later survey of relevant literature that also concludes that economists 'seem quite evenly divided' on whether Japan's unusual trade patterns 'indicate unusual protection or unusual economic characteristics and comparative advantage'.

³⁸⁶ The main focus of this section is on the trade issue. See Mason (1992) and Encarnation (1992) for studies on Japan's relatively low internal foreign investment.

³⁸⁷ Golub (1994: 17) points to a pervasive problem in interpreting results from all such trade model studies 'as it is a joint study of the validity of the model and the normalness of Japan'. Hence a finding that Japan's trade is not consistent with the model is not necessarily an indication of import barriers.

³⁸⁸ Lawrence's work set off a long-running debate with Saxonhouse. For later perspectives of both scholars, see Saxonhouse (1993) and Lawrence (1993).

surprisingly was subject to academic criticism, at least one knowledgeable observer scored it as providing ‘the seal of approval of the economics establishment to the charge that Japan’s markets for manufactures are tacitly closed to imports’ (Krugman 1987b: 549). Hardliners drew directly on the Lawrence analysis in making their case for a results-oriented policy. The business community’s ACTPN (1989) report made a point of citing the studies of Balassa and Lawrence and highlighting Krugman’s ‘seal of approval’ statement. Other work by the Brookings Institution’s Edward Lincoln (1988, 1990) reinforced the outlier thesis based on Japan’s relatively low level of intra-industry trade.

Economists’ puzzling about Japan also took the form of more concerted attention to the micro-institutional features of the Japanese economy around which claims about abnormally low imports and peculiar structural barriers to balance of payments adjustment could be plausibly grounded. As noted previously, the exchange rate/trade deficit adjustment puzzle was one of the central arguments hardliners used to attack the credibility of mainstream economists and their non-institutionalist analysis of Japan. It provoked a stream of work by economists on factors which might explain the persistence of the US trade deficit and Japan’s continued high trade surpluses despite the large depreciation in the US dollar from its early 1985 peak.³⁸⁹ One line of inquiry on the external adjustment issue concerned the pricing strategies of Japanese firms in response to exchange rate changes and the conjecture that this reflected strategic behaviour permitted by the presence of a sanctuary market at home. This “pricing to market” behaviour by Japanese firms ensured their capacity to alter their cost-price margins in order to stabilise their level of demand (Marston 1990, 1991).³⁹⁰

Other studies looked to identify non-tariff barriers or “insider relationships” as structural impediments and hence sources of economic friction. This work focused on the alleged impact of *keiretsu* business arrangements and purchasing practices, imperfectly competitive market structures and Japan’s complex distribution system. A widely-cited study by Kreinin (1988) compared purchasing behaviour of Japanese, American and

³⁸⁹ See, for example, Krugman and Baldwin (1987), Baldwin (1988), Hooper and Mann (1989) and Lawrence (1990). For persuasive evidence that the external adjustment process as postulated by a conventional Mundell-Fleming model remained operative through the second half of the 1980s, see Krugman (1991b) and Bosworth (1993).

³⁹⁰ See Dornbusch (1987) on the theoretical basis for pricing to market.

European manufacturing subsidiaries operating in Australia and concluded that Japanese firms were much more inclined to use closed procurement practices and to source products from home suppliers.³⁹¹ Applying a cross-industry framework, Petri (1991) found that imports into Japan tended to be relatively lower when the Japanese government was the buyer, when goods were sold to other businesses, or when high distribution margins suggested oligopolistic behaviour. Lawrence (1991b) added *keiretsu* affiliation to Petri's model finding that while *vertical keiretsu* affiliation may be efficiency enhancing (leading to lower imports and higher exports), *horizontal keiretsu* affiliation was not (reducing imports only). Another study by Fung (1991) found that (*ceteris paribus*) *keiretsu* structures tended to increase Japan's trade surplus with the rest of the world in general, and the United States in particular. Using a cross-national framework, Noland (1992) concluded that *keiretsu* were consistently associated with higher than expected net exports and with lower than expected imports, but cautioned that whether this reflected efficiency-enhancing *keiretsu* affiliation or barriers to entry was indeterminable.³⁹²

Complementing the wave of trade model studies and micro-institutional analyses of Japan was greater attention to relative prices in Japan and the inference that large and sustained price differentials for similar or identical products provided plausible evidence of informal trade barriers. The much remarked upon "47th Street Photo Phenomenon" was perhaps the most famous anecdote on the price differential issue, although subsequent evidence suggested a mixed picture concerning the relative price of Japanese goods in Japan relative to the United States (Saxonhouse 1993). At least one set of statistics generated much less controversy — the degree to which *imported* goods in Japan were more expensive than in their home markets (Golub 1994: 21). Evidence that traded goods generally were priced significantly higher in Japan compared with other industrial countries figured prominently in debates about Japanese structural impediments in the late 1980s and early 1990s (Economic Planning Agency of Japan 1989; US Department of Commerce 1989, 1991; Lawrence 1991a). A joint survey by the US Commerce Department and MITI under the bilateral Structural Impediments

³⁹¹ For a contrary view arguing that Kreinen's findings largely reflect the more recent origins of Japanese manufacturing operations in Australia, see Drysdale (1993).

³⁹² For studies emphasizing the economic logic and efficiency benefits of *keiretsu* and challenging the barriers-to-entry view, see Sheard (1991, 1992, 1994) and Aoki (1994).

Initiative found that two-thirds of the products surveyed were on average 37 per cent more expensive in Japan than in the United States.³⁹³

This virtual cottage industry of research on Japan's openness that sprung up in the second half of the 1980s was preceded, and to some extent informed, by new perspectives on trade theory and policy in the economics profession. For the most part, traditionalist free trade orthodoxy maintained that free trade was the most appropriate policy for maximising national welfare regardless of what other countries did.³⁹⁴ Hence, if Japan was seeking to shield its economy from foreign competition it was mostly hurting itself; effects on other countries were distinctly secondary. By contrast, the so-called "new trade theory" and its policy-oriented counterpart – "strategic trade policy" – carried a distinct message that the economic stakes of Japan being different and relatively closed *could* be very high. The new trade perspective provided important legitimation for government intervention and an activist trade policy, although the strict assumptions in strategic trade models meant most mainstream economists remained cautious about declaring free trade passé.

The late 1970s witnessed the origins of new trade theory based on the integration into the trade literature of insights from industrial organisation theory with models assuming imperfect competition, production externalities or some combination.³⁹⁵ As originally conceived, new trade theory was overwhelmingly an exercise in positive rather than normative economics.³⁹⁶ The starting point was the idea of non-comparative advantage trade and that underlying differences in national resources and aptitudes do not fully determine the pattern of international trade specialisation. That the fastest growing component of trade after World War II was between industrial countries with similar factor endowments provided one of the real world puzzles for questioning the hegemony of the traditional comparative advantage view. Another was that many of the goods that entered into international commerce were produced in imperfectly competitive

³⁹³ Later studies concluding that price differentials are suggestive of informal barriers have included Knetter (1994), Sazanami, Urata and Kawai (1995) and Noland (1995).

³⁹⁴ The static optimal tariff argument was the long-standing exception.

³⁹⁵ Important early contributions to the new trade theory are Krugman (1979, 1980, 1981), Dixit and Norman (1980), Lancaster (1980), Helpman (1981) and Ethier (1982). See Krugman (ed.) (1986) for an accessible introduction to this literature.

³⁹⁶ Proponents of the new view readily concede antecedents, not least in Adam Smith's (pre-Ricardo) idea that division of labour lowers unit costs. Indeed, it has been argued that the new view should be seen largely in terms of formalisation and a synthesis of old and new views (Dixit 1993: 17).

industries. The basic insight of the new trade view was that trade patterns among countries were indeterminate under economies of scale and imperfect competition implying the importance of increasing returns as a cause of trade and the need to model international markets as imperfectly competitive. According to one new trade theorist, the 'key feature of the new trade theory was that it offered models in which increasing returns were allowed their natural affinity with imperfect competition — which made a huge difference in terms of plausibility and persuasiveness' (Krugman 1992: 426). With indeterminate trade patterns, the new trade view was grounded in a world in which 'expectations matter, and historical accidents and temporary government policies can all matter forever. ... Countries can inherit shares in a given alternative by historical accident or can stake claims to shares by policy aimed at getting there (that is, reaching some preferred alternative) first' (Richardson 1993: 91).

The new trade theory provided a source of internal dissent from the traditionalist free trade view in terms of the positive economics of trade. Its crossover into the realm of policy in the form of strategic trade policy proved more controversial given its capacity to justify neo-mercantilist policy demands. With a view of markets as imperfect, the new view of trade opened the door to a rigorous economic justification for international trade policies that were not only interventionist but involved an element of international confrontation. Of the early contributions in this literature, the most famous models identified a capacity for governments to shift oligopolistic profits towards one's own firms (Spencer and Brander 1983, Brander and Spencer 1985) and for import protection to serve as export promotion (Krugman 1984). Such insights were quickly incorporated into a raft of hardline-friendly diagnoses of the Japan problem by analysts whose view of the world stressed competitive advantage of firms (rather than comparative advantage), pervasive externalities and the imperative of an industrial policy to promote "high value" industries, especially in manufacturing. The new trade view saw external economies as a legitimate and potentially high-stakes international competitive issue and pointed to the possibility that a country that systematically tries to promote industries subject to external economies can raise its standard of living at the expense of other countries. This was precisely the sort of Japanese motivation and strategy which analysts at the Berkeley Roundtable on the International Economy promoted as the "real story of why Japan works" with the notion of Japan's 'moving band of protection' and a superior

development strategy of targeting industries on the basis of their potential for economic growth and technological change (Tyson and Zysman 1989, Tyson 1992).

The more economically mainstream intersection of the new trade view with the Japan problem focused less directly on Japan's trade and industrial policies, but nonetheless stressed 'the ability of a government to create the moral equivalent of a border policy by its choice of non-border policies' (Richardson 1993: 101). This, in turn, provided a basis for legitimate grievances about Japan's weak competition policy, barriers to foreign direct investment (including tightly regulated financial services markets), permissive policies towards recession cartels among weak firms, and the real and long-lasting impact of a restrictive distribution system. The upshot, according to Richardson's careful survey, was a new pragmatism among a large section of mainstream international economists courtesy of the new trade literature. According to this pragmatism, 'Competition and open markets are on balance good things. But there *are* exceptions, and these exceptions may warrant policy intervention. ... The new view has hardly killed the case for free trade; if anything, it has probably strengthened it ... what *has* been killed though, is the ability to defend free trade on the basis of ideology alone — and that may be just as well' (Richardson 1993: 93-94).³⁹⁷

The new trade view saw the emergence of a reputable wing of mainstream economists less enthralled by the twin ideas of comparative advantage and unconditional free trade and more pragmatic in their willingness to countenance interventionist and confrontational policy reactions, especially in the presence of plausible evidence of strategic or collusive behaviour in imperfectly competitive markets. That such work found its way into the thinking of pragmatic free traders in the US policy process is hardly surprising given the salience of the Japan problem. One long-time US Treasury Department official offers a sense of this evolution from the *laissez-faire* high tide associated with the first Reagan Administration:

There used to be sharper cleavages between the Chicago school view versus the Berkeley Roundtable view. Now it is closer to a merger; people see market imperfections. The theoretical work on imperfect competition and economies of scale —

³⁹⁷ Richardson's (1989) own empirical work has been cited widely as evidence of how the new view can strengthen the case for free trade.

Krugman models — have had an effect. There are few who argue pure free trade with Japan. Before you had two schools; now it's harder to perceive two schools.³⁹⁸

Of course, there are obvious limits in focusing narrowly on the role of specialist learning around the ebbs and flows of scholarly literature. There is no clear reason to suspect perceptions of economists to be any less influenced by non-cognitive circumstances or human motivations grounded in self-interest (in the case of the latter possibly less). The basic point, however, is to draw attention to the fact that by the end of the 1980s a significant wing of the American economics profession was willing to countenance that the way Japan worked challenged *core* parts of a traditional free trade paradigm. In effect, some of the lessons drawn by the hardliners were not radically different from lessons drawn by hitherto avowed free traders. Writing in 1990, for example, Princeton economics professor Alan Blinder argued at length that the way Japan worked 'should make economic theorists squirm'.

Our intellectual conceptualization of the Japanese economic system undergirds policies towards Japan. If our picture is distorted, our policies will be, too.

Studying the Japanese economy has led me to a tentative conclusion: that market capitalism, Japanese-style, departs so much from conventional Western economic thought that it deserves to be considered a different system. ...

Who is right? I'm not sure. My only claim is that the Japanese do not do business the American way. ... The Japanese seem to seek a degree of economic autarchy that standard theory sees as inappropriate. ... All in all, economists weaned on Western economic theory must conclude that Japan does almost everything wrong. ...

American capitalism rests on a grand theory begun by Adam Smith. There is no comparable theory of Japanese capitalism, but we need one if we are to formulate an intelligent economic policy toward Japan. The Japanese themselves seem less concerned with conceptualizations than with results. So, we may have to produce that theory ourselves.³⁹⁹

The Structural Impediments Initiative

This process of puzzling about Japan by free traders in the American trade policy community found a form of policy expression in the Bush Administration's Structural Impediments Initiative. The previous chapter highlighted the significant pressures on the Bush Administration to adopt a more confrontational approach to Japan. With SII,

³⁹⁸ Not-for-attribution interview.

³⁹⁹ 'There are capitalists, then there are the Japanese' by Alan Blinder, *Business Week*, 8 October, 1990 p. 9.

pragmatic free traders in the administration sought to deal with what they saw as the underlying structural sources of US-Japan trade tension, without resorting to a results-oriented market access policy. In the words of one of its key architects, SII 'was seen as a way of demonstrating to ourselves, the Japanese and the US Congress that there was a serious initiative underway in the Bush Administration to tackle the underlying problems which led to 301-type tensions'.⁴⁰⁰

'Suggested remedies for dealing with the "Japan problem" ran the gamut of the policy spectrum' when the Bush Administration took office (Janow 1994: 55). The administration's immediate challenge was the implementation of Super 301 and hardline demands that Japan as a country be declared an unfair trader.⁴⁰¹ At her confirmation hearing in January 1989, new USTR Carla Hills told the Senate Finance Committee that she would 'aggressively implement' the 1988 trade law, using the 'credible threat' of retaliation to provide 'essential leverage'.⁴⁰² As she recalls, 'the Bush Administration didn't think that that law was the way to accomplish the objective, but it was on the books and the Trade Representative was required to carry out the law'.⁴⁰³ At hearings in March 1989, Senator John Danforth ensured Bush Administration officials were under no doubt about the view of hardliners in Congress, saying that 'Super 301 was designed to be aimed at more than Japan but no less than Japan. ... Super 301 was written with Japan in mind'.⁴⁰⁴

Against this backdrop, SII was tactically important in demonstrating to Congress that the administration had its own ideas about how to deal with the Japan problem.⁴⁰⁵ It also had a wider purpose in that Bush Administration officials were keen to avoid fall-out from Super 301 compromising their top trade priority that was to make progress on the Uruguay Round of GATT talks. As Mastanduno (1992b: 237-238) suggests:

⁴⁰⁰ Charles Dallara, interview with author, 28 August 1996, Washington DC.

⁴⁰¹ Schoppa (1997: 69) notes that 'as Bush's cabinet appointees appeared before the Senate for confirmation hearings, Senators like John Danforth and Max Baucus (both of whom had led the fight for the Super 301 provision of the [1988] Trade Act) made it clear that Congress would not be satisfied unless the administration "named" Japan'.

⁴⁰² Statement of United States Trade Representative-designate Carla Hills before the Senate Finance Committee, 27 January 1989.

⁴⁰³ Hills, interview, 1996.

⁴⁰⁴ *Inside US Trade*, 7(9), 3 March 1989, p. 1.

⁴⁰⁵ As one former USTR official put it, SII was 'in part a response to Congress' demands that we do Super 301 against Japan; a way to fend off "results-oriented" negotiations'. Massey, interview, 1996.

Executive officials believed that without the SII, Congress was likely to adopt measures that would jeopardize the successful completion of the Uruguay Round of multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT) – the administration's top priority in trade policy – and drive American policy in the illiberal direction of managed trade.

Bush Administration officials in Treasury and USTR began piecing together the components of SII in March 1989.⁴⁰⁶ The central objective was to address the macroeconomic sources of the trade imbalance and the structural regulations, laws and business practices in the Japan seen as impeding balance of payments adjustment. To be sure, the 'idea of a structural initiative had been floating around the bureaucracy' for some time (Mastanduno 1992b: 245). The Reagan Administration had initiated the United States-Japan Structural Economic Dialogue chaired by State Department officials between April 1986 and October 1988 (Wallis 1987). This had followed a speech by then Secretary of State George Shultz at Princeton in April 1985 addressing the internal macroeconomic imbalances underlying the large US trade deficit.⁴⁰⁷ Treasury took the lead on SII as the key agency charged with macroeconomic coordination and drawing on its earlier experience with the yen-dollar talks. The frustration of Treasury officials with their unsuccessful attempts to influence Japanese fiscal policy through the G7 and through one-on-one pressure on the Ministry of Finance led to greater interest in a cross-agency approach (Schoppa 1997: 79). Critical in the thinking of Treasury officials was the slow adjustment of Japan's external surplus in the wake of the sustained appreciation of the yen following the Plaza Accord of 1985. They concluded that structural barriers were getting in the way of market mechanisms and that macroeconomic adjustment had to occur in tandem with tackling issues such as Japan's distribution system, *keiretsu* business relationships and land policy. Charles Dallara, the key Treasury official in the development of SII, reflects on the ambitious nature of the exercise:

The fact is when you try to deal with the so-called micro problems in any particular sectors, you find that you run into similar structural impediments – industry to industry to industry. Obviously, they vary, but problems in the distribution system in Japan were not unique to any particular sector, so trying to tackle those problems through a sector-

⁴⁰⁶ The key figures in the formulation and selling of SII in the US system were Treasury official Charles Dallara and Deputy USTR S. Linn Williams. Dallara recalls that, 'Linn was in some ways my primary partner in shaping these SII talks because we had the germ of an idea, but if USTR had not jumped on board very soon it would have probably not gone very far because building support for it wasn't that easy'. Dallara, interview, 1996. Also see Schoppa (1997: 78).

⁴⁰⁷ The Bush Administration's Ambassador to Japan has described the structural dialogue as 'an intellectual forerunner of the structural talks because it acknowledged that the trade problems were embedded in the macroeconomic approach of each government'. Armacost, interview, 1996.

by-sector approach is kind of an endless game and so it seemed to us a lot more sensible to go to the bigger problem.

We used the analogy that structural impediments in the Japanese economy are a bit like roots in a swamp; there are just so many of them and they are tied together and you really have little choice but to go down there and start cutting away at the roots. If you try just by chopping down individual trees in the swamp, I don't think you are going to get too far. And it seemed to us that whether the issue was the distribution system, lack of enforcement of anticompetitive laws, the lack of openness in the direct investment system, the policies on land use – all of those really played fundamental roles.⁴⁰⁸

SII would emerge as 'the broadest attempt ever undertaken to address underlying differences in structure between the US and Japanese economies' (Janow 1994: 70). It underlined how many in the free trade-oriented agencies in the US government had signed on to elements of the hardline/revisionist view that the market was not working as it should in Japan. Still, some of the more ardent free traders in the Bush Administration had reservations with SII. As then Deputy USTR Linn Williams recalls:

The cabinet officials bought off on it with some difficulty. I think that the ideological free traders – Darman, Kemp, Boskin slightly less – didn't like it because they thought it was intervention in another country's system. The cabinet bought off on it for pragmatic reasons. I think they bought our [USTR's] argument that it could make a difference, but they understood that if it did make a difference it would be over an extended period of time. What really made the difference to them, and I know it made the difference to Bush, was that it softened Super 301.⁴⁰⁹

Along with the tactical considerations, Schoppa (1997: 74-75) highlights the role of ideas in explaining the content of SII. At least in part, it was the product of 'the ideological battle between traditional liberal economic and Cold War principles on the one hand and the emerging "revisionist" views on the other'. While hardliners were keen to focus on results, most of the team assembled by President Bush 'saw such creeping revisionism as a threat to US leadership of the global trade regime and its continued good relations with its Western allies. For these officials, SII represented a chance to articulate a constructive alternative to the managed trade approach, to tackle exactly those barriers that bothered the revisionists, but with a rule-based approach' (Schoppa 1997: 75). The Commerce Department's Mike Farren sums up SII's appeal to some of the more hardline officials in the Bush Administration:

When we got to the review of Japan most of the people around the table had been through the MOSS process and been actively engaged in the 301 process ... And it was

⁴⁰⁸ Dallara, interview, 1996.

⁴⁰⁹ Williams, interview, 1996.

also pretty clear that if you were to cite specific practices for 301 and then tried to define it by sector into a matrix, the same practices would show up in every sector. There was actually a discussion about “Super 301-ing” all of Japan. That, everyone finally agreed, was perhaps too provocative, although it would have satisfied Congress and it also would have been very accurate. You could have easily justified it intellectually. ...

So it was agreed that instead we would propose to the Japanese in a positive fashion a bilateral set of negotiations on structural impediments. Basically all the same practices you would have cited in Super 301 and all the practices that cut across sectors, but do it in a nonconfrontational, much less provocative way.⁴¹⁰

Linn Williams acknowledges the influence of revisionism, but also highlights the degree to which SII was premised on a different view of the scope for change in Japan. He argues that:

The notion was that there are structural barriers and that they are removable. That's where we parted company with the revisionists. The revisionists say there are structural barriers and they are there forever; there is nothing you can do and therefore all we should do is negotiate sectoral deals. ...

I think one of the things that had taken root in the Bush Administration was that element of revisionism which says that the Japanese system is functioning differently in many ways. That had taken root. What had not taken root is the darker side of revisionism which is that the system is antithetical to our agenda of change and one has to just strike a Faustian peace. That never took hold.⁴¹¹

On 25 May 1989, the Bush Administration proposed structural talks at the same time that it announced that Super 301 was to be targeted narrowly on three government-related barriers in Japan (on supercomputers, satellites and forest products). USTR Hills declared that, ‘These negotiations would initially focus on major structural barriers to imports such as rigidity in the distribution system and pricing mechanisms. The negotiations sought by the United States in the structural adjustment initiative will address broader issues and will take place outside of Section 301’.⁴¹² The Bush Administration went to great lengths to paint SII as distinct from the confrontational

⁴¹⁰ Farren, interview, 1996.

⁴¹¹ Williams, interview, 1996.

⁴¹² *International Trade Reporter*, 6(22), 31 May 1989, p. 684.

posture struck by the Super 301 provision.⁴¹³ In a statement to hearings by the House Ways and Means subcommittee on trade, Ambassador Hills stated that a different mechanism was needed to take up such issues as Japan's distribution system and competition laws because 'a rigorous time frame might not be conducive to constructive negotiations' (Naka 1996: 52). Even so, Japanese officials approached SII warily, laying down three conditions for their involvement: (1) that it was not a "negotiation", (2) that it was a two-way dialogue discussing structural problems not only in Japan but also in the United States, and (3) that the outcomes not be interpreted as trade agreements actionable under US trade law (Naka 1996: 25-26).

President Bush and Prime Minister Uno formally launched SII on 14 July 1989, stating that the talks were designed to 'identify and solve structural problems in both countries that stand as impediments to trade and to balance of payments adjustment with the goal of contributing to the reduction of payments imbalances'.⁴¹⁴ The two leaders agreed to establish a joint interagency working group at sub-cabinet level to undertake the talks and to present a final report to the heads of government within a year.⁴¹⁵ The United States proposed six issues related to the operation of Japan's economy: (1) the savings-investment imbalance, (2) the price mechanism, (3) the distribution system, (4) collusive business practices, (5) land reform, and (6) *keiretsu* arrangements. In order to at least give an appearance of two-way dialogue, Japanese officials nominated seven areas of the US economy: (1) US saving and investment patterns, (2) corporate investment activity and supply capacity, (3) corporate behaviour, (4) government regulation, (5) research and development, (6) export promotion, and (7) workforce education and training. As Armacost (1996: 49) notes:

⁴¹³ As then Deputy USTR Williams recalls, 'The political view was to bring Super 301 and SII out together because it had the benefit of softening the Super 301 law. Unfortunately, it also had the detriment of characterising SII as a trade negotiation, albeit a different kind of negotiation that did not have Super 301 behind it'. Williams, interview, 1996. Michael Armacost recounts that 'in the initial presentation to the Japanese it was taken out of the 301 context and we rationalised it by saying: "we don't want to put them in the framework that Congress has created"'. So the aim was to secure some of the leverage Congress had provided without putting yourself in a straight-jacket that required all these things to be put in the context of Super 301 with all the deadlines and so forth that were associated with it'. Armacost, interview, 1996.

⁴¹⁴ 'Joint Statement by President Bush and Prime Minister Uno on Economic Issues', White House Office of the Press Secretary, 14 July 1989.

⁴¹⁵ On the US side, the SII working group included: Treasury, USTR, State, Commerce, Justice and the CEA; and on the Japanese side: Foreign Affairs, MITI, Finance, the Economic Planning Agency (EPA), and the JFTC.

The Japanese reluctantly agreed to it for several reasons: they could not deny the need to do something about the trade imbalance; the proposal was advanced by President Bush himself; it allowed talks to take place outside the Super 301 framework; and since each side would be able to present its concerns, the Japanese could construe the process as a two-way street.⁴¹⁶

In order to present SII in the best possible light, American officials made maximum use of reform proposals from within Japan. This involved an exhaustive survey of suggestions that had emanated from Japanese sources, including the Maekawa Commission, the Administrative Reform Council, industrial federations like Keidanren and Keizai Doyukai, academic journals, as well as the popular press (Armacost 1996:50). As the Commerce Department's lead SII official recalls:

We made the decision in SII to trace every one of our requests back to a Japanese source, for example, the Maekawa Commission. So at one point we presented 200 recommendations in a consolidated list and we could have annotated every one of those recommendations back to a Japanese commission, government agency, scholar, or political leader. So it was clear these were not US demands. They were demands that Japanese experts had made of their own government over the last 10 to 15 years. And that was very persuasive to the Japanese press.⁴¹⁷

For the Japanese government, however, the incursion of SII into such politically sensitive areas as land policy and the distribution system was something to be staunchly resisted. As Schoppa (1997: 12) observes, 'the list of interests adversely affected by US proposals looked like a "who's who" of the rich and powerful in Japanese politics'. From the first SII meeting in September 1989, Japanese officials rebutted criticisms made by their US counterparts of structural barriers, seeking to switch the focus to the US budget deficit and arguing that most of the US complaints were 'misunderstandings'.⁴¹⁸ By the end of the second round of SII talks in November, US officials vented their frustration with the lack of progress. Treasury Assistant Secretary Charles Dallara complained that there was 'less flexibility [than expected from the Japanese side] in reaching a common ground on the nature of the problems, even problems generally recognized as problems in Japan. ... There was a general unwillingness to look at ways to make changes'.⁴¹⁹ At this point, US officials intensified work on a more concrete list of Japanese impediments

⁴¹⁶ Yamamura (1990: 4) suggests that the Japan's agenda was accepted 'only to make it easier for the Japanese to participate'.

⁴¹⁷ Farren, interview, 1996.

⁴¹⁸ *International Trade Reporter*, 6(36), 13 September 1989, p. 1138.

⁴¹⁹ *Inside US Trade*, 7(45), 10 November 1989, p. 7. *International Trade Reporter*, 6(45), 16 November 1989, p. 1466.

and measures to address them.

The Bush Administration also faced a sullen Congress, less than impressed with what they saw as a minimalist deployment of Super 301 against Japan. Scepticism about SII, especially in relation to enforcement, was evident at congressional hearings in November 1989, and again in February-March 1990. Congressional hardliners continued to favour a more draconian Super 301 response to Japan's structural barriers. Even before hearings in November, key congressional hardliners led by Senator Max Baucus (D, MT), chair of the Senate Finance Committee's international trade subcommittee, began threatening to 'require Section 301 to be used against Japanese structural barriers should the SII fail'.⁴²⁰ This scepticism was mirrored by revisionist hardliners such as Clyde Prestowitz, by now a regular panellist before congressional hearings on US-Japan trade relations. Appearing before the Joint Economic Committee on 11 October 1989, Prestowitz criticised SII as the United States 'spinning its wheels' in efforts to reduce structural barriers. Advocating an approach geared towards 'cutting a deal', Presowitz said that, 'We need to be honest and see that certain markets just aren't going to open'.⁴²¹

By early 1990, American demands had become more specific following the presentation of a list of 240 demands under the six SII headings (Naka 1996: 55).⁴²² This was later narrowed to a list of 18 items as the deadline for an interim agreement approached (Naka 1996: 79). Increased American pressure was brought to bear at a summit meeting between President Bush and Prime Minister Kaifu in March 1990. Following the meeting, Prime Minister Kaifu pledged to make 'maximum efforts' to resolve outstanding trade disputes and convened a cabinet-level group to find results on SII.⁴²³ An interim report was released in early April 1990 with Japan agreeing to US demands in a range of areas. The major focus was on commitments to increase public works spending over ten years, a shortening of administration and approval times under the Large Retail Store Law, and a proposed increase in cartel surcharges under Japan's Anti-Monopoly law. USTR Hills described the interim report as 'enough to be a good

⁴²⁰ *International Trade Reporter*, 6(39), 4 October 1989, p. 1264.

⁴²¹ *International Trade Reporter*, 6(41), 18 October 1989, 1349-1350.

⁴²² In response, Japan developed a list of 80 items of structural reform in the United States.

International Trade Reporter, 7(14), 4 April 1990, p. 461.

⁴²³ *International Trade Reporter*, 7(10), 7 March 1990, p. 324. *Inside US Trade*, 8(12), 23 March 1990, p. 3.

downpayment' and a 'blueprint we need to build on'.⁴²⁴ The US section of the interim report did not include many new commitments on the part of the Bush Administration.

In subsequent weeks, officials argued over the details of the SII package, with the Japanese government resisting American demands for a specific target for public works spending as a share of GNP.⁴²⁵ On 28 June 1990, the US and Japan announced the final SII report stating that measures 'should contribute to the promotion of open and competitive markets, the reduction of trade and current account imbalances, and an improved quality of life'.⁴²⁶ While rejecting a specific share of GNP on public works, Japan agreed to a \$2.8 trillion package over the 1990s. Other commitments announced included the shortening of the approval process for applications to build Large Retail Stores to 12 months, foreshadowed legislation on land taxation reform, and more 'vigorous enforcement' of Japan's Anti-Monopoly law with 'much stronger criminal enforcement'. Officials agreed to follow up the final report with annual reports on each country's progress in solving problems raised in SII, while affirming that 'these talks have taken and will take place outside section 301 of the US Trade Act'.⁴²⁷

Various interpretations have surrounded the results secured by the US across the different SII agenda items. Schoppa (1997: 9) found that the US 'achieved much of what it wanted' in the areas of Japan's savings-investment imbalance, distribution system and land policy, but 'came away with very little' on collusive business practices and *keiretsu* arrangements.⁴²⁸ Naka (1996: 222) similarly found a high level of Japanese concession on savings and investment patterns, a medium level of concession on the distribution system and on land policy, a low level of concession on exclusionary business practices, and lower still on *keiretsu*. While US officials sought to exert further leverage on issues

⁴²⁴ *International Trade Reporter*, 7(15), 11 April 1990, p. 496. *Inside US Trade*, 8(15), 13 April 1990, p. 11. On 27 April, USTR Hills announced that Japan would not be named under Super 301 in 1990. 'Perhaps Japan had the farthest to go, but it moved farther and faster than any of our trading partners in the past 12 months', Hills told a press conference. *International Trade Reporter*, 7(18), 2 May 1990, p. 614.

⁴²⁵ *International Trade Reporter*, 7(23), 6 June 1990, p. 790. The reported target was an average 9 per cent public works spending to GNP ratio. As Dallara observes, the infrastructure spending issue 'became a real sort of cause celebre for both sides'. Dallara, interview, 1996.

⁴²⁶ *Inside US Trade – Special Report*, 29 June 1990, p. 1. *International Trade Reporter*, 7(27), 4 July 1990, p. 982.

⁴²⁷ *Inside US Trade*, 8(27), 6 July 1990, p. 9.

⁴²⁸ Within a "two-level game" approach, this variation in outcomes is seen as reflecting largely the variable efficacy of different strategies employed by the United States to take advantage of divisions of opinion and interest on the Japanese side. (Schoppa 1997).

such as *keiretsu* business arrangements where Japan made only minor concessions, SII would suffer from a loss of momentum following the 1990 agreement. Armacost (1996: 56) writes that:

June 1990 proved to be the high-water mark for the SII process. Successful resolution of differences over some unusually sensitive issues had been achieved without provoking a serious nationalist backlash in either country. ... Regrettably, negotiations went downhill from there. Not that any organized effort on either side sought to roll back the commitments made. But the momentum for collaboration gradually dissipated.

... On the Japanese side, the bureaucracy, which detested the SII process, dug in its heels about making any new commitments. More generally, the impetus for reform in Japan stalled in 1991 as the bubble economy burst. Implementing an agreement could not command the kind of press attention that negotiating it had, and the public gradually lost interest.

Likewise, former USTR official Merit Janow highlights the stalemate SII had reached in the last years of the Bush Administration. She recalls that:

It was extremely time intensive in terms of research at the first stage and outreach at all stages — with Japanese academics, business, opposition, consumers and actively with the press — the results of which were often inchoate. It was seen as very positive if a major newspaper took up an issue and did its own series on it. ... But it was enormously time intensive and SII was not met with very much enthusiasm in this country. It was very hard to say how the Japanese business environment had been substantially altered as a result of the terribly time- and resource-intensive process. So you began to see both US businesses and the Congress get very tired of SII. ... By the end it was an excruciating process, and I believed in it.⁴²⁹

By 1992, the Bush Administration was under a more general assault from critics arguing that the president was out of touch with the economic anxieties of average Americans. The political circumstance favoured a policy entrepreneur adept at forming a new governing coalition and at articulating the need for policy redirection. For the first time, the hardline ascendancy was about to find voice in the highest levels of the US policy process.

Conclusion

By the start of the 1990s hardline propositions on which the case for a results-oriented Japan policy rested had gained a new level of credibility within the American trade policy community. This reflected both a more politically defensive free trade coalition

⁴²⁹ Merit Janow, interview with author, 12 March 1996, New York.

and learning across the American trade policy community that the way Japan worked challenged free trade orthodoxy. Within a few years, a long list of American economists, including highly reputable figures in international economics, had lent support to the view that Japan was indeed different in terms of its international openness and the pervasiveness of collusive, insider relationships. The Bush Administration's Structural Impediments Initiative incorporated lessons from this puzzling about Japan by the free traders, but in a deliberately process-oriented framework. SII was designed to deal with what pragmatic free traders saw as the structural sources of trade tensions, but with the additional aim of holding off pressures for a high-profile, results-oriented approach. The following chapter looks at the final stage in the ascendancy of the hardliners as a coupling of hardline ideas with politically advantageous times ensured such pressures encountered no such resistance in the Clinton Administration.

9 The Revisionist Moment with a Hardliner-in-Chief

'He [Democratic Party Leader in the House, William Larkin] became passionate, and very detailed, about the intransigence of the Japanese in trade negotiations. Stanton [Southern Governor running for president] showed he could be equally passionate, and even more detailed, on the same subject'.

Anonymous (1996), *Primary Colors*, p. 241.

Introduction

The first term of the Clinton Administration was the culmination of a somewhat haphazard shift by the United States towards a results-oriented market access policy towards Japan. It marked the final phase in the ascendancy of the hardliners in the American trade policy community and the high tide of their efforts at securing measurable results across a range of sectors. As in the past, the United States requested that Japan take specific actions to open its market. What distinguished the first term of the Clinton Administration was the emphasis on quantitative indicators of market access, and on demands for trend-line improvements. In the words of one US government official, 'the main difference was in taking what had been an exceptional policy of the Reagan and Bush Administrations and putting it at the centre of our policy'.⁴³⁰

The Clinton Administration's Japan policy was a marriage of political entrepreneurship to hardline policy ideas. With the Democratic Party capturing the White House for the first time in 12 years, an obvious political logic attached to embracing a supposedly new and better approach while casting the policies of previous Republican administrations as synonymous with failure. The Arkansas Governor's election campaign meshed domestic coalition-building with a more aggressive commercial policy by appealing to constituencies threatened by economic change and anxious about American economic decline. Soon after he was elected, President Clinton promised to ensure 'that economics is no longer a poor cousin to old school diplomacy' (Dryden 1995: 383). As one knowledgeable analyst has observed, 'When Clinton said economics should get a higher priority in US foreign policy, it was Japan that was foremost in his mind' (Destler 1996: 21-22).

⁴³⁰ Not-for-attribution interview.

The Clinton Administration exemplified how deeply a process of learning about the Japan problem had lodged in the American trade policy community by the early 1990s. With the White House setting the tone, executive branch agencies that traditionally had sought to temper a hardline approach – the Treasury, the CEA and the State Department – were key institutional actors in formulating and defending a results-oriented policy towards Japan. Revisionist articles of faith – that the Japanese market was closed, that past negotiations and agreements (with the odd exception) had not yielded results, and that Japan's government already managed trade – encountered negligible intellectual resistance. Officials might emphasise different aspects of the Japan problem and debate negotiating tactics (often inconclusively). But, from the president down, the Clinton Administration was determined to make a Japan policy based on quantitative indicators of market access the distinguishing element of its trade policy.

The first phase of this process was the period from the negotiation of the July 1993 Framework Agreement to the impasse at the February 1994 summit meeting between President Clinton and Japanese Prime Minister Morohiro Hosokawa. Exactly what the Clinton Administration demanded of Japan in this initial phase of Framework talks remains an issue of contention. The range of actors involved and the clouding of US goals in the often-vague language of negotiating tactics complicate the picture. Yet the evidence suggests that in key sectors the United States sought to secure specific numerical commitments in market access agreements with Japan. This in turn generated intense resistance from the Japanese government to anything that smacked of a numerical target.

The key agreements secured by the Clinton Administration between 1994 and 1996 established some new benchmarks in bilateral negotiations. But, at the same time, the Japanese government was successful in blunting demands for explicit quantitative indicators or targets. The high-profile dispute over automotive products in 1995 proved a critical test of the Clinton Administration's leverage to realise its results-oriented objectives. The renegotiation of the US-Japan semiconductor agreement in 1996 with reduced government involvement signified a more general retreat from a market access strategy focused on quantitative indicators that had proved contentious and difficult to implement.

By the end of the Clinton Administration's first term in office, a range of factors helped to explain the reduced impetus for an aggressive results-oriented policy. The two primary factors were the strong and sustained resistance by Japan to quantitative market access indicators and the increasingly divergent economic performances of the United States and Japan. The negotiation of a stronger set of global trade rules with the establishment of the World Trade Organization (WTO) and renewed attention to bilateral security issues further reinforced the scaling back of American demands. By the mid 1990s, the sense of competitive threat from Japan that had underpinned the rise of the hardliners had been largely overtaken by an air of "Japan fatigue" in Washington.

The Clintonites take charge

Bill Clinton's election to the presidency in November 1992 ushered in a period of intense conflict in US-Japan trade relations arising from US demands for measurable improvements in market access in Japan. To be sure, relations with Japan were not among the major issues in the 1992 US election. The successful Clinton campaign was centred on an activist plan to restore American economic growth and competitiveness and to address pressing domestic issues such as health care, education, and crime (Clinton and Gore 1992). While recognising that America's economic performance hinged overwhelmingly on domestic economic policies, the Clinton team also argued strongly for a more aggressive trade policy to open world markets for American products. As described by one senior Clinton Administration official, it was committed to 'an export-activist trade policy directed at opening markets, expanding trade, and ensuring that our major trading partners bear a greater responsibility for supporting the global trading system'.⁴³¹

As a presidential candidate, Bill Clinton supported efforts to conclude the Uruguay Round of GATT and, with certain qualifications, to ratify the North American Free Trade Agreement (NAFTA). But he also decried a history of 'empty promises on trade' and proposed the revival of the controversial Super 301 provision as a unilateral tool for forcing open markets. In a speech before the election, Clinton said that, 'Although the

⁴³¹ Statement by Lawrence Summers, Undersecretary of Treasury for International Affairs, before the Japan Society in New York, 20 May 1993.

US has negotiated many trade agreements, particularly with Japan, results have been disappointing. I will ensure that all trade agreements are lived up to' (Lincoln 1999: 123). Journalist John Judis recounts that:

During the campaign, Clinton began educating himself on trade strategy and US-Japan economic relations. At the urging of Derek Shearer, the campaign's unofficial spokesman on US-Japan relations, Clinton read the writings of former US trade negotiator Glen Fukushima; he also read [Clyde] Prestowitz's *Trading Places*, Lester Thurow's *Head-to-Head*, Robert Kuttner's *The End of Laissez-Faire* and [Laura] Tyson's *Who's Bashing Whom?* Together, these authors argued for a revision of US trade strategy and of the American view of Japan.⁴³²

Common threads connected the Japan hardliners and revisionists with calls for the United States to adopt a more activist, "strategic" trade policy. The premise was that with the end of the Cold War economic competition between states had displaced military competition at the centre of international affairs. This loose collection of ideas appeared to resonate with a president keen to display his hands-on commitment to putting economic issues at the centre of foreign policy. In his critical analysis of the so-called "strategic traders" and their newfound influence in the Clinton Administration, economist Paul Krugman (1994: 267) would argue that:

one should not have in mind a picture of the President being sold a set of ideas that he did not understand. ... Bill Clinton wasn't captured by the strategic traders: he was a strategic trader himself. He was in one person both policy entrepreneur and politician.

In what would prove a trademark of his policy disposition, President Clinton's first major address on international economic issues combined messages of economic orthodoxy with calls for new policy approaches.⁴³³ Saying that America 'must compete, not retreat', he sort to dispel any notion that this "New Democrat" president would cave-in to protectionism. At the same time, President Clinton argued that 'it is time for us to make trade a priority element of American security'. The new administration would avoid the 'extremes' of the trade debate – the views that 'government should build walls to protect firms from competition' or that 'government should do nothing in the face of

⁴³² 'Rougher Trade' by John B. Judis, *The New Republic*, 31 May 1993, p. 28. Advisers on Japan included Glen Fukushima, former director of the Japan office in USTR, Derek Shearer, a professor at Occidental College outside Los Angeles, and Michael Mochizuki, a professor at the University of Southern California. *Inside US Trade*, 10(46), 13 November 1992, p. 6. *JEI Report* 39A, 14 October 1994.

⁴³³ Remarks by President Bill Clinton at American University Centennial Celebration, White House Office of the Press Secretary, 26 February 1993.

foreign competition'. The president said his administration's trade policy would 'bypass the distracting debates over whether efforts should be multilateral, regional, bilateral, or unilateral. The fact is that each of these efforts has its place'. President Clinton's early support for completion of the Uruguay Round and NAFTA left Japan policy as the obvious outlet for a more aggressive trade stance.

The new president sat at the apex of an administration determined to overturn the perceived historical bias in favour of US-Japan security relations to the detriment of American economic interests. According to Roger Altman, Treasury Deputy Secretary and a key architect of the Clinton Administration's Japan policy, the administration 'began with a sense that prior administrations had put security and foreign policy issues ahead of economic and trade issues. They may well have had fine reasons for that, but we were going to reverse the priorities'.⁴³⁴ Distinguishing the Clinton Administration from earlier administrations was the degree of unity behind this objective and the extent of presidential involvement in reversing priorities. The administration 'was filled with officials who saw themselves as "Japan hawks"' (Destler 1996: 22). The White House itself set the tone. Edward Lincoln (1999: 123) notes that, 'The interest of President Clinton in spending time on these issues in speeches and meetings represented a change. So the incoming administration chose to shift the emphasis on Japan from security to economics and assigned these issues a higher priority on the crowded presidential agenda'.⁴³⁵ In his first formal press conference on 23 March 1993, the president highlighted the US-Japan trade imbalance and the market access problems faced by American companies, saying that 'the persistence of the [trade] surplus the Japanese enjoy with the United States and with the rest of the developed world can only lead one to the conclusion that the possibility of obtaining real, even access to the Japanese market is somewhat remote'.⁴³⁶

Early statements by key Clinton appointees underscored the administration's intention to get tough with Japan and to distance itself from past policies. At his Senate confirmation hearing in January 1993, new USTR Mickey Kantor pointedly rejected any attachment to

⁴³⁴ Roger Altman, telephone interview with author, 5 August 1996.

⁴³⁵ Lincoln served as economic adviser to Walter Mondale, US Ambassador to Japan during the first Clinton Administration.

⁴³⁶ MacKnight (1994, Appendix: 5).

'trade theology', stating his intention 'not to engage in endless debate about whether someone is a free trader, a protectionist, a managed trader, or results-oriented' (Lavin 1993: 30). Before the Senate Finance Committee on 9 March 1993, Kantor argued that 'the US-Japan trade relationship needs immediate and serious attention. ... despite efforts by both sides, we still find ourselves with an intolerable trade deficit, and still limited access to this critical market'.⁴³⁷ On an early visit to Japan, President Clinton's Commerce Secretary Ron Brown provided a textbook articulation of a hardline policy approach informed by revisionist ideas. Brown stated that:

The Clinton Administration intends to end our American obsession with process. Our focus will, instead, be on results. Markets will be considered open not when rules and regulations and arrangements change, but when we see that American products, successful all over the world, have an equal opportunity for success in Japan. By this measure, our semiconductor agreement is a success. ... What we are doing, is freeing ourselves from the bonds of trade dogma.⁴³⁸

More significant than the views of senior figures in USTR and Commerce was the general blurring of the dividing line between hardliners and free traders when it came to Japan. According to one Clinton Administration Treasury official:

A feature of this administration was a much more unified view on the need to be consistently tough. In the past, Treasury and State were often viewed as checks on the "hawks", but in this administration there was a much stronger consensus that unless you were able to make significant progress in resolving trade problems [with Japan] you were going to see more damaging corrosion in the relationship over time. That's why the credible "dove" position became quite "hawkish".⁴³⁹

A number of key Clinton Administration officials, including Chairman of the National Economic Council Robert Rubin, NEC Deputy Director W. Bowman Cutter, Treasury Deputy Secretary Roger Altman, and Commerce Undersecretary for International Trade Jeffrey Garten, shared a hawkish view of Japan shaped by private sector business dealings prior to joining the administration. Rubin, for example, was quoted as saying that 'we have all learned from our experience with Japan. I do believe in free trade, but I

⁴³⁷ Testimony of United States Trade Representative Ambassador Mickey Kantor before the Senate Finance Committee, 9 March 1993.

⁴³⁸ Remarks by Secretary of Commerce Ronald H. Brown before the American Chamber of Commerce in Japan, 23 April 1993, Tokyo.

⁴³⁹ Not-for-attribution interview.

believe in two-way free trade, and we haven't had two-way free trade'.⁴⁴⁰ Cutter, who previously had managed a business-consulting firm, recounted how:

Company after company with whom I did business wouldn't even consider initiating operations in Japan or strategically pinpointing Japan as a potential major market; not because of their view that their products weren't better than Japanese products on price or whatever, but [due to] the sense that what they would do is spend an endless amount of time doing it and, at the same time, the Japanese business-government relationships would ensure they would fail.⁴⁴¹

Surveying the Clinton team after a year in office, *Washington Post* journalist Clay Chandler concluded that:

The team the president has assigned to manage America's relationship with its most important trade partner is made up of neither scholars steeped in the subtleties of Japanese language and culture, nor striped-suit diplomats versed in the complexities of the US-Japanese security relationship. Instead, most of them are business professionals – like Altman, National Economic Council Chairman Robert E. Rubin and Rubin's deputy, W. Bowman Cutter – who gained their knowledge of Japan in the school of hard knocks, trying to help US companies pry open markets in Japan and fend off a seemingly unstoppable invasion of Japanese competitors at home. ... they acknowledge privately that their experiences have left them fed up with Japan's restrictive business practices, wary of Japanese assurances and convinced of the need to precisely quantify Tokyo's progress in opening its markets.⁴⁴²

This hard-edged view of Japan was replicated across the traditional free trade agencies in the executive branch. As Treasury Secretary, Lloyd Bentsen was a stout defender of fiscal conservatism and open trade. Even so, the former chairman of the Senate Finance Committee had been one of the main architects of Super 301 and the congressional strategy to pressure the Bush Administration into a tougher Japan policy. Bentsen's Undersecretary of International Affairs at Treasury, Lawrence Summers, married strong credentials as an academic economist with a tough line on Japan. In 1989, Summers endorsed a results-oriented Japan policy in a stinging attack on the book *The Japan That Can Say No* by Akio Morita and Shintaro Ishihara. Writing in the *New York Times*, Summers argued that:

The United States learned a lesson in dealing with civil rights. Only when policy shifted to a results-based standard, in which companies were presumed to have discriminated if

⁴⁴⁰ 'Old Master' by John B. Judis, *The New Republic*, 13 December 1993, p. 24. Destler (1996: 37) notes that on Japan trade issues, 'Rubin considered himself a hawk on the matter, having had unhappy experiences with Japan at Goldman Sachs'.

⁴⁴¹ W. Bowman Cutter, telephone interview with author, 29 August 1996.

⁴⁴² 'Japan team has learned the hard way' by Clay Chandler, *Washington Post*, 22 February 1994, p. A1.

they did not achieve certain hiring goals, did it start to have real effects. The same logic suggests that we should lead a worldwide effort to establish goals for Japanese imports of manufactured goods. If these goals are not met, we should find ways of retaliating that would harm Japanese commercial interests without hurting American consumers.⁴⁴³

Summers set out the Clinton Administration's approach to Japan with particular clarity in the *Financial Times* in June 1993:

Strategic continuity in the [US-Japan] relationship will require economic discontinuity – a fundamental change in Japan in the way economic integration is promoted and its benefits shared. ... Japan has an imbalance problem – a chronic external surplus rooted in macroeconomic forces. And it has a penetration problem – a peculiar resistance to foreign goods, services and investment that cannot be explained by benign factors like geography, a modest endowment of natural resources, or the competitiveness of its products.

... the ultimate test of any trade agreement is the changes it brings about. And it is difficult to see any other way than by looking at benchmarks to monitor progress. ... The lesson of trade negotiations with Japan is that exceptional measures are sometimes necessary.⁴⁴⁴

President Clinton's choice of Laura Tyson as chair of the Council of Economic Advisers was especially notable given her clearly articulated view that some forms of managed trade were preferable to free trade with an economy such as Japan.⁴⁴⁵ Tyson's 1992 book, *Who's Bashing Whom? Trade Conflict in High Technology Industries*, argued that America's competitiveness problems were attributable, at least in part, to manipulative trade and industrial policies of its trading partners, especially Japan. She shared the revisionist view that whatever the differences between American and European capitalism, they paled in comparison with those between American and Japanese capitalism. While a critic of protectionism, Tyson made the case for 'cautious activism' in America's trade and industrial policies. She was comfortable with unorthodox approaches towards Japan, arguing that 'in Japan something akin to managed trade is often required to achieve something akin to a market outcome' (Tyson 1992: 263). She offered support for VIEs such as the semiconductor agreement, 'if the alternative is a

⁴⁴³ 'Tough Talk from Tokyo: What to do when Japan says "No"' by Lawrence Summers, *New York Times*, Section 3, p. 2. According to one observer, 'Bentsen and Treasury Undersecretary Lawrence Summers stressed revaluation [of the yen] over results in dealing with Japan, but they have not been against choosing sectoral targets'. 'Rougher Trade' by John B. Judis, *The New Republic*, 31 May 1993, p. 29.

⁴⁴⁴ 'Now is the time to spend – Japan must boost demand-led growth and open its markets' by Lawrence Summers, *Financial Times*, 29 June 1993, p. 14.

⁴⁴⁵ Drew (1994: 26) writes that President Clinton 'admired' Tyson's work, 'especially her writings on trade policy', seeing her as someone who was less of a purist on trade.

situation in which a given national market is reserved for national suppliers' (Tyson 1992: 264). In her Senate confirmation hearing, Tyson noted that the US 'needs to recognise that the kind of international competition we are engaged in is not simply a market phenomenon' and that hence 'free trade is not necessarily and automatically the best policy'.⁴⁴⁶

Alan Blinder of Princeton University, another CEA member closely involved in the early formulation of Japan policy, exemplified how sections of the economics profession traditionally at the core of the free trade coalition were prepared to discard orthodoxy in the case of Japan. He has argued that:

Japan involves a perversion of what economists say trade is about ... you gain from importing and you export in order to earn money to import. The Japanese don't see it that way. It's a very clannish, clubbish style of capitalism. It is hard for outsiders to penetrate and foreigners are almost automatically outsiders. ... The rationalisation for the sort of approach we took was that the Japanese were managing trade. In some sense all trade in Japan is managed and it didn't really make sense to take this holier than thou attitude.⁴⁴⁷

The 1994 *Economic Report of the President* would highlight how free trade opinion on the Japan problem had fragmented since the early 1980s, when the Reagan Administration's top economists vigorously attacked hardline arguments. The Clinton Administration's CEA argued that:

Japan presents a special case for the United States. ... certain of Japan's trade patterns appear to differ from those of other major industrial countries. Japan has an unusually low share of manufactured imports in domestic consumption, an unusually low share of intraindustry trade, an unusually small stock of inward foreign direct investment, an unusually small share of domestic sales accounted for by foreign-owned firms, and an unusually high share of intrafirm trade, which is predominantly controlled, moreover, by Japanese rather than foreign-based firms. ... The existence of such a large, technologically dynamic, and distinctive economy as Japan poses special trade problems for the United States (CEA 1994: 15-20).

Mainstream economists were not the only elements of the Free Trade-Good Relations coalition supportive of a more aggressive Japan policy. The end of the Cold War had left the role of the State Department in international economic policy diminished, but also no

⁴⁴⁶ *Inside US Trade*, 11(3), 22 January 1993, p. 1.

⁴⁴⁷ Alan Blinder, interview with author, 6 August 1996, Princeton NJ.

longer so clearly at odds with the hardliners.⁴⁴⁸ Winston Lord, Assistant Secretary of State for East Asia and the Pacific in the first term of the Clinton Administration, saw an aggressive market access policy as necessary to maintain ongoing support for the US-Japan relationship in the American political system.

From the beginning it was clear, particularly given the tie-in to the domestic economy (exports and jobs), that economic matters had increasing importance generally and specifically with Japan. ... The relationship was in good shape, but the one area that needed attention and fixing was the economic side – the persistent deficit, closed nature of their market, [Japan's] global surplus. ... We knew we were going to run into some problems if we took the Japanese on hard over these issues, but we had no choice. If we let the deficit fester, and if we didn't make an effort to open that market, and be seen by our domestic audience (including the Congress) that we were going to do this, then over time the rest of the relationship could be affected. We would lose support for the security alliance, for our presence of troops and so on.⁴⁴⁹

By any measure, the Clinton Administration displayed a remarkable degree of consensus behind a hardline policy approach. Defenders of Japan were virtually non-existent and the old free trade coalition that had sought to block results-oriented market opening policies towards Japan over many years was in eclipse. As Destler (1996: 37) notes:

Unlike in previous administrations, there was not a serious gap between “hawks” at USTR and Commerce and “doves” at State and Treasury. ... neither was there a strong NSC-State-Defense move to mute economic conflict for the sake of the broader security relationship.

Contributing to this new level of unity on Japan across the executive branch was President Clinton's major institutional innovation in high-level policy-making, the National Economic Council. President Clinton was keen that the NEC avoid the allegedly fractious economic debates within the Bush Administration, and that it play the role on international economic issues that the NSC had played traditionally on security issues. Where existing agencies maintained sway on other domestic and international economic issues, the NEC's so-called “deputies group” took the lead operational role on Japan policy. Indeed, as Destler (1996: 22) points out, ‘the Japan issue dominated NEC

⁴⁴⁸ Craib (1994: 4) notes that by the Clinton Administration, the State Department ‘instead of being paired primarily with the Department of Defense on international issues, now would find itself on “the same page” as other agencies, particularly those overseeing trade matters’.

⁴⁴⁹ Winston Lord, interview with author, 21 June 1996, Washington DC. A criticism made of the Clinton Administration was that none of the senior officials in the State Department had significant experience dealing with Japan. One Japan watcher noted at the start of the administration that the Clinton team was well staffed with China experts (including Lord) but had ‘not a Japan veteran in the lot’. ‘Foreign policy arm missing Japan hand’ by Don Oberdorfer, *Washington Post*, 30 January 1993.

deliberations during the administration's first 18 months, particularly at the deputies level'.

In fact, for substantial periods, it seems that the Japan process *was* the NEC at the deputies level. The deputies committee convened two and three times a week to discuss everything from large issues – how and why the Japanese market was so closed – to tactics – who should meet with whom and what the common US message would be. ... This [experience] ... brought the main participants to talk the same line. Japanese seeking to find discrepancies between agency positions in order to play one official off against another were generally frustrated. And this was no mean achievement: in prior administrations the Japanese had done this all too well (Destler 1996: 37).⁴⁵⁰

The early months of the Clinton Administration saw considerable speculation surrounding what a results-oriented Japan policy would look like in practice. According to one Commerce Department official closely involved in Japan trade issues over a number of administrations, the shared view was that:

While there were some successful agreements, by and large the agreements that we negotiated through all those years were typically not particularly successful because they assumed that if you put rules in place that were based on market forces, then the problem would fix itself. ... The focus on results was really designed to get around the fact that the kinds of procedures we typically think are going to work do not; you need something else.⁴⁵¹

Timed to take advantage of an administration formulating its policy was another report on US-Japan trade relations by the high-profile Advisory Committee on Trade Policy Negotiations issued in January 1993. Following on its report at the start of the Bush Administration, ACTPN (1993) argued even more strongly for a results-oriented Japan policy asserting that the 'problem of market access in certain sectors of the Japanese market is unique, thus requiring unconventional solutions'. The ACTPN report suggested that 'where invisible barriers exist, temporary quantitative indicators (TQIs) to measure progress toward achieving an open market should be used when appropriate to achieve true market access. These indicators should reflect a level of global imports which would result if commercial considerations were the sole determinant of the level of imports in a particular sector'. The ACTPN report recommended as a target the doubling of Japan's imports of manufactured goods as a percentage of apparent consumption by the end of

⁴⁵⁰ The key participants were Bowman Cutter (NEC), Lawrence Summers and Roger Altman (Treasury), Joan Spero and Daniel Tarullo (State), Charlene Barshefsky (USTR), Laura Tyson and Alan Blinder (CEA) and, at a later point, Jeffrey Garten (Commerce) (Destler 1996: 37). The Defense Department was not included in NEC deliberations.

⁴⁵¹ Marjory Searing, interview with author, 15 July 1996, Washington DC.

the decade. In February, President Clinton met with the leadership of ACTPN, praising the Japan report.⁴⁵² Merit Janow, who left her position as Deputy Assistant USTR for Japan and China after a hand-over period to the new Japan team, recalls that the ACTPN report:

was latched onto by the new team as what needed to be done because it sounded sensible. It had the support of major American companies and this administration wanted to be pro-business in some areas because it had associated with labour in others. The fact that our trading partners hated it was not part of the thinking, and the fact that it was so heavily resisted contributed to the feeling that this must be the right way to go.⁴⁵³

Particular attention focused on the sorts of agreements that might provide models for the Clinton team, especially the semiconductor agreement and the auto deal negotiated by the Bush Administration in 1992. What outgoing US Ambassador to Japan Michael Armacost (1996: 177) found 'particularly noteworthy' from his discussions with Clinton Administration officials in February 1993 was the 'widespread supposition – particularly at the US trade representative's office and the White House – that the semiconductor agreements of 1986 and 1991 and the auto parts understandings of January 1992 were virtually the only bilateral trade agreements that had produced any noteworthy results'. Early statements and actions concerning both the semiconductor agreement and the 1992 automotive deal did nothing to allay Japanese concerns that the Clinton Administration would pursue a policy of numerical targets in trade agreements. Speaking in March 1993, when the 20 per cent market share on semiconductors had been attained, USTR Kantor stated that the US expectation was one of continued market share growth over the next three years, and that 'we would expect growth regardless of what happened to the Japanese economy'. Commenting on the wider applicability of the semiconductor agreement, Ambassador Kantor said that the administration would 'need to evaluate it in terms of other sectors to see if it might bear some fruit for us. It certainly is consistent with the ACTPN report ... quantitative indicators and strategic industries coming together. And so we certainly would look at this carefully and have some interest in its applicability in other areas'.⁴⁵⁴ Japanese fears that any explicit reference to numbers could take on a life of its own were heightened by a letter from USTR Kantor and

⁴⁵² 'Trade issues take the lead: Inside Clinton's Japan team' by Peter Ennis, *Tokyo Business Today*, July 1993, p. 8.

⁴⁵³ Janow, interview, 1996.

⁴⁵⁴ USTR Background Briefing with Mickey Kantor and a senior US trade official, Washington DC, 19 March 1993.

Commerce Secretary Brown to MITI Minister Mori in early April 1993 characterising the 1992 auto parts plans announced by Japanese car manufacturers as ‘pledges’ backed by the Japanese government.⁴⁵⁵

Predictably strong messages from hardliners in Congress, plus the array of statutory deadlines which Congress had put in place since the mid 1980s, reinforced the Clinton Administration’s determination to be tough on trade with Japan. House Majority Leader Richard Gephardt and Senate Finance Committee chair Max Baucus endeavoured to keep pressure on Japan with bills almost identical to those introduced during the Bush Administration. In February 1993, Senator Baucus introduced bills to revive and extend for five years the Super 301 trade provision (S. 268) and to allow private parties to petition the US government for a review of whether a foreign country is complying with a trade agreement (S. 269).⁴⁵⁶ The announcement in February that Japan’s trade surplus with the United States had widened to \$43.6 billion in 1992 was cited by Representative Gephardt as ‘a call to action – an end to the policies of the past and a move to a results-oriented trade policy’.⁴⁵⁷ The end of March saw the release of the annual NTE report cataloguing unfair foreign trade practices, with 28 pages devoted to Japan. In advance of an end April deadline to announce any action against government procurement discrimination under Title VII of the 1988 Trade Act, US officials sought to secure a Japanese commitment for ‘a specific allocation for foreign goods and services’ as a way to ensure implementation of various government procurement agreements, including construction, computers, and supercomputers.⁴⁵⁸

This hawkish coalition across a new American administration, Congress and the business community provided the backdrop to the first meeting between President Clinton and

⁴⁵⁵ *Inside US Trade*, 11(13), 2 April 1993, p. 9. The letter asked Minister Mori to ‘inform us of the steps Japan intends to take to meet this pledge to expand US auto parts sourcing’, and said that Japan ‘must accelerate the progress that has been made to date’. As Destler (1996: 37) notes, the letter had the ‘undesired effect of hardening Tokyo’s resistance to anything that looked like the quantitative import targets that Commerce and USTR favored’.

⁴⁵⁶ *Inside US Trade*, 11(5), 5 February 1993, p. 9.

⁴⁵⁷ *JEI Report* 6A, 19 February 1993, p. 9.

⁴⁵⁸ *Inside US Trade*, 11(13), 2 April 1993, p. 10. *International Trade Reporter*, 10(13), 31 March 1993, p. 526. On 30 April, USTR Kantor identified Japan under Title VII as a target for special consultations over alleged discrimination against US firms in procurement of construction, architectural, and engineering services, and announced a review of Japan’s implementation of the 1990 supercomputer agreement. A delay in sanctions was later announced following the 60-day period for construction consultations. *International Trade Reporter*, 10(27), 7 July 1993, p. 1109.

Japan's Prime Minister Kiichi Miyazawa on 16 April 1993. The president called for 'the rebalancing of the relationship through an elevated attention to our economic relations'.⁴⁵⁹ Citing the 'successful' US-Japan semiconductor agreement, President Clinton called for a 'focus on specific sectors and specific structures, with a view toward getting results'. In response, Prime Minister Miyazawa reiterated Japan's strong opposition to numerical targets saying that solutions to trade problems must be 'based upon the principle of free trade' and 'cannot be realised with managed trade or under the threat of unilateralism'. The two leaders agreed to set up a new framework to discuss US-Japan trade issues with details to be worked out before the July meeting of the G7 industrial countries in Tokyo.

"You get as much as you can": A Framework for confrontation

In the weeks following the April meeting between President Clinton and Prime Minister Miyazawa, the NEC deputies group led by Bowman Cutter and Roger Altman met regularly to develop a framework for negotiations with Japan. Consensus developed around pushing for market access results through a mechanism that simultaneously addressed macroeconomic imbalances, structural issues, and product-specific barriers in Japan. The key elements of the US proposal for a new bilateral dialogue were approved at cabinet-level in mid May and forwarded to President Clinton. The proposal included a macroeconomic goal framed in terms of an overall reduction of Japan's current account surplus, and a microeconomic goal of achieving measurable results under five 'baskets' of sectoral and structural issues. 'Multiple benchmarks' would be used to assess progress in the opening of the Japanese market in various sectors.⁴⁶⁰ Speaking at the Japan Society in New York on 20 May, Treasury Undersecretary for International Affairs Lawrence Summers outlined the rationale for the US strategy towards Japan describing macroeconomic policies directed at imbalances and microeconomic policies directed at import penetration as 'like two blades of a scissor'. Criticising 'grand, but vague designs to remake Japan in our own image', an obvious allusion to the Bush Administration's

⁴⁵⁹ 'A promise kept: Clinton presses Japan on trade, meets election pledge' by Susumu Awanohara, *Far Eastern Economic Review*, 29 April 1993, p. 15.

⁴⁶⁰ *Inside US Trade* 11(20), 21 May 1993, p.18, *Inside US Trade*, 11(22), 4 June 1993, p. 8.

SII, Summers argued it was time to focus ‘less on process and more on results, and results have to be measurable’.⁴⁶¹

An outline of the US proposal was delivered to Japanese officials on 7 June in advance of meetings to thrash out the new framework. The paper laid out what the Clinton Administration described as the ‘basic bargain’ for future negotiations.⁴⁶² On the macroeconomic front, it called for Japan to ‘reduce its [global] current account surplus to a range of 1.0 to 2.0 percent of GDP within three years’. And on the microeconomic front, Japan should commit to ‘increase its manufactured imports by one-third as a share of GDP within three years’.⁴⁶³ Where the US was looking to tackle structural and sectoral barriers, ‘multiple benchmarks will be established in order to monitor progress in improving market access’ with the precise benchmarks to be negotiated bilaterally. The other key plank of the US strategy was to make the proposed framework subject to unprecedented high-level attention through semi-annual heads of government meetings.⁴⁶⁴ On the central issue of quantitative indicators, USTR Kantor maintained that the ‘one thing we don’t want to do, is continue along this trail where you reach agreements, and they’re not concrete, and you don’t have a measure of whether or not both sides are adhering to their responsibilities. And that’s what we’re going to insist upon. In certain cases, it may not mean so-called “quantitative indicators”. In certain cases, it might’.⁴⁶⁵

Discussions in advance of President Clinton’s visit to Tokyo for the G7 summit pointed to the hardening of attitudes among American and Japanese negotiators that would dog US attempts to operationalise a results-oriented policy. The deepest divisions were over the ground-rules for the proposed market access negotiations. Officials from MITI opposed any Japanese concessions, suspecting that ‘multiple benchmarks’ were just a

⁴⁶¹ Statement by Treasury Undersecretary for International Affairs, Lawrence Summers, before the Japan Society in New York, 20 May 1993.

⁴⁶² *Inside US Trade*, 11(23), 11 June 1993, p. 1.

⁴⁶³ The United States would agree as its part of the ‘bargain’ to ‘carry through its plans to substantially reduce the budget deficit, and to increase public investment’, and to ‘maintain its open market and investment policies, provided that there is satisfactory progress towards a more open trade and investment regime in Japan’.

⁴⁶⁴ *Inside US Trade*, 11(23), 11 June 1993, pp. 13-14.

⁴⁶⁵ *International Trade Reporter*, 10(23) 9 June 1993, p. 934. Soon thereafter, Ambassador Kantor told the Senate Finance subcommittee on international trade that ‘we reserve the right to establish such benchmarks ourselves in order to evaluate progress in an objective manner’. *Inside US Trade*, 11(24), 18 June 1993, p. 6.

guise for market share or import volume quantitative targets. It was left to Prime Minister Miyazawa to break the deadlock. In a personal letter to President Clinton on 2 July he indicated that, although numerical targets were unacceptable, Japan could live with an 'illustrative set of criteria', whether qualitative or quantitative. Talks again reached an impasse with US officials rejecting Japanese language that the criteria would be used only to gauge progress, not 'as targets or commitments for the future'.⁴⁶⁶

After difficult negotiations in Washington and Tokyo, President Clinton and Prime Minister Miyazawa announced the so-called Framework Agreement for a New Economic Partnership on 10 July.⁴⁶⁷ In line with American goals, it covered macroeconomic objectives and foreshadowed sectoral and structural negotiations under five baskets. Japan agreed to pursue policies 'intended to achieve over the medium term a highly significant decrease in its current account surplus, and at promoting a significant increase in global imports of goods and services, including from the United States'. American officials had sought firmer commitments and would continue to stress their interpretation that the agreement should see a reduction in Japan's external surplus within four to five years from over three per cent of GDP down to 'historical norms' of the previous two decades of less than two per cent (Altman 1994: 4). At the microeconomic level, the negotiated language called on Japan to 'deal with structural and sectoral issues in order substantially to increase access and sales of competitive foreign goods and services through market-opening ... measures'. American officials interpreted this to mean a one-third increase in manufactured imports as a share of GDP over the medium term of three to four years (Altman 1994: 4). The nominated five baskets mirrored those proposed by the United States. These were (1) government procurement, especially medical equipment, telecommunications equipment and services, computers (including supercomputers) and satellites; (2) regulatory reform and competitiveness, in particular insurance and financial services and structural issues such as competition policy and distribution systems; (3) other major sectors (most notably automotive vehicles and parts); (4) economic harmonisation, encompassing issues such as foreign direct

⁴⁶⁶ *JEI Report 26B*, 16 July 1993, p. 6.

⁴⁶⁷ *US State Department Dispatch*, 4(28), 12 July 1993, pp. 493-496.

investment, intellectual property rights and buyer-supplier relationships in Japan; and (5) implementation of existing agreements.⁴⁶⁸

The agreement largely papered over the key area of contention concerning the sort of market access benchmarks acceptable to both sides. The accord called for progress to be assessed by using 'objective criteria, either qualitative or quantitative, or both as appropriate, which will be established using relevant information and/or data that both Governments will evaluate. ... These criteria are to be used for the purpose of evaluating progress achieved in each sectoral and structural area'. Important for the Clinton Administration's results-oriented agenda was the insertion of language referring to the direction of change expected in economic variables. In the area of government procurement, the agreement noted that measures negotiated should 'aim at significantly expanding Japanese government procurement of competitive foreign goods and services'. In the automotive sector, the agreement called for 'significantly expanded sales opportunities to result in a significant expansion of purchases of foreign parts by Japanese firms in Japan and through their transplants'. While this language was doubtless more vague than the Clinton Administration would have wanted, it provided sufficient grounds for US negotiators to herald the Framework Agreement as a policy breakthrough.⁴⁶⁹ Negotiations on insurance, automotive products and government procurement of telecommunications and medical equipment were identified as 'high priority areas' with agreements to be sought within six months of the agreement, or by the first heads of government meeting in 1994. Agreements on remaining issues were to be reached by July 1994. The two sides pointedly drafted side-letters in addition to the Framework text. Rejecting a Japanese request, the United States reserved all rights to apply its national trade laws and noted explicitly that all agreements and measures arising under the Framework would be actionable under Section 301. In a parallel letter, the Japanese government reserved its right to withdraw from any negotiation if the US government launched Section 301 investigations on any matters under negotiation.

⁴⁶⁸ Apart from some minor concessions, Japan was unsuccessful in expanding the framework to include practices that the Japanese government and industry believed restricted business activity in the United States.

⁴⁶⁹ 'Clinton achieves trade framework in Japanese pact', by David Sanger, *New York Times*, p. 1. Lincoln (1999: 128) suggests that since 'both sides make concessions in any negotiation, presumably the Clinton administration had initially asked for language stronger than "significant increase" on particular sectoral issues'.

Announcing the Framework Agreement, President Clinton stated that, 'We should have no illusions. We announced today a framework to govern specific agreements yet to be negotiated. Negotiating those agreements will surely be difficult. But now, at least, we have agreed what the outcome of these negotiations needs to be: tangible, measurable progress'.⁴⁷⁰ In practice, however, two factors would mitigate against agreement in future negotiations. The first was the difficulty the Clinton Administration had in specifying exactly what it wanted from Japan. The second was the resolve of Japanese negotiators to avoid any 'objective criteria' which could ultimately become numerical targets subject to the full force of US trade law.

The interagency process chaired by NEC Deputy Director and lead Framework negotiator Bowman Cutter had been effective in building consensus and collegiality on Japan policy in the early months of the administration. But it would struggle to operationalise a results-oriented policy when negotiations got under way.⁴⁷¹ For example, there was disagreement in the case of automotive vehicles and parts between those in the administration prepared to build on the processes established by the MOSS talks and those who saw past approaches as a complete failure, preferring simply to negotiate objective criteria and then hold Japan to these benchmarks.⁴⁷² After interviewing many of the key US officials, Destler (1996: 38) quotes one participant as bemoaning a process:

producing "a massive amount of paper," including draft language and "a single set of talking points" for negotiations, "a common press strategy", etc. A higher-level official from a different agency saw much that was positive in the process but noted that the NEC "never got its act together in terms of organizing the discussions in a really efficient way." The meetings did generate decision memos to the president from time to time, but they seemed to participants to be recycling the same questions over and over.

The central issue remained the nature and specificity of US demands for quantitative objective criteria. In congressional testimony on 22 July 1993, Deputy USTR Charlene Barshefsky continued to emphasise specific numerical measures of progress.

What we will be seeking in each sector are data points that will be gathered and then jointly monitored. We will utilize quantitative information where appropriate on such

⁴⁷⁰ *International Trade Reporter*, 10(28), 14 July 1993, p. 1150.

⁴⁷¹ With Cutter as the overall head of the US team, responsibility for the 16 subgroups identified under the five Framework baskets was shared between USTR and the departments of State, Treasury and Commerce. *Inside US Trade*, 11(34), 27 August 1993, p. 13.

⁴⁷² *Inside US Trade*, 11(35), 3 September 1993, p. 20.

factors as relevant market trends, market share statistics in Japan, or comparisons between the public and private sector. We will also employ qualitative indicators where helpful, such as the nature of the business links between Japanese manufacturers and their suppliers in the United States, or changes in the business and regulatory environment favoring foreign firms. There will most likely be several such data points in each sector; no single benchmark will determine the success or failure of a sectoral agreement (Ahearn 1994: 2).

Bowman Cutter would reflect later on the extent to which there was ‘unstated and undigested disagreement’ on the issue of quantitative indicators.

Probably from the beginning there was a different point of view on the part of Commerce and USTR as against the more macro agencies. But it was not very much debated in those early months because I think it was assumed by everyone that words were being heard in the same way. ... In part, I think something like that emerges because of the general intense desire of a new administration to function as a team. So no one wants to start a big fight by asking: “What exactly do you mean there?” ... If you distinguish between the word goal and the word target, it probably was the case that the macroeconomic agencies thought of things as goals and micro agencies thought of things as targets. ... I think the more micro agencies saw things much more as percentage share targets or growth of imports targets.⁴⁷³

Despite intense interagency discussions prior to the first round of talks in September 1993, the United States had yet to agree on specific objectives for the targeted areas of insurance, automotive products and government procurement of telecommunications and medical equipment.⁴⁷⁴ At the second round of negotiations in mid October, the US team tabled a range of data, along with proposals for agreements in the four priority areas.⁴⁷⁵ By the third round of negotiations in November, the two sides were arguing over US-drafted agreements calling for ‘prompt, substantial and continuous’ increases in sales in targeted areas. The draft text for automotive products triggered a strong Japanese reaction against what was perceived as the ultimate intent of American negotiators. It identified quantitative criteria for foreign vehicle sales in Japan, sales of parts to Japanese transplants in the United States, and purchases of foreign parts in Japan, and stated that for these criteria ‘specific expectations shall be included in the Arrangement pending further discussions between the two governments’.⁴⁷⁶ The draft also called on

⁴⁷³ Cutter, interview, 1996. Lincoln (1999: 144) also argues that the administration ‘moved too quickly’ and ‘had not really reached internal agreement on how it wanted to proceed on issues such as how to define the vague notion of results-oriented negotiations’.

⁴⁷⁴ One report noted that ‘at best, apparently, the American participants could only outline the White House’s general objectives in each of the three targeted areas’. *JEI Report* 36B, 1 October 1993, p. 8.

⁴⁷⁵ *Inside US Trade*, 11(42), 22 October 1993, p. 19. *JEI Report* 40B, 29 October 1993, p. 9.

⁴⁷⁶ *Inside US Trade – Special Report*, 1 November 1993. In interviews for this study, a number of US officials highlighted this draft agreement, and its discovery by the press, as an important factor making the administration vulnerable to charges of seeking managed trade.

the Japanese government to use 'administrative guidance' to secure increased sales of foreign vehicles and parts. In the case of parts sales to Japanese transplants in the United States, 'guidance' was demanded to ensure 'special consideration for non-Japanese US auto parts'. Draft agreements on government procurement of telecommunications and medical equipment were framed based on an expectation that sales should lead, over the medium term of three to four years, to foreign market shares comparable to those of other developed countries.⁴⁷⁷

According to Edward Lincoln, US negotiators faced the problem, having secured the Framework commitment to objective criteria, that 'nobody knew what it meant'.

In the [northern] fall of 1993, they were still trying to figure that out. They were floating little balloons with the Japanese: "We understand you can't accept market share numbers. We're not going to do managed trade, but how about inserting language such as that the goal of the Japanese government in this area will be to move over time closer to the OECD average". And the Japanese came back and said, "Absolutely not, that's a number. You can calculate that average and you will come to us and say you have not reached this market share for foreign penetration". ... I think the administration got caught in its own logic because they couldn't argue back with this.⁴⁷⁸

The sense of distrust between the two sides made the search for compromise formulas all the more difficult. Armacost (1996: 178) writes that 'the distrust was mutual. If US negotiators assumed that Japanese trade pledges were worthless unless they were reduced to quantitative targets, the Japanese team believed that even the vaguest promises made to Americans would be transformed into explicit pledges to accomplish a specific result within a fixed time frame'. Each side accused the other of flouting global trade principles in an intense public relations battle over their respective free trade credentials. Japanese officials proved very effective in tagging the Clinton Administration as intent on managing trade through numerical targets, armed with hardline statements from US government officials and draft agreements suggesting American demands for specific targets. A group of high-profile economists (including five Nobel Prize winners) joined the criticism in a joint letter to President Clinton and the new Japanese Prime Minister Morihiro Hosokawa in September 1993. Organised by Columbia University's Jagdish Bhagwati, the letter urged President Clinton to abandon

⁴⁷⁷ *Inside US Trade – Special Report*, 11(43), 29 October 1993. *Inside US Trade*, 11(44), 5 November 1993, p. 18.

⁴⁷⁸ Lincoln, interview, 1997.

the course of ‘managed-trade targets’, saying that to ‘start down that road is to take risks for the world trading system that are both large and unwarranted’.⁴⁷⁹ The American side was not without its supporters from the ranks of economists, the most notable being the conversion of key figures at the Institute for International Economics to the selective use of VIEs in the case of Japan (Bergsten and Noland 1993).⁴⁸⁰ But for the most part the Japanese government successfully painted the Clinton Administration as pursuing a radical departure from free trade norms and won support for this view from other trading partners. In the words of one senior US official, ‘in terms of what we aimed for and what was debated, we did a lousy PR job’.⁴⁸¹

There remain sharply different views on exactly what the US negotiating team was pursuing in the Framework talks.⁴⁸² Marjory Searing, then Deputy Assistant Secretary of Commerce for Japan and the lead US negotiator in the government procurement talks on medical equipment, provides a useful perspective on where the US position had evolved to by late 1993:

The theology is subtle. It was not meant to be: “Sales have to be X by date Y or it would be an agreement violation”. The line was: “If you truly negotiate an agreement that opens the market then we should be able to see sales rise to X. If they don’t then we go back and see what the problem is”. It was recognized that we were not likely to get a semiconductor-type agreement (or sales target) in each case. But if you were clear up front on what is a successful agreement then you get as much as you can. Nobody expected numbers to survive in agreements, but if you say that afterwards nobody will believe you.⁴⁸³

This statement highlights the problem the Clinton Administration faced in searching for what, if anything, could be inserted in agreements to ensure measurable results without succumbing to the charge of seeking numerical targets. In part, it reflects the nature of the negotiating process with both ambit claims and fallback positions cast under the

⁴⁷⁹ *Inside US Trade*, 11(40), 8 October 1993, p. 18.

⁴⁸⁰ *The Economist* magazine editorialised that even ‘true believers in free trade, such as the denizens of Washington’s International Institute for Economics (sic), have recently begun to argue that “managed trade” also has its place’. *The Economist*, 3 July 1993, p. 17.

⁴⁸¹ Lord, interview, 1996. The Commerce Department’s Jeffrey Garten would remark later that, ‘In one of the great ironies of the late 20th century, Japan – which has rigged its economic systems for over a hundred years – branded the US as wanting to “manage trade”. From Seoul to Sydney, from London to Frankfurt, and even around the US, the image stuck. From a public relations standpoint we never recovered’. *International Trade Reporter*, 11(48), 7 December 1994, p. 1887.

⁴⁸² While reaching different conclusions, Lincoln (1999) and Schoppa (1997) provide two of the more sophisticated analyses of US demands in the Framework negotiations.

⁴⁸³ Searing, interview, 1996.

banner of a results-oriented policy. This factor has been emphasised by analysts such as Lincoln (1999: 151) who remain sympathetic to US policy objectives:

A major difficulty in assessing the administration's strategy in these early phases of the negotiations stems from the nature of the negotiating process. Negotiators begin with requests that they know are unacceptable to the other side. Which parts of the initial negotiating drafts represented core parts of the administration's agenda and which were fluff to be discarded as negotiations became more serious is often difficult to disentangle.

Still, evidence from the negotiations in the final quarter of 1993 points on numerous occasions to US demands for explicit quantitative indicators, albeit short of market share targets. By the end of 1993, with a deadline looming of early February 1994 when the heads of government were due to meet, the two sides remained far apart on all priority sectors. Japan came forward with its own carefully defined sets of qualitative and quantitative criteria.⁴⁸⁴ American negotiators maintained calls for more specific language to establish 'trend-lines' for the movement of Japanese import indicators more into line with other G7 economies. Trend-line demands were cast as establishing standards for measuring progress rather than setting numerical targets. But Japanese negotiators saw little difference. MITI Vice Minister Sozaburo Okamatsu dismissed new formulations of the American position. He was quoted as saying that 'the US said Japan should move in line with the other G7 nations, but it remains vague how it differs from the so-called numerical targets'.⁴⁸⁵

Japanese officials were wary of any terminology – indicators, benchmarks, standards, yardsticks, targets – which could be interpreted as a government commitment enforceable under US trade law. Experiences surrounding the semiconductor agreement and the 'voluntary' automotive plans were critical in this context. A letter from Vice Minister Okamatsu to Commerce Undersecretary Garten following talks on automotive products at the end of 1993 underlined the resolve of the Japanese government to avoid similar arrangements in the future. Responding to American attempts to clarify its demands in the automotive sector, Okamatsu wrote:

While you stressed the differences between your proposal of setting standards or trend-lines and numerical target setting, the two appear to be no different from our point of view. ...

⁴⁸⁴ *International Trade Reporter*, 10(48), 8 December 1993, p. 2060.

⁴⁸⁵ 'Japan, US poles apart in auto talks' by Hiroshi Nakamae, *Nikkei Weekly*, 27 December 1993-3 January 1994.

During negotiations concerning semiconductors, the US Government emphasized that the 20% figure was merely a benchmark to assess progress and not a guarantee or a commitment. The language of the arrangement, reflecting such an explanation, characterized the 20% figure as the expectation of the US industry. However the 20% figure had a life of its own which left a painful lesson for us. No matter how the US side explains its intention, and no matter how the language is carefully drafted, once number relating to the future is referred to, the nature of the number will be subject to distortion. The explanation by the US side regarding the standard for assessment or trend-line reminded me of the similar explanation the US side had provided to us during the semiconductor negotiations.

Your idea of having the private sector make a statement concerning their plans or intentions also raises serious concerns among us. The Action Plan of January 1992 regarding auto parts, was a set of voluntary action plans announced by Japanese automobile companies. The Government of Japan only aggregated the numbers announced by each company. However, the aggregated number was eventually characterized as a "pledge" by the US Government (sic) in the letter sent to our former Minister Mori. This experience left us with another lesson that private sector announcement can be easily turned into a commitment of the Japanese Government.⁴⁸⁶

By January 1994, USTR Mickey Kantor assumed a more prominent role in talks with Japan, having finalised negotiations on the Uruguay Round and secured congressional approval for NAFTA. Describing the objective criteria issue as 'the heart' of the Framework Agreement, Kantor restated the Clinton Administration's determination to pursue quantitative indicators of trend-line improvement in market access towards levels similar to other industrialised countries. He argued that, 'What you would look for is a trajectory of progress which would lead finally to convergence. Now it could be the number of years you would indicate or the percentages, and how you would measure that could be quite different as you look at any particular sector. But the ideas would remain the same'.⁴⁸⁷

In the days before the Clinton-Hosokawa summit, American assurances of flexibility on the selection of indicators and denials that market share goals were being sought met firm Japanese resistance. Japanese officials were in turn accused of thwarting the original intent of the Framework. With officials shuttling between Washington and Tokyo, USTR Kantor warned that the United States would look for 'other options' if the Framework

⁴⁸⁶ *Inside US Trade*, 12(2), 14 January 1994, p. 14.

⁴⁸⁷ *International Trade Reporter*, 11(3), 19 January 1994, p. 79.

talks failed.⁴⁸⁸ At the final pre-summit meetings American officials said they were ready to put in writing that the quantitative indicators would not be used later as 'targets'.⁴⁸⁹ Still, the prospect of a summit failure did not elicit any last minute concessions from the Japanese side. Tsutomu Hata, then Japan's Foreign Minister, summed up the reason for the impasse saying, 'You don't trust us without numbers; we don't trust you with numbers'.⁴⁹⁰

After seven months of negotiations, President Clinton and Prime Minister Hosokawa announced that the two countries had failed to reach accords in the sectors assigned priority. Speaking at a joint White House press conference, President Clinton said, 'We could have disguised our differences with cosmetic agreements. But the issues between us are so important ... that it is better to have reached no agreement than to have reached an empty agreement'. The problem, Clinton suggested, 'may be one of words, or it may be one of the feelings behind the words. ... We couldn't agree on what constitutes a market opening'. In reply, Prime Minister Hosokawa said that Japan had not 'been able to clear the hurdle of numerical targets, and we regret that very much'. In a rebuff to a US President without precedent in modern US-Japan relations, Hosokawa politely remarked that both sides 'need a cooling off period'.⁴⁹¹

Speaking on February 15, President Clinton said that he agreed with Prime Minister Hosokawa on the need for a 'period of reflection', but said that the administration is 'reviewing all of our options, and we haven't ruled anything out'.⁴⁹² On the same day, USTR Kantor announced that the United States was drawing up a list of sanctions against Japanese products, worth up to \$300 million, for its alleged violation of the 1989 agreement granting Motorola greater access to Japan's cellular phone market. The

⁴⁸⁸ *International Trade Reporter*, 11(6), 9 February 1994, p. 202. Both sides remained furthest apart in the automotive negotiations with Commerce Undersecretary Garten saying that despite intensive negotiations 'held almost continuously since July, not to mention the years of previous discussion, we do not seem to have even a common understanding of the problem, let alone consensus on the solutions'. *International Trade Reporter*, 11(6), 9 February 1994, p. 204.

⁴⁸⁹ *The Economist*, 19 February 1994, p. 33.

⁴⁹⁰ *International Trade Reporter*, 11(23), 8 June 1994, p. 892.

⁴⁹¹ *International Trade Reporter*, 11(7), 16 February 1994, p. 242-243. 'Going cellular' by Fred Barnes, *The New Republic*, 7 March 1994, p. 11. *JEI Report* 7B, 18 February 1994, pp. 13-14.

Illustrating the degree to which Japanese characterisations of the talks had put the United States on the defensive, President Clinton mentioned three times during the half-hour press conference that the US had not asked Japan to commit to a specific volume of imports within a certain period of time.

⁴⁹² *Inside US Trade*, 12(7), 18 February 1993, p. 8.

Japanese company, IDO, was accused of having made 'only token progress' in building a network of base stations to allow Motorola's cellular phones to compete in the Tokyo-Nagoya region.⁴⁹³ Kantor described the case as 'the best possible example of why we adopted a results-oriented approach in the Framework talks'.⁴⁹⁴ On 3 March, with Congress threatening to legislate even tougher action against Japan, President Clinton signed an executive order reinstating for two years the lapsed Super 301 provision requiring the targeting of priority foreign trade barriers.⁴⁹⁵ The order gave the Administration until 30 September to identify priority sectors based on the NTE report to be released at the end of March.⁴⁹⁶

In the words of one Clinton Administration official, the US strategy was to 'slowly ratchet up the psychological pressure on Japan until it makes the next move to get the talks going again. We're prepared to wait them out, but the next phone call is going to have to come from them'.⁴⁹⁷ The threat of sanctions in the cellular phone case saw an agreement concluded by mid March. This committed IDO to expand the infrastructure necessary to cover 90 per cent of the Tokyo-Nagoya market by December 1995.⁴⁹⁸ At the end of March, a politically-weakened Hosokawa Government came forward with a package of economic reform measures aimed, in the Prime Minister's words, at 'fully responding to international criticism that our market remains closed'. The package included measures on deregulation, competition policy, government procurement and import promotion, as well as voluntary measures in the priority sectors of the Framework negotiations. The same week, a number of Japanese automotive companies announced new goals for future purchases of US and other foreign automotive parts, extending their former voluntary plans from the end of fiscal year 1994 to the end of JFY-1996. But the

⁴⁹³ *International Trade Reporter*, 11(8), 23 February 1994, p. 281.

⁴⁹⁴ *Inside US Trade*, 12(7), 18 February, p. 3.

⁴⁹⁵ The Super 301 provision did not carry some of the elements of the 1988 measure legislated by Congress. For example, it called only for the identification of priority practices rather than priority practices and priority countries. *JEI Report* 10B, 11 March 1994, p. 8. Bayard and Elliott (1994: 42).

⁴⁹⁶ The NTE report saw 44 pages devoted to Japan, including new sections highlighting barriers in Japanese procedures on standards and testing, import clearance and utility company procurement. *Inside US Trade*, 12(13), 1 April 1994, p. 21.

⁴⁹⁷ 'Tough Talk: Are the US and Japan headed for a trade war', *Business Week*, 28 February 1994, p. 15.

⁴⁹⁸ The Japanese government agreed to guarantee implementation of a plan requiring IDO to meet scheduled quarterly commitments to transfer 1.5 megahertz of frequency to the Motorola system, and to build 159 new base stations within 18 months. USTR Kantor hailed the agreement as validating a results-oriented approach by establishing a 'step-by-step plan of action associated with specific and measurable actions by the government of Japan and the Japanese commercial entities involved'. *Inside US Trade*, 12(11), 18 March 1994, p.13.

increase (from \$19 billion to roughly \$21.3 billion) fell well below the 20-30 per cent increase reportedly sought by US officials in the Framework negotiations. The Clinton Administration's signalled its unwillingness to return quickly to the negotiating table. USTR Kantor dismissed the Japanese reform package as having 'limited substance'. The auto plans were criticised both for being 'not as large as we might have expected' and because 'the government of Japan is not involved in these so-called voluntary efforts'.⁴⁹⁹

Modest results: The first Framework agreements

After a cooling off period of over three months, US and Japanese officials agreed on 24 May to resume negotiations on the four priority sectors. The United States also secured agreement to expand the Framework talks to include financial services, flat glass, and intellectual property. As part of the terms for the restart of negotiations, Japan reaffirmed the original Framework commitment to pursue a 'highly significant decrease in its current account surplus, and to promote a significant increase in global imports of goods and services, including from the United States'.⁵⁰⁰ It also acknowledged that talks in the priority sectors would aim 'substantially to increase access and sales' with agreements to include quantitative and qualitative objective criteria. For its part, the United States affirmed that these criteria 'do not constitute numerical targets, but rather are to be used for the purpose of evaluating progress achieved toward the goals of the Framework'. The US also agreed that no single indicator would govern the assessment of any agreement. The critical issue left unresolved was whether the quantitative indicators ultimately agreed would establish specific expectations as to when a significant increase in access or sales had occurred.

Resumed negotiations on telecommunications and medical equipment took place under the shadow of a 30 June deadline for a US decision on whether to cite Japan under Title VII of the 1988 Trade Act for discrimination against US firms in government procurement.⁵⁰¹ In the wake of further political uncertainty in Japan, US officials delayed

⁴⁹⁹ *Inside US Trade – Special Report*, 1 April 1994, pp. S1-S4.

⁵⁰⁰ *Inside US Trade – Special Report*, 27 May 1994, p. S1.

⁵⁰¹ On 30 April, USTR Kantor deferred a decision for 60 days following the resignation of Morihiro Hosokawa and his replacement as Prime Minister by Tsutomu Hata. *International Trade Reporter*, 11(18), 4 May 1994, p. 708.

a decision until the end of July.⁵⁰² On 1 August, Japan was cited under Title VII with USTR Kantor stating that ‘the time has come to use our trade laws’.⁵⁰³ This established a 60-day consultation period prior to any initiation of sanctions, ending at a time that coincided with the 30 September deadline for naming countries with serious trade barriers under Super 301. Among the stumbling blocks in the telecommunication talks were the level of the threshold above which any new procurement rules would apply, and whether the language negotiated in any government-to-government agreement would cover NTT.⁵⁰⁴ In the medical equipment negotiations, Japanese negotiators continued to oppose American requests for a high-level Japanese government directive encouraging procuring entities to seek out competitive foreign suppliers. But the issue of quantitative indicators remained the major point of contention. While Japan came forward with a modified proposal on procurement in July, US officials continued to insist on a clear link between the overall goal of significantly increased access and sales and the individual criteria used to measure progress.⁵⁰⁵ Having drawn back from demands for trend-line improvements, the United States now called on Japan to commit to ‘significant annual increases’ in the value of procurements made by government entities.⁵⁰⁶ This was later modified to ‘annual progress’ in the value and share of foreign products.⁵⁰⁷

The resumption of automotive talks yielded little evidence of substantive change in positions. Negotiations remained deadlocked over US demands that Japan commit to a certain number of dealerships that would sell foreign cars, that the voluntary commitments by Japanese carmakers to purchase US parts be accelerated and included in some form in an official agreement, and that Japan deregulate the after-market for parts to allow access for US firms. Japanese officials continued to insist that key demands by US negotiators in the auto parts sector were simply numerical targets by another name.⁵⁰⁸ In contrast with the other priority sectors, quantitative criteria were not the major obstacle to an agreement on insurance. These negotiations continued to have a largely

⁵⁰² In early July 1994, Tomiichi Murayama, the fourth Japanese Prime Minister since President Clinton was elected, replaced Tsutomu Hata as Prime Minister.

⁵⁰³ *International Trade Reporter*, 11(31), 3 August 1994, p. 1208.

⁵⁰⁴ At that time, purchases by NTT still accounted for more than half of the Japanese telecommunications equipment market.

⁵⁰⁵ *Inside US Trade*, 12(30), 29 July 1994, p. 1.

⁵⁰⁶ *Inside US Trade*, 12(31), 5 August 1994, p. 4.

⁵⁰⁷ *Inside US Trade*, 12(39), 30 September 1994, p. 20.

⁵⁰⁸ The reported US demand was that Japan increase purchases of foreign parts from an anticipated \$19 billion at the end of JFY-1994 to \$40 billion by the end of JFY-1998. *Inside US Trade*, 12(39), 30 September 1994, p. 19.

procedural focus on the transparency of regulations, the schedule of deregulation, and the liberalisation of restrictions on the rate and form of insurance products firms could offer in the Japanese market. A central US demand was that Japan not deregulate the so-called “third-area” of specialised niche insurance products (where US and other foreign insurers had gained a presence covering sickness and injury insurance) ahead of the life and non-life markets where Japanese firms were dominant.⁵⁰⁹

With negotiations again at a crisis point due to looming statutory deadlines, on 1 October 1994 the United States and Japan reached agreements covering insurance and government procurement of telecommunications and medical equipment.⁵¹⁰ Both sides also reached an ‘in-principle’ agreement on flat glass to be finalised within 30 days.⁵¹¹ However, officials from the two countries were unable to settle differences in the contentious automotive negotiations. In response, the US initiated a Section 301 trade action targeting regulation of the Japanese after-market, in particular the Japanese Transport Ministry’s vehicle safety inspection system, or *shaken*. Japanese officials continued to insist that the regulatory system was necessary for safety and environmental reasons.

Elements of compromise and ambiguity coexisted in the procurement agreements announced on 1 October. Under the ‘Quantitative Criteria’ heading, the agreements called for ‘annual evaluation of progress in the value and share of procurements ... to achieve, over the medium term, a significant increase in access and sales’ of competitive foreign products. Evaluation would take place with reference to ‘recent trends in the value, rate of growth and share of procurements’. Among the other quantitative and qualitative criteria included to assess implementation of the telecommunications and medical equipment agreements were the annual number of entities procuring foreign products and services and the annual number and value of contracts awarded as a result of the decrease in single-source tendering. Officials from both sides sought to place their own interpretation on what had been agreed. One senior US official praised the

⁵⁰⁹ *Inside US Trade*, 12(35), 2 September 1994, p. 12.

⁵¹⁰ *International Trade Reporter*, 11(39), 5 October, p. 1522. On 15 August, the United States and Japan had reached an agreement on patent harmonisation, the first accord reached in the Framework talks. *Inside US Trade*, 12(33), 19 August 1994, p. 6.

⁵¹¹ In addition to these sectoral deals, Japan signalled a macroeconomic commitment to extend a \$55 billion cut in personal income tax, and to delay offsetting tax rises until April 1997.

agreements as meeting the US goal of having 'forward-looking indicators connected to the value and share and connected to a commitment to achieve a significant increase over the medium term'.⁵¹² By contrast, a Japanese Foreign Ministry official labelled the objective criteria as 'basically neutral'.⁵¹³

The United States could claim at least a partial victory for its results-oriented approach with the concessions made by Japan in the government procurement agreements. Japan had seemingly backed away from its earlier refusal to commit to a 'forward-looking' process of evaluation based on recent trends in data. As Lincoln (1999: 152) notes, the government procurement agreements 'put on record the Japanese government acquiescence to the concept that greater market openness should result in some real increase in the foreign presence in the market, without attaching any numerical dimensions'. And yet Japan achieved its overriding objective of avoiding any reference to specific sales expectations in the future. Schoppa's (1997: 267) critical analysis of the Clinton Administration's results-oriented approach concluded that:

the Clinton team failed to achieve its most critical aim of securing a Japanese commitment to "results" which would be explicit enough to allow the US to hold the Japanese government accountable under US trade law. ... the more innocuous phrase "annual progress in the value and share" of foreign procurements, which could have been interpreted as having committed the government to guaranteeing at least some increase every year, was excised. The final language, with multiple words requiring an element of interpretation, simply fell short of what the US needed in order to hold Japan accountable.

In the other key area of contention in the telecommunications negotiations, Japan held firm in insisting that the language on objective criteria and recent purchasing trends not apply to NTT.⁵¹⁴ On medical technology, Japan met a key US goal by agreeing to issue a directive to government hospitals encouraging the use of foreign medical technology and services. On insurance, Japan agreed to compile and publish its standards for approval of licences and new products and to allow companies to introduce new products simply by notifying regulators rather than obtaining prior approval. Japan also agreed to avoid any

⁵¹² *Inside US Trade*, 12(40), 7 October 1994, p. 23.

⁵¹³ *International Trade Reporter*, 11(39), 5 October 1994, p. 1522.

⁵¹⁴ A subsequent letter agreed to the weaker commitment that NTT 'believes that the improvement in NTT's procurement procedures will increase access to its procurement opportunities and can lead to an increase in the foreign value and share of its procurement over the medium term'. *Inside US Trade*, 12(44), 4 November 1994, p. 3.

‘radical change’ in the third area of specialised markets until ‘meaningful and substantial liberalization’ took place in the life and non-life markets.⁵¹⁵

The agreements overwhelmingly took the form of procedural changes, notwithstanding the disproportionate focus on quantitative indicators during the negotiations. The Clinton Administration placed particular emphasis on what it proclaimed as a new era of more intense monitoring of agreements with considerable data to be collected and annual review processes built into the agreements.⁵¹⁶ But the change from earlier administrations was a matter of degree. As Lincoln (1999: 152-153) states in the case of the procurement deal:

the indicators and follow-up meetings did not constitute the core of the agreement, which consisted of 20 pages of detailed changes in government procurement procedures intended to make procurement more transparent and objective.

This language was quite similar to what the Bush administration had obtained in some of its agreements – vague references to increased sales of foreign goods coupled with a bilateral review process. ...

In reality, the phrase “substantial increase” was not very precise or distinctive, so that the administration did not have any clear definition of “success” in carrying out its assessment of agreements. Nevertheless, the institutionalization of a review or assessment process based on a basket of qualitative and quantitative indicators was an important innovation of the 1990s, with due credit to the Bush Administration.

The Clinton Administration was less willing to compromise on its position in the automotive negotiations. While focusing its Section 301 action on the Japanese after-market for parts, USTR Kantor made clear additional progress was required in the other areas under discussion, namely on automotive dealerships and parts sales. In response to the Section 301 action, Japanese officials suspended further automotive negotiations. MITI Minister Ryutaro Hashimoto affirmed the Japanese position of ‘limiting the “government reach” to within what the government can influence [over the private sector] in automobiles and auto parts and all other areas of the framework while refusing numerical targets’.⁵¹⁷ In two letters to Ambassador Kantor in October 1994, Mr Hashimoto insisted that US demands on dealerships and parts purchasing plans could not be discussed under the Framework because they were beyond the reach of

⁵¹⁵ *Inside US Trade*, 12(40), 7 October 1994, p. 24.

⁵¹⁶ According to one US official, the extent of monitoring to be undertaken was ‘very different from what we had in the past’. *Inside US Trade*, 12(44), 4 November 1994, p. 3.

⁵¹⁷ *International Trade Reporter*, 11(39), 5 October 1994, p. 1525.

government.⁵¹⁸ Kantor and Commerce Secretary Brown responded to Hashimoto restating that a comprehensive solution to the automotive dispute needed to address these two elements, plus deregulation in the Japanese after-market.⁵¹⁹

Despite strong pressure from industry and Congress, the Clinton Administration stopped short of levelling a Super 301 action against Japan in the automotive sector.⁵²⁰ Having secured at least some agreements, the administration chose instead to identify Japan's market access for wood and paper products as areas warranting future attention as part of a Super 301 'watch list'. Japan was cited for failing to provide detailed information on steps to encourage the use of foreign wood and paper products contrary to a 1990 wood products agreement and a 1992 action plan for increased access for paper products. The October 1994 sectoral agreements also provided the basis for the United States to focus more on deregulation, administrative reform and competition policy enforcement in Japan under the 'regulatory reform and competitiveness' basket of the Framework. On November 15, US officials presented a comprehensive set of demands under 36 categories, covering over 200 specific items.⁵²¹ The US proposal called on Japan to adopt a broad and continuous review of all regulations, a policy of regulation as the exception, enhanced transparency and accountability, prohibition of informal delegation of government authority and promotion of market mechanisms.⁵²²

A sharper sense of the constraints on US action accompanied this greater emphasis on deregulation by the end of 1994. In early December 1994, Commerce Undersecretary Garten spoke of a 'growing fatigue and weariness among the negotiators on both sides of the Pacific'. He also acknowledged the limits growing economic interdependence placed on US leverage, saying 'our ability to take tough trade action – while an option we must preserve and use when necessary – is constrained increasingly by a world economy

⁵¹⁸ *Inside US Trade*, 12(43), 28 October 1994, p. 1.

⁵¹⁹ *Inside US Trade*, 12(44), 4 November 1994, p. 6.

⁵²⁰ USTR Kantor argued that, 'Given the success of reaching five trade agreements today under the framework, given the fact that, of course, 301 and Super 301 have the same effect, as you know – it's only a timing difference – we thought it would be appropriate to act under 301 and to self-initiate than to initiate a Super 301 action'. *International Trade Reporter*, 11(39), 5 October 1994, p. 1524.

⁵²¹ *International Trade Reporter*, 11(46), 23 November 1994, p. 1804. *Inside US Trade - Special Report*, 18 November 1994, p. 1. Japan had already signalled its intention to pursue a five-year deregulation program to be finalised in the first half of 1995.

⁵²² Specific proposals were identified in a number of sectors: agriculture, automobiles and auto parts, construction materials, distribution, energy production and delivery, financial services, investment, legal services, medical equipment, and pharmaceuticals and telecommunications.

which has become so interconnected ... When it comes to negotiations such as the Framework, results are difficult to achieve and slow in coming'.⁵²³ Garten's Commerce Department colleague Marjory Searing was even more direct, conceding that the Clinton team 'may have oversold the framework as a panacea for all our economic problems with Japan'.⁵²⁴

After an extra two months of discussions on how to measure progress, a final agreement on flat glass was reached in mid December.⁵²⁵ The agreement called for the Japanese distributors of flat glass to announce publicly their intention to diversify their sources of supply to include competitive foreign suppliers, while Japanese glass manufacturers were to support diversification in their distribution networks. The agreement also gave a direct role to MITI, both in collecting data about glass sales and in ensuring diversification to foreign suppliers.⁵²⁶ January 1995 saw an agreement reached on financial services liberalising access to Japan's corporate securities market and cross-border financial transactions, and allowing foreign investment advisory companies to compete in the management of public pension assets and a larger share of corporate assets.⁵²⁷ This left the automotive negotiations as the remaining priority sector of the Framework Agreement when talks resumed in January 1995.

To the brink on autos

The automotive negotiations stood as a critical test of the Clinton Administration's trade strategy towards Japan. They were described by one of the lead US negotiators as 'the one that matters most, where the stakes are highest'.⁵²⁸ The statement foreshadowing the resumption of talks affirmed that discussions would continue on the three elements

⁵²³ *International Trade Reporter*, 11(48), 7 December 1994, p. 1887.

⁵²⁴ *Inside US Trade*, 12(49), 9 December 1994, p. 4. For a discussion of how financial market factors put constraints on US trade threats towards Japan in 1994, see 'The great bond market massacre' by Al Ehrbar, *Fortune*, 17 October 1994, pp. 57-68.

⁵²⁵ *International Trade Reporter*, 11(49), 14 December 1994, p. 1931. *Inside US Trade*, 12(50) 16 December 1994, p. 11.

⁵²⁶ Japan successfully rejected a US demand that progress under the agreement be based on capital affiliation of the exporting companies so that imports from Japanese-affiliated companies located abroad could be distinguished from imports of US-owned and other non-Japanese companies. *Inside US Trade*, 12(49), 9 December 1994, p. 3.

⁵²⁷ *Inside US Trade*, 13(2), 13 January 1995, p. 4.

⁵²⁸ Remarks by Office of the US Trade Representative General Counsel Ira Shapiro to the Japan Society, New York, 21 April 1995.

identified by the United States as essential to an agreement – access to Japan’s motor vehicle market through dealerships, auto parts purchases by Japanese auto manufacturers, and deregulation of the Japanese auto parts after-market. The critical divergence related to Japan’s much narrower definition of the scope of government responsibility in these areas. The agreement to resume negotiations made no reference to the Section 301 investigation of barriers in the Japanese after-market for parts.⁵²⁹ With the Section 301 action providing for a one-year investigation process through to October 1995, US officials quickly became frustrated at their limited leverage to secure concessions from Japan. Soon after talks began, the NEC decided to speed up the Section 301 case in the absence of significant progress in the negotiations by the end of March.⁵³⁰ This date coincided with the end of the Japanese fiscal year, marking the end point of the 1992 voluntary commitments by the Japanese automotive companies.

Part of the US strategy was to use direct talks with the Japanese automotive manufacturers to raise both parts purchases and access to dealerships in Japan. In a sharp exchange of letters in March 1995, MITI Minister Hashimoto warned USTR Kantor that the US could be violating international trade rules if it ‘requests that Japanese auto companies increase their purchases of particular auto parts in a “de facto” coercive or discriminatory manner’.⁵³¹ Hashimoto demanded that the US affirm that the issue of voluntary company purchasing plans was outside the scope of government-to-government negotiations. He also reiterated Japan’s resolve to bring a case to the World Trade Organization if the US launched trade sanctions in the dispute. In reply, Ambassador Kantor stressed that new voluntary plans were central to any agreement, saying that the Japanese government played an important role in securing the 1992 plans, ‘and frankly, the situation should not be different at this time’. Kantor also warned that the United States would be prepared to demand ‘a broad inquiry into Japan’s lack of effective adherence to the market opening objectives of the WTO’.⁵³²

⁵²⁹ USTR Kantor was quoted saying that the administration would ‘continue with our investigation and possible action, but these talks will be carried on on a separate track’. *Inside US Trade*, 13(1), 6 January 1995, p. 3.

⁵³⁰ *Inside US Trade*, 13(10), 10 March 1995, p. 7. *International Trade Reporter*, 12(10), 8 March 1995, p. 450. Automotive industry groups had urged the administration to bring forward the Section 301 deadline since early December 1994.

⁵³¹ *Inside US Trade*, 13(12), 24 March 1995, p. 1.

⁵³² Adding to the sense of looming confrontation in the automotive talks was the sharp criticism levelled by the United States at Japan’s five-year deregulation plan outlined at the end of March. USTR Kantor criticised the plan as ‘not specific ... it has no time frames, or at least not the time frames we would want’. *Inside US Trade*, 13(14), 7 April 1995, p. 4.

A revised US proposal on access to Japanese dealerships and after-market deregulation was presented in late March. It sought public statements by the Japan Automobile Manufacturers' Association (JAMA) and the Japanese government that they would actively support the 'substantial expansion of sales of foreign vehicles in Japan'. The proposal also called for Japan's largest association of vehicle dealers to announce publicly 'the intention and desire' of dealers to enter into franchise agreements with foreign vehicle manufacturers. Japanese officials continued to focus on the need for US companies to improve the quality and cost of their products, to ensure stable delivery of their products and after-sales service, and to introduce new models (especially compact cars) suitable for the Japanese market. The US proposal on deregulation of Japan's vehicle inspection system called for a drastic reduction in the "critical parts" list – those parts for which a vehicle must be reinspected by Japan's Ministry of Transportation unless a 'certified garage' performed the work.⁵³³ It also called for Japan to change the system of certified garages to allow specialised repair operations to be established. Japan's counter proposal provided for only a narrow focus on specific cases where the US alleged that a particular regulation posed a barrier to parts imports.⁵³⁴ Japanese officials accused the Clinton Administration of ratcheting up its demands on foreign access to Japanese dealerships and after-market deregulation as a tactic to increase pressure over the parts purchasing issue. Particular sensitivity surrounded continued US demands for some form of Japanese government endorsement of any plans, with MITI Vice-Minister Yoshihiro Sakamoto accusing the US of 'still insisting on a numerical targeting approach'.⁵³⁵

The Clinton Administration's preparedness to move towards sanctions became more explicit following a meeting of the NEC in April 1995. Speaking on 13 April, White House Press Secretary Mike McCurry said that if the negotiations continued to drag on President Clinton was 'willing to proceed to consideration of other options, and failing a negotiated solution to our concerns ... he is prepared to act if necessary'. McCurry

⁵³³ The draft US text stated that the immediate review of the critical parts list was 'expected to result', within six months in the removal from the list of 'a substantial percentage of parts replacement operations'. It also demanded that Japan immediately remove trailer hitches, shock absorbers and struts, and routine brake service from those measures requiring reinspection.

⁵³⁴ *Inside US Trade*, 13(16), 21 April 1995, p. 6.

⁵³⁵ *Inside US Trade*, 13(16), 21 April 1995, p. 25. *International Trade Reporter*, 12(17), 26 April 1995, p. 724. Mr Sakamoto had replaced Sozaburu Okamatsu as MITI Vice Minister and lead negotiator in the automotive talks in January 1995.

pointedly said that if Japan was 'to enjoy the full benefits' of the bilateral relationship in other areas, 'there must be progress in the economic sphere, and that's what the trade talks have been aimed to achieve'.⁵³⁶ By the end of April, US officials had agreed on a final damage estimate in the Section 301 case that provided the basis for a sanctions list against Japan. On 10 May, following the breakdown of talks between USTR Kantor and MITI Minister Hashimoto, the United States announced a two-pronged strategy: a retaliation list would be published as part of the Section 301 case; simultaneously, a WTO case would be launched against Japanese automotive practices alleging that Japanese government actions had 'nullified and impaired' the benefits that should have been enjoyed by the US and other countries under the multilateral trading system. Calling the US plan for retaliation 'very regrettable', Hashimoto said that the initiation of the WTO dispute alongside the move towards sanctions 'is a contradictory decision that goes against one of the basic principles of the WTO – prohibition of unilateral action in trade disputes – and such a decision is incomprehensible to us'.⁵³⁷ Japan viewed continued insistence by the United States on new voluntary parts plans by the Japanese manufacturers as the main stumbling block to an agreement.⁵³⁸

The escalation of the automotive dispute in the 1990s carried a heavy political dimension in the wake of the Democratic party's loss of control of Congress in November 1994 and President Clinton's bid for reelection in 1996. Difficult trade battles (especially over NAFTA) left the administration looking to shore up support for its trade policy in Congress, particularly among Midwestern Democrats.⁵³⁹ President Clinton used two public addresses, including one at an auto assembly plant, to underline his determination to pressure Japan to accept American demands (Lincoln 1999: 133). In his regular Saturday radio address of 13 May President Clinton assured Americans that he was prepared to 'fight for a fair shake for American products' as the US had been 'hitting a brick wall' in 20 months of talks with the Japanese (Woodward 1996: 202).⁵⁴⁰ Not surprisingly, the Clinton Administration found strong support on Capitol Hill for its

⁵³⁶ *Inside US Trade*, 13(15), 14 April 1995, p. 18.

⁵³⁷ *Inside US Trade*, 13(19), 12 May 1995, p. 1.

⁵³⁸ Mr Hashimoto stated that the demand for voluntary plans 'is nothing more than de facto numerical targets and would lead to managed trade. If the US stops demanding voluntary plans, we feel there is ample room for an agreement'. *International Trade Reporter* 12(19), 10 May 1995, p. 840.

⁵³⁹ One analyst noted that, 'In the auto war with Japan, the underlying issue was how to gain political support in the rust belt states, especially from unions' (Malmgren 1995: 15).

⁵⁴⁰ The President rejected a more inflammatory text for his address prepared by his political advisers described as 'raw-meat rhetoric for auto workers in Michigan' (Woodward 1996: 202).

move towards sanctions and on May 10 the Senate passed a resolution (S. Res. 118) supporting the action by a vote of 88-8.⁵⁴¹

On 16 May, USTR Kantor unveiled a sanctions list that threatened 100 per cent tariffs on \$5.9 billion worth of Japanese luxury car imports.⁵⁴² President Clinton defended the US action saying, 'We can't deny this or sweep it under the rug. We've got to go forward, and we're going to do that'. Japan responded on 17 May with the first step in a WTO case, a request for bilateral consultations on the dispute. Convinced by mid June that the White House was serious about retaliation, Japan signalled its intention to go part of the way towards meeting US objectives with speculation surrounding announcements of new purchasing plans by the five Japanese auto manufacturers.⁵⁴³ Still, the Japanese government continued to rule out specific numerical projections or government endorsement of any plans. An agreement was secured only hours before the tariffs were to come into effect, and only when USTR Kantor abandoned the Clinton administration's demand for specific numbers. This concession, it has been noted, 'which had repercussions for resolution of the dealer access issue in addition to its primary impact on the nature of the Japanese automotive industry's parts purchasing plans, was the one compromise Washington previously had refused to make even while it backed away from most of its original specifications for a comprehensive auto pact'.⁵⁴⁴

On 28 June, the United States and Japan announced an agreement averting punitive tariffs. Japan withdrew its WTO complaint against unilateral sanctions and the United States announced that it saw no reason to pursue its case against Japan in the WTO. The official agreement was supplemented by a collection of statements from Japanese and American automotive groups that left room for both sides to claim victory and to interpret the nature of that victory for their respective audiences. In what one trade official described as 'creative deal-making', a joint statement was released with figures left blank until the US government devised its own numerical estimates of the impact of new Japanese business plans on auto parts purchases and of the expansion of Japanese

⁵⁴¹ *Inside US Trade*, 13(19), 12 May 1995, p. 23. *International Trade Reporter*, 12(19), 10 May 1995, p. 837.

⁵⁴² The list comprised 13 models of luxury cars made by Honda, Toyota, Nissan, Mazda, and Mitsubishi. While timed to go into effect on 28 June, the sanctions were slated to apply retroactively from 20 May. *International Trade Reporter*, 12(20), 17 May 1995, p. 848.

⁵⁴³ *Inside US Trade*, 13(24), 16 June 1995, p. 1.

⁵⁴⁴ *JEI Report 24B*, 30 June 1995, p. 9.

dealerships carrying foreign vehicles. Significantly, each side agreed that the plans were outside the scope of government negotiations and, therefore, would not be subject to domestic trade laws.⁵⁴⁵ The plans foreshadowed an increase of vehicle production by Japanese manufacturers in the United States from 2.1 million units to 2.65 million units by 1998 and increasing North American content. The US government unilaterally estimated that parts purchases in the United States would increase by \$6.75 billion by 1998 while foreign parts bought in Japan would rise by about \$6 billion. Forming part of the *joint* announcement was the astonishingly frank statement to the effect that: 'Minister Hashimoto said the Government of Japan has had no involvement in this calculation because it is beyond the scope and responsibility of government. He said that USTR's estimates are solely its own'.⁵⁴⁶

On the issue of dealerships, the agreement called for a letter from MITI to all Japanese auto dealers affirming their freedom to carry foreign vehicles, the establishment of contact points in the Japanese government and the major manufacturers to facilitate foreign partnerships, and a government survey to determine the interest of Japanese dealers in selling foreign vehicles. Again, the US government was left to envision its own estimate of approximately 200 new sales outlets for foreign cars in the agreement's first year and 1000 new outlets by the end of 2000. And again, the joint announcement carried a clear Japanese disclaimer whereby: 'Minister Hashimoto said that the Government of Japan has had no involvement in this forecast because it is beyond the scope and responsibility of government. Minister Hashimoto said that these forecasts are solely those of the Government of the US'.⁵⁴⁷

The United States could claim progress on after-market deregulation designed to raise the number of garages that were likely to carry foreign auto repair parts, reduce the

⁵⁴⁵ The agreement stated that: 'The two ministers recognize and understand that the plans by the US or Japanese companies are commitments and are not subject to the trade remedy laws of either country. Rather, they are business forecasts and intentions of the companies based on their study of market conditions and other factors. Both ministers recognize and understand that changes in market conditions may affect the fulfilment of these plans'. Joint Announcement by Ryutaro Hashimoto, Minister of International Trade and Industry of Japan, and Michael Kantor, United States Trade Representative, Regarding Autos and Auto Parts, 28 June 1995.

⁵⁴⁶ Joint Announcement by Ryutaro Hashimoto, Minister of Trade and Industry of Japan, and Michael Kantor, United States Trade Representative, Regarding the Japanese Auto Companies' plans, 28 June 1995.

⁵⁴⁷ Joint Announcement on Dealerships by Ryutaro Hashimoto, Minister of Trade and Industry of Japan, and Michael Kantor, United States Trade Representative, 28 June 1995.

inspection requirements for after-market parts, and allow Japanese garages to specialise in specific repairs using parts that may be imported. Japan agreed to a one-year review of its critical parts list with the goal of deregulating any parts not central to health and safety concerns.⁵⁴⁸ It also agreed to ease the requirements for the establishment of 'designated garages' allowed to self-certify repairs under the *shaken* system, and to establish a system of 'specialized certified garages', reducing the areas where repairs would be subject to reinspection by the Ministry of Transport. The US claimed that these measures would increase purchases of American parts by almost \$9 billion or 50 per cent over three years. Even so, the US Government failed to achieve its ultimate objective of separating repair shops from *shaken* facilities and it reserved the right to resort again to Section 301 or to a WTO case if it was not satisfied with the results of the agreement.

Announcing the auto agreement, President Clinton described it as one that 'will begin to truly open' Japan's auto and auto parts markets to American companies 'after two decades of presidential attempts to fix this problem. This agreement is specific. It is measurable. It will achieve real, concrete results'.⁵⁴⁹ USTR Kantor insisted that, 'What we have here are objective criteria, both qualitative and quantitative, which will hold Japan's feet to the fire to make sure there is significant increase in access, sales, and opportunities for US autos and auto parts manufacturers. ... Remember that "significant increase" commitment by Japan can be enforced by US trade laws'.⁵⁵⁰ Minister Hashimoto said simply that 'the result of these talks is that Japan was able to maintain its basic principles'.⁵⁵¹ Beyond the rhetoric, the United States accepted an agreement without the specific numerical forecasts for purchases of foreign auto parts or Japanese dealerships selling foreign cars that they had set previously as the benchmarks for a settlement. The *Washington Post* reported that 'the Clinton administration's assault on the barriers in Japan's automotive market has ... [been] notable for the bellicose US threats – but not for the significance of its results'.⁵⁵² On what many observers saw as the central interest of the United States, Malmgren (1995: 13) noted that:

⁵⁴⁸ Among items delisted immediately were struts, shock absorbers, power steering systems and trailer hitches.

⁵⁴⁹ 'Clinton says trade deal will make inroads in Japan' by Steve Holland, Reuters News Service, 28 June 1995.

⁵⁵⁰ *International Trade Reporter*, 12(27), 5 July 1995, p. 1132.

⁵⁵¹ *International Trade Reporter*, 12(27), 5 July 1995, p. 1133.

⁵⁵² 'An auto market left undented', by Paul Blustein, *Washington Post National Weekly Edition*, 3-9 July 1995, p. 22.

it was clear the Japanese had not given one centimeter on two key points: there was no Japanese commitment to quantitative targets for increased automotive parts purchases; and there was no Japanese government official guarantee that Japanese automotive industry forecasts would be carried out.

Working in favour of the agreement in 1995 and a major factor driving the relocation of Japanese auto production capacity and sourcing of auto parts offshore was the strength of the yen in the first half of the 1990s. By 1994, production of Japanese-owned plants in the United States had reached over 20 per cent of all cars sold in the American market with the strong US expansion after 1992 adding to incentives for the expansion of US production bases (Nanto, Cooper and Bass 1995).⁵⁵³ In response to the Japanese auto manufacturers' business plans, then Chrysler Chairman Robert Eaton was quoted as saying, 'That was all stuff that was going to happen anyway. As far as I'm concerned, nothing's changed at all'.⁵⁵⁴

The agreement to avert sanctions did not prevent further sparring by US and Japanese officials over the accord's interpretation, while discussions continued for six weeks over how to monitor progress toward the agreement's goals. In mid August, USTR published a 30 page version of the agreement which included two general gauges of progress – market conditions in the two countries and follow-through on individual provisions – and 15 specific quantitative and qualitative objective criteria to be assessed on an annual basis.⁵⁵⁵ This was followed by a US government announcement in early September of 'unprecedented collaboration' between government and industry to track Japan's compliance with the automotive agreement. The monitoring effort called for expanded data collection by government and industry, as well as six-monthly assessments of the accord's effectiveness. It also foreshadowed the establishment of an interagency monitoring team headed by officials from USTR and the Department of Commerce.⁵⁵⁶

The automotive monitoring exercise was part of a broader shift by the Clinton

⁵⁵³ See also MacKnight (1996).

⁵⁵⁴ 'More Japanese US production may hurt Detroit' by David Lawder, Reuters News Service, 29 June 1995.

⁵⁵⁵ An exchange of letters between USTR Kantor and Commerce Secretary Brown on behalf of the United States and Japan's Ambassador to the United States, Takakazu Kuriyama, on 23 August put into effect the finalised auto trade agreement. Japan also released a separate document still claiming that statements in US background documents on the auto agreement were misleading or inaccurate. *International Trade Reporter*, 12(35), 6 September 1995, p. 1469.

⁵⁵⁶ *Inside US Trade*, 13(36), 8 September 1995, p. 5.

Administration from targeting new product areas under the Framework to implementing and monitoring agreements already reached. In the words of one senior US official, the administration had moved 'into a phase in which we are going to be monitoring, implementing, and making sure our agreements have the results we all hoped to achieve'.⁵⁵⁷ This meshed with the increased US emphasis on deregulation and administrative reform in Japan that had begun the previous year.⁵⁵⁸ Overshadowed by the automotive dispute in mid 1995 was a decision by President Clinton and Prime Minister Tomiichi Murayama to extend the US-Japan Framework for a New Economic Partnership, originally due to expire in July 1995, but without specifying any new areas that would be discussed during the extension.⁵⁵⁹ In the aftermath of the automotive dispute, Clinton Administration officials settled on a strategy of trumpeting the unprecedented 20 trade agreements reached between the United States and Japan since the start of the administration. To vindicate the administration's Japan policy, the CEA and Treasury released research in November 1995 which found that in the sectors covered by the 20 trade agreements US exports to Japan had grown by nearly 80 per cent since the Clinton Administration took office, nearly two and a half times greater than growth in other US exports to Japan. By the end of 1995, both USTR and the Commerce Department had devised plans for permanent offices devoted exclusively to monitoring and enforcement of trade agreements.⁵⁶⁰

The hardliners scale back

Speaking on 4 December 1995, US Ambassador to Japan Walter Mondale referred to 'a cycle' in trade talks, with the United States now 'in the second generation of concerns, which is implementation and monitoring of these agreements'. At the same time, he identified two issues as 'looming on the horizon', namely the semiconductor agreement timed to expire in July 1996, and a Section 301 investigation of an Eastman Kodak complaint alleging anticompetitive practices in the Japanese film and photographic paper

⁵⁵⁷ *International Trade Reporter*, 12(36), 13 September 1995, p. 1531.

⁵⁵⁸ In November 1995, the United States presented Japan with a revised proposal on deregulation broadly similar to the previous year's attempt to influence the Japanese deregulation announcements. *Inside US Trade*, 13(46), 17 November 1995, p. 6.

⁵⁵⁹ *Inside US Trade*, 12(25), 23 June 1995, p. 5.

⁵⁶⁰ *Inside US Trade*, 13(50), 15 December 1995, p. 1. *Inside US Trade*, 13(51), 22 December 1995, p. 1. Alongside the automotive agreement, the 1994 insurance agreement emerged as a particular target of US enforcement efforts in the light of US concerns that Japan was proceeding with plans to open the third-area market.

market. While the automotive dispute largely exhausted the Clinton Administration's appetite for high-profile attempts to secure quantitative market access indicators, dispute remained over what, if anything, would replace the signature example of this approach – the US-Japan semiconductor agreement. The SIA flagged its desire for a new agreement early in 1995. USTR Kantor registered the US government's interest in a new agreement in September 1995, while stopping short of setting out desired terms and conditions.⁵⁶¹ Soon after, Minister Hashimoto rejected the US demand, saying that 'the objectives of the agreement have already been fulfilled. There is no need for a government-to-government arrangement. Our market is already open'.⁵⁶² Japan's opposition to a new agreement was reinforced with the release of figures in November 1995 showing that foreign market share in Japan had risen to 26.2 per cent.⁵⁶³

Significantly, the Clinton Administration decided not to seek a new numerical target while maintaining that a government-to-government agreement was essential to sustain further expansion in market access. American officials focused their attention on Japanese sectors seen as lagging in terms of foreign semiconductor sales (such as automotives, telecommunications and video games) and also called for more to be done in the areas of design-ins and sales to small and medium-sized Japanese companies. Through the early months of 1996, Japan continued to reject official negotiations on a new agreement, emboldened by its capacity to blunt US demands under the Framework.⁵⁶⁴ The first sign of flexibility came in a letter from now Prime Minister Hashimoto to President Clinton in advance of an April 1996 summit meeting. He indicated that his government supported efforts by US and Japanese semiconductor industry representatives to come to an accord, 'barring some kind of very strange agreement'.⁵⁶⁵

⁵⁶¹ Kantor was quoted as saying, 'we've almost reached the critical mass where we'll have a good and solid and legitimate percentage of that market, but a new agreement would be very helpful'. *Inside US Trade*, 13(38), 22 September 1995, p. 1.

⁵⁶² *International Trade Reporter*, 12(42), 25 October 1995, p. 1760.

⁵⁶³ *Inside US Trade*, 13(50), 15 December 1995, p. 7.

⁵⁶⁴ MITI Vice Minister Sakamoto went as far as to suggest in March 1996 that 'the era of bilateralism is over' in US-Japan trade relations. Acknowledging that bilateral disputes would not disappear, Sakamoto foresaw that 'any such friction from now on will have to be solved in accordance with the WTO and other international rules and by following market mechanisms'. The MITI official's American counterparts were less than impressed with what one US official labelled as 'MITI's wishful thinking'. *Inside US Trade*, 14(12), 22 March 1996, p. 3.

⁵⁶⁵ *Inside US Trade*, 14(15), 12 April 1996, p. 1.

Talks between the respective industries remained deadlocked with the Japanese side continuing to rule out US industry demands for an agreement which would include government monitoring, language similar to the earlier agreements calling for 'steady and gradual progress' in market share, and provisions allowing for rapid response to dumping allegations.⁵⁶⁶ A June proposal by the EIAJ called for a three-year industry agreement that explicitly disavowed government involvement in favour of cooperative activities between chip users and suppliers in the Japanese market. It also called for the creation of a World Semiconductor Council to promote industrial cooperation with the aim of further diminishing any bilateral government involvement in the semiconductor industry.⁵⁶⁷ The fact that semiconductor sales by non-Japanese affiliated companies topped 30 per cent for the first time in the first quarter of 1996 only made it harder for American negotiators to secure Japanese government endorsement for further market share gains and for continued monitoring by capital affiliation.⁵⁶⁸

With a looming deadline of 31 July 1996, both sides made minor concessions. Japan modified its opposition to government involvement by proposing a Global Governmental Forum on the semiconductor industry alongside the private sector body proposed by the EIAJ. The United States signalled that it would be willing to accept private sector monitoring of market share.⁵⁶⁹ The two sides remained split over how governments could use this data to assess market access conditions in Japan with the Japanese government determined to avoid language that would imply a guarantee of further improvement in market share.

A new semiconductor arrangement that unwound key parts of the framework in place since the mid 1980s was announced on 1 August 1996. The SIA and the EIAJ agreed under the new arrangement to establish a private sector Semiconductor Council 'to enhance mutual understanding, to address market access matters, to promote cooperative industry activities and to expand international cooperation in the semiconductor sector in order to facilitate the healthy growth of the industry from a long-term, global perspective'. The Council would make quarterly reports to governments on market

⁵⁶⁶ *Inside US Trade*, 14(16), 19 April 1996, p. 4. *Inside US Trade*, 14(18), 3 May 1996, p. 1.

⁵⁶⁷ *Inside US Trade*, 14(23), 7 June 1996, p. 1.

⁵⁶⁸ *Inside US Trade*, 14(25), 21 June 1996, p. 1.

⁵⁶⁹ *Inside US Trade*, 14(26), 28 June 1996, p. 1. *Inside US Trade*, 14(30), 26 July 1996, p. 1.

developments through regular ‘analysis of semiconductor market data’, including on ‘market size, market growth, and market shares of foreign semiconductor products in Council member markets and other major semiconductor markets’. The agreement stated that the ‘purpose of this analysis is not to create numerical targets, but instead to assess trends, better comprehend market dynamics, and promote deeper understanding. No piece of data will be determinative of the assessment of market developments’.⁵⁷⁰

The official statement announced the establishment of a Global Governmental Forum on semiconductors and provided for annual meetings of the US and Japanese governments to review industrial cooperation and market developments, including data gathered by the industries. This was the minimum which would allow Acting USTR Charlene Barshefsky to proclaim that the agreement would ‘further enhance the strong position of American firms in the Japanese semiconductor market ... [and] allow our countries to build on the progress achieved under the 1991 US-Japanese semiconductor arrangement’. Welcoming the ‘new multilateral cooperative framework’ for semiconductors, MITI Minister Shumpei Tsukahara stressed that the new deal ‘put[s] an end to a system of managing trade by reviewing market share [and] taking into account numerical targets’.⁵⁷¹

The 1996 semiconductor agreement highlighted the scaling back of US demands for quantitative market access indicators in Japan by the end of the Clinton Administration’s first term in office. A number of factors contributed to the quiet shelving of a results-oriented Japan policy. Part of the explanation lies in the natural policy cycle spoken of by Ambassador Mondale following the auto dispute. American officials could claim plausibly that at least some of their stated goals had been achieved, thus assisting them to downplay the Japan problem. By the end of 1996, Japan’s overall trade surplus had fallen from more than three per cent to 1.4 per cent of GDP. And a mini import boom in Japan in the first half of the 1990s allowed the White House to highlight areas of

⁵⁷⁰ *Inside US Trade – Special Report*, 5 August 1996.

⁵⁷¹ *Inside US Trade – Special Report*, 5 August 1996. Japan also denied the US language in the agreement along the lines of the 1991 requirement for Japanese producers to provide cost and pricing data on an accelerated basis in the event that the US industry filed an antidumping case.

impressive US export growth.⁵⁷²

A combination of underlying political factors and international economic conditions provide the more fundamental reasons for the paring back of US demands. Critical was the strong and sustained resistance from Japan to American demands for quantitative indicators. The complete lack of support in Japan for the Clinton Administration's policy objectives set limits on the implementation of hardline policy preferences. The resolve of key Japanese actors not to make major concessions to a US president underscores in a Japanese context the power of domestic incentives and the permissiveness of international constraints. The binding constraint proved to be *Japanese* policy preferences. As Schoppa (1997: 272) notes:

With the bureaucrats, the media, and other opinion leaders uniformly against the Clinton demands, there was little incentive for political leaders to intervene to broker a deal ... The key politicians during the Framework, Prime Minister Hosokawa in the lead-up to February 1994 and MITI Minister Hashimoto since the summer of 1994, both earned accolades, not for smoothing out relations with the Americans but by refusing to give in.

Reinforcing the demise of a results-oriented Japan policy by the mid 1990s was a transformation in the economic performances of Japan and the United States. The bursting of the late 1980s "bubble economy" in Japan left a legacy of financial crisis, industrial hollowing-out, corporate bankruptcy and rising unemployment. The Japanese economy entered a period of prolonged economic stagnation, experiencing its worst recession since the 1920s and its first major financial failures and bank runs of the postwar era. Between 1992 and 1995, Japan's economy averaged 0.5 per cent growth per annum. By contrast, following a relatively mild recession in 1990-92, the United States began a period of sustained economic growth. A sustained fall in the unemployment rate to 5.4 per cent by 1996, with inflation remaining at between two and three per cent, allowed the Clinton Administration to go to the 1996 election proclaiming the American economy as the healthiest it had been in three decades. It also provided the space for US trade officials to quietly de-emphasise trade complaints against Japan. While various indicators suggested a resurgence of American industrial power, nothing so caught the

⁵⁷² Some scholars argue that most of the credit for strong import growth rested with the dramatic appreciation of the yen between 1993 and 1995 (Asher 1996).

eye of White House speechwriters as the chance to claim by the election year that 'America is selling more cars than Japan for the first time since the 1970s'.⁵⁷³

Other secondary factors worked to muzzle American market access policy towards Japan by the mid 1990s. The establishment of the World Trade Organization in 1995 created a more binding set of rules for the conduct of international trade, including a dispute settlement system with the potential to find US threats of sanctions to be inconsistent with these rules. By giving it an opportunity to appeal to a dispute settlement panel if subject to sanctions, the WTO 'improved Japan's "no agreement" options' (Schoppa 1997: 293).⁵⁷⁴ The record of the automotive dispute points to the WTO dispute settlement system changing the way the US calculated the costs and benefits at stake in disputes, in this case influencing the Clinton Administration's decision to accept a deal. A high level of uncertainty surrounded the prospects of the United States winning its WTO case against Japan, while Japan more confidently approached its case against unilateral US trade action.⁵⁷⁵ Schoppa (1997: 288-289) suggests that the net impact was:

slightly in Japan's favor since it reduced the impact of US threats. Japan had made it clear that it would take the US to the WTO if it followed through on its threats – regardless of any damage this might do to the WTO. Japan knew that the US, faced with this choice, would seek a negotiated settlement. It therefore discounted the US threats, forcing the US to accept a deal without meaningful results.

Notwithstanding American official statements to the contrary, the WTO worked to blunt American aggressive bilateralism via the tools of Super 301 and Section 301. Prestowitz (1995: 2) captured the frustration of the hardliners in the wake of the auto dispute, bemoaning that 'this case demonstrated that Section 301 is dead: the United States' ability to act unilaterally on trade issues has come to an end'. While American membership of the WTO did not diminish the ability of the United States to initiate Section 301 cases, it did require it to submit cases involving WTO trade agreements to

⁵⁷³ 'State of the Union Address of the President', Office of the Press Secretary, The White House, 23 January 1996.

⁵⁷⁴ The former GATT processes only provided for a weak system of dispute settlement with countries able to delay dispute panels and to block panel findings on appeal. Under the WTO, a member could automatically get the formation of a panel to hear its complaint that international trade rules have been violated. Once a panel makes such a finding, the offending party either can correct the cited practices or negotiate compensation with the accusing party. While the WTO cannot force nations to bring their laws into line with panel rulings, it can authorise the party whose trade rights had been violated to impose WTO-legal sanctions to put pressure on the offending party to modify its behaviour.

⁵⁷⁵ Also, third-parties – in this case, the EU and Australia – were able to assert their rights in seeking to avoid a deal which could have been a *de facto* source of discrimination.

the WTO for dispute settlement. At the same time, the WTO has strengthened the multilateral option for the United States in seeking to remove formal or informal restrictions on access to the Japanese or other markets.⁵⁷⁶

Increased efforts by parts of the Free-Trade-Good Relations coalition to rejuvenate bilateral security ties also led Washington to check its aggressive Japan policy by the mid 1990s (Funabashi 1999). Concerned about fall-out from regular trade disputes and signs that Tokyo was becoming increasingly sceptical of US reliability as Japan's ally and protector, policy-makers in the Pentagon became convinced that the United States had to act quickly to demonstrate the importance of the US-Japan security alliance. Under the direction of US Assistant Secretary of Defense Joseph Nye, a series of measures was initiated to reaffirm American security commitment to Japan and to East Asia more generally (Nye 1995). The Nye Initiative culminated in an April 1996 agreement between President Clinton and Prime Minister Hashimoto to establish a new set of guidelines for US-Japan defense cooperation. One analyst would go so far as to argue that 'by the end of its first term the administration had reversed course and headed down the same "defense first, trade later" path trodden by its predecessors' (Asher 1997: 343).

Conclusion

The Clinton Administration arrived in office determined to make the aggressive pursuit of quantitative indicators in market access negotiations with Japan its distinctive trade policy feature. The Framework negotiations begun in 1993 saw demands in a range of areas for specific numerical benchmarks and trend-lines to be inserted in bilateral agreements. While American negotiators achieved some modest gains over previous sectoral efforts, Japan successfully rebuffed demands for explicit numerical indicators. The back-down by the United States in the automotive dispute of 1995 was the last gasp for an aggressive results-oriented approach. By 1996, momentum behind a high-profile results-oriented approach had waned due to a confluence of factors. Especially important were the strong resistance of the Japanese government and changing economic fortunes

⁵⁷⁶ By the end of 1999, the United States could claim out of 49 complaints made under the dispute settlement process it had prevailed in 22 out of 24 cases settled to that point – winning 12 cases in litigation and favourably settling in 10 cases without litigation (CEA 1999: 25).

of the United States and Japan. The final chapter analyses briefly the experience of the second Clinton Administration, draws out some key theoretical perspectives from this study and flags how the framework developed here might apply to future research on US trade policy.

10 The Eclipse of the Japan Problem?

The second Clinton Administration

By 1996, the US government had stepped back from making quantitative indicators in market access agreements the key objective of its trade policy towards Japan, placing greater emphasis on monitoring and enforcing existing agreements. During the Clinton Administration's second term, the sense of looming crisis in US-Japan trade relations subsided. There was no shortage of criticism of Japan, but now it was synonymous with Japanese weakness rather than economic strength. The main target was the inability of Japanese policy-makers to stimulate Japan's economy, a complaint that was amplified with the onset of the Asian economic crisis in late 1997. There were periodic sectoral tensions, but for the most part market access concerns centred on disappointment at the slow pace of Japanese deregulation.⁵⁷⁷

In June 1997, President Clinton secured endorsement from Prime Minister Hashimoto for a US-Japan Enhanced Initiative on Deregulation and Competition Policy.⁵⁷⁸ The emphasis on accelerated regulatory reform underscored the reversion to a more process-oriented market access focus by US negotiators. American officials continued to articulate the Japan problem in familiar terms of 'closed distribution systems, exclusionary business practices, over-regulation, discriminatory and nontransparent procurement procedures, and inappropriately close relationships between ministries and the industries they regulate'.⁵⁷⁹ They continued to charge that Japan was failing to implement a long list of market access arrangements on such products as flat glass, insurance, autos and auto parts, telecommunications, computers, wood products and construction services. But the appetite for high-profile disputes backed by credible threats of retaliation if Japan did not agree to specific market access commitments had

⁵⁷⁷ The major sectoral negotiations during the second Clinton Administration related to insurance, telecommunications, port services and civil aviation.

⁵⁷⁸ *JEI Report* 24B, 27 June 1997, p. 1. This initiative grew out of American frustration with the perceived modest results of Japan's three-year deregulation initiative completed in March 1997. Working groups were created to focus on a number of economy-wide structural issues as well as regulatory reform in specific areas: housing, financial services, telecommunications, medical devices and pharmaceuticals, and later the energy sector.

⁵⁷⁹ Remarks of US Trade Representative Ambassador Charlene Barshefsky to the Japan National Press Club, Tokyo, 17 September 1998.

disappeared. Bilateral deregulation talks produced an annual cycle of announcements that went a long way to ensuring that market access issues no longer dominated summit talks between President Clinton and his Japanese counterpart.⁵⁸⁰

Significantly, the Clinton Administration faced virtually no pressure from Congress to revive an aggressive sectoral approach towards Japan. The Japan problem was no longer a hot issue in Congress, partly due to the loss of control of Congress by the Democratic Party at the 1994 mid-term elections. The new Republican majority had priorities altogether different from trying to extract market access victories from an Asian ally no longer seen as threatening American economic ascendancy. A year into the Clinton Administration's second term, one analyst would conclude that:

Japan will continue to fade from the radar screen of American policymakers. Most members of the Republican majority in the House of Representatives, for example, have no personal experience with the transpacific trade frictions of the 1980s. They know Japan, if at all, as an ailing neighbour of the People's Republic of China or as the home of a multinational company with a plant in their district. Neither perception is likely to induce a rush to the ramparts of a future bilateral trade war (Ostrom 1997: 15).

The Clinton Administration's less confrontational approach was tested by an adverse decision in the Kodak case when a WTO panel in December 1997 rejected the US complaint that the Japanese government had systematically discriminated against foreign competitors in the consumer photographic film and paper market in Japan.⁵⁸¹ While USTR Charlene Barshefsky criticised the decision as focusing on 'narrow technical issues', the US reaction was notably muted.⁵⁸² Importantly, the United States could point to seven WTO dispute settlement victories prior to the Kodak decision.⁵⁸³ A surging American trade deficit alongside growing Japanese global and bilateral trade surpluses through the second half of the 1990s provided a further test of

⁵⁸⁰ In July 2000, President Clinton and Japan's Prime Minister Yoshiro Mori agreed to extend the Enhanced Initiative on Deregulation and Competition Policy for a fourth year. *Inside US Trade*, 18(30), 28 July 2000, p. 9.

⁵⁸¹ Lincoln (1999: 160) notes that the US government 'lost on all the substantive allegations made, winning only a small moral victory on some of the theoretical issues (concerning the possible WTO-illegality of administrative guidance)'.

⁵⁸² 'Statement by Ambassador Charlene Barshefsky regarding the WTO Dispute on Photographic Film and Paper', Office of the US Trade Representative, 5 December 1997. 'Kodak's loss', *Washington Post*, 9 December 1997, p. A24.

⁵⁸³ Rather than appeal the Kodak decision, the US government established a monitoring and enforcement committee in February 1998 to review Japan's implementation of representations made to the WTO regarding its efforts to ensure the openness of its photographic film and paper market.

the Clinton Administration's low-key approach. But in a growing US economy the chief complaint against Japan came from a more traditional source, with the steel industry forcing the administration in 1999 to press Japan and other nations to cut back their steel exports.⁵⁸⁴ Not even a sharp fall in sales of US-produced automotive products in Japan after 1997 could ignite an aggressive response with the US side acknowledging the impact of industry restructuring and the Japanese recession on the automotive sector in Japan.⁵⁸⁵ Renewed speculation about a more confrontational approach accompanied President Clinton's reinstatement by executive order of Super 301 in January 1999.⁵⁸⁶ But Japan market access targets were conspicuously missing from major announcements of American trade priorities in both 1999 and 2000, even though difficult negotiations continued over insurance, flat glass and internet interconnection rates.⁵⁸⁷ The half-hearted attempt by the Clinton Administration to secure a follow-up agreement to the 1995 auto pact pointed to how Japan market access issues had become of second-order importance towards the end of the Clinton presidency – somewhere below discussions on the launch of a new round of multilateral negotiations in the WTO, talks surrounding China's accession to that body, and a series of thorny WTO disputes, especially involving the EU.

By the end of 2000, the Clinton Administration could claim to have secured 39 bilateral and multilateral market access agreements with Japan. A passing reference to these agreements was the only mention of Japan in a speech by Charlene Barshefsky marking the end of her tenure as USTR.⁵⁸⁸ In the minds of US trade officials, the Japan problem had not so much disappeared as been eclipsed.

January 2001 saw a new administration assume power in Washington, even less inclined towards an aggressive Japan market access policy. With its strong emphasis on alliance relationships, the Republican team of President George W. Bush made no

⁵⁸⁴ *Inside US Trade*, 17(2), 8 January, 1999, p. 1. *Inside US Trade*, 17(32), 13 August 1999, p. 6.

⁵⁸⁵ 'Statement by US Trade Representative Charlene Barshefsky and Commerce Secretary William M. Daley upon release of US-Japan Automotive Agreement Monitoring Report', Office of the United States Trade Representative, 3 June 1999.

⁵⁸⁶ 'USTR Barshefsky announces Super 301 and Title VII Executive Order', Office of the United States Trade Representative, 26 January 1999.

⁵⁸⁷ 'USTR sets priorities for global trade expansion and enforcement', Office of the United States Trade Representative, 30 April 1999. 'USTR Charlene Barshefsky highlights Clinton Administration 2000 trade policy agenda and 1999 annual report', 2 March 2000. *JEI Report* 18B, 5 May 2000, p. 6.

⁵⁸⁸ 'Thoughts at a Moment of Transition', Remarks by Ambassador Charlene Barshefsky, Economic Strategy Institute, Washington DC, 19 December 2000.

secret of the fact that it thought the Clinton Administration had spent too much time lecturing Japan about its economic inadequacies.⁵⁸⁹

Theoretical perspectives

Tracing the rise and fall of America's results-oriented Japan policy provides lessons on the key factors which shape US trade policy. This study's core focus has been on explaining what drove the United States to depart radically from traditional process-oriented market access negotiations with Japan in the late 1980s and early 1990s. The scaling back of US market access demands in the second half of the 1990s in turn raises questions about the future of US-Japan relations. Are we simply at the low-point of a cycle of attention to the Japan problem, or is it truly the end of an era? If indeed the Japan market access issue has become less important what remains of the hardline ideas that previously framed debate on the Japan problem?

The state-society framework of this study points to the primary determinants of American trade policy arising from the interaction of large-scale international political-economic conditions, macroeconomic forces and shifts in the broad governing coalitions of American politics. The American trade policy regime provides the most appropriate vantage-point for identifying the broad determinants of change in US market access policy towards Japan. The policy sequence that culminated in America's results-oriented Japan policy was part of a broader response to a crisis in the institutions, rules and norms of the American trade policy regime in the first half of the 1980s. This crisis saw a resurgence of congressional trade activism that forced the second Reagan Administration in September 1985 to adopt a more aggressive bilateral market access policy, in contrast with the dominant multilateral approach of the postwar era.

The interaction of long-term change in America's international economic position and macroeconomic policy decisions of the first Reagan Administration were the fundamental sources of the regime crisis and, ultimately, the broad determinants of change in US market access policy towards Japan. The internationalisation of US

⁵⁸⁹ *Inside US Trade*, 18(49), 8 December 2000.

manufacturing industry and the emergence of new sources of surplus capital in the world economy eroded America's postwar economic dominance. By the 1980s, Japan had emerged as the broadest and deepest economic challenger to the United States. But a central argument of this study is that a focus purely on international forces can obscure how and when such forces matter. What was special about the mid 1980s in producing a major policy turning point? What shaped the nature of America's response in the direction of a more aggressive bilateralism versus other possibilities such as a shift towards state-sanctioned protectionism? International-level variables help to shape the broad contours of policy, but they do so in indeterminate ways.

Domestic policy decisions, in particular the macroeconomic policies of the first Reagan Administration, were critical in shaping the timing and intensity of the trade regime crisis in the first half of the 1980s. Via its effects on the US dollar, the American traded goods sector, and US external deficits, a marked loosening in fiscal policy by the first Reagan Administration helped to push the American trade policy regime to crisis point. In short, Reaganomics had large, unintended consequences for US trade policy.

Japan was the primary target of American grievances about unfair trade barriers given the scale of its competitive challenge and the size of the bilateral trade imbalance. But a more fine-grained explanation of the shift towards a results-oriented policy draws attention to the political fortunes of key advocacy coalitions contesting Japan policy. Hardliners and free traders approached the Japan market access problem with different views about what was at stake and what, if anything, America should do about it. Hardliners coalesced around the view that Japan was different from other industrialised economies in terms of its international openness and responsiveness to process-oriented negotiations. To the free traders, the idea that Japan was sufficiently different to warrant a departure from process-oriented negotiations was either challenged on intellectual grounds, or it was considered irrelevant in the light of more important challenges facing the United States.

The regime crisis had a far-reaching impact on the institutional influence and standing of these key advocacy coalitions. Prior to the regime crisis, the dominant free trade coalition kept the hardliners in check, largely through their institutional dominance of

the executive branch. The regime crisis enabled hardliners to exert more influence over US policy as evident by the increased number of formal bilateral agreements and the move by the second Reagan Administration and the Bush Administration towards a selective, results-oriented Japan policy.

The political contest between the hardliners and the free traders was also a battle of ideas. This study explored the fit between politics and ideas as a way of highlighting the circumstances that led to a major departure by the United States from the norms of process-oriented negotiations. The policy sequence after 1985 points to a role for policy learning where changing beliefs about the Japan problem helped to alter the boundaries for policy innovation. The emergence of revisionism as a coherent hardline paradigm in the second half of the 1980s drew strength from the fertile political soil of US-Japan disputation, the end of the Cold War and a deterioration of elite attitudes towards Japan. A fragmented and defensive free trade coalition was further weakened by reputable economists in the American policy community concluding that Japan was indeed different from other industrialised economies in terms of its international openness. Over time, hardline ideas left an imprint on Japan policy in a way that cannot be tied simply to changes in the relative positions of the US and Japanese economies, macroeconomic circumstances or the superior resources of one coalition over another.

The Bush Administration's Structural Impediments Initiative incorporated elements of this learning across the American trade policy community in a process-oriented framework. The coupling of fertile political soil with hardline ideas saw the Clinton Administration pursue a policy of demanding quantitative indicators in market access agreements. That this policy proved short-lived reflected determined Japanese opposition and a reversal in the economic fortunes of both countries in the 1990s. The former underscored why an emphasis on policy preferences (what states want) does not mean that states get what they want. Japanese policy preferences proved the binding constraint on the hardliners. At the same time, increasingly divergent performances by the US and Japanese economies through the 1990s lessened the stakes for US policy-makers from aggressively pursuing market access results in Japan.

The demise of a results-oriented Japan policy by the second half of the 1990s resulted from a powerful reassertion of the core (non-cognitive) factors which this study portrays as the primary drivers of policy change. By the beginning of the 21st century, the economic resurgence of the United States and the “lost decade” in Japan had sharply reduced the political and economic salience of the Japan problem. Significantly, America’s resurgence was bound up with an orthodox economic strategy of fiscal prudence and continued economic openness, reinforcing core premises of the free traders.

This highlights the complex picture surrounding the role of learning about the Japan market access problem. In particular, it underscores the importance of focusing on fertile political soil and not simply the nature of ideas themselves. The fertile soil revisionists exploited to frame debate on the Japan problem reflected a particular set of circumstances that have now changed dramatically. Most notably, Japan’s economic malaise has dealt a blow to core hardline beliefs about the stakes surrounding the Japan problem. This highlights the need when probing the links between politics and ideas to focus not simply on ideas but also on what makes them take hold and grow. This study illuminates the peculiar combination of circumstances by which radical ideas made their way into the policy process. Underlying concerns about the Japan problem have not disappeared, but the particularly fertile soil of the 1980s and early 1990s has.

The key conclusions from this study build on insights from the historical institutionalist school of politics with its sensitivity to historical contingency, the importance of institutional factors, separately-located policy processes, and path dependency.

The powerful interaction in the early 1980s of Japan’s high-technology challenge and America’s self-inflicted budgetary wounds severely disrupted the institutional balance of American trade policy. The unintended consequences for US trade policy of macroeconomic developments reinforces the need to cast a broad eye over domestic politics. As well as altering the finely-balanced institutional bargain between Congress and the executive branch, the regime crisis favoured certain groups and their particular definitions of America’s trade problems over others. The hardliners became

more influential in the second half of the 1980s and the path on which US trade policy was set saw their ideas gain in credibility. Still, the experience surrounding revisionism suggests that new ideas struggle to hold ground once more fundamental “real world” determinants of policy move against them.

Consistent with the pattern of recent years, America’s economic resurgence has ameliorated both the pressures on, and temptation for, US policy-makers to again make the Japan problem a major focus of US foreign economic policy. Japan remains the world’s second largest economy and a major location of production, consumption, capital and technology. Yet no serious economic forecaster now believes that it will overtake the United States as the world’s major economic power.

Japan’s future growth prospects remain uncertain with some estimates suggesting that its long-term economic growth rate has declined to around 1 per cent a year in the absence of major restructuring in the way the economy operates (OECD 1999a).⁵⁹⁰ Many of the attributes that revisionist analysts saw as sources of Japanese strength in the past now appear as ailments, adding up to a ‘web of nonmarket mechanisms that allocate investment funds’ (Alexander 1998: 12). These include the residual influence of a state-led economic development model, weak private sector orientation towards profit, a banking sector not geared towards liberal financial decision-making structures and the absence of an active market for corporate control.⁵⁹¹ The government sector is marked by considerable inefficiency, while Japan’s long-term fiscal outlook remains bleak following the dramatic increase in public debt in the 1990s and with its population aging more rapidly than that of any other developed nation (OECD 2000b).⁵⁹² The OECD (1999b: 12) has identified a more general regulatory problem due to ‘the lack of a coherent concept of the role of the state in a period of market-led growth has left regulatory intervention fragmented, incoherent and vulnerable to a host of special interests’. The failure of Japanese policy-makers to

⁵⁹⁰ See Posen (1998) for an analysis arguing that correct macroeconomic policies rather than far-reaching structural reform is the key to restoring economic growth in Japan.

⁵⁹¹ Among the symptoms are a net return on corporate capital in Japan which is half that earned in the United States, while productivity in the nonmanufacturing part of the Japanese economy is only around 60 per cent of the US level (Alexander 1998, Asher and Smithers 1998). Japan also lags well behind other developed economies in the use and development of information technology (IT) (OECD 2000a).

⁵⁹² Gross debt in relation to GDP is already the highest in the OECD (well over 100 per cent), and just to stabilise it at a significantly higher level in ten years would require a substantial amount of fiscal consolidation – possibly 10 percentage points of GDP (OECD 2000b: 14).

deal with the legacies of the “bubble economy” has severely damaged the reputation of Japan’s elite bureaucrats, especially the Ministry of Finance.⁵⁹³

There remains no shortage of high-level pronouncements on the need for structural reform.⁵⁹⁴ In May 2001, new Prime Minister Junichiro Koizumi vowed to ‘ceaselessly advance structural reform’, urging his countrymen to ‘overcome barriers of vested interests and free ourselves of past limitations’.⁵⁹⁵ Still, such exhortations confront a system of institutionally weak leadership and entrenched resistance to any national consensus for wide-ranging reform (Katz 1998, Carlile and Tilton (eds.) 1998).⁵⁹⁶

By contrast, at least prior to the economic softening of late 2000, respected figures were prepared to venture that the United States had entered a new economic era with its economic structure well-adapted to innovation and to generating productivity improvements from the new economy.⁵⁹⁷ The US economic expansion from 1992 to 2000 was the longest since records began to be kept around 1850 (OECD 2000c: 21). In each of the years 1997, 1998, 1999 and 2000 the US economy expanded by more than 4 per cent annually accompanied by large improvements in productivity. Trend labour productivity growth is estimated to have roughly doubled from the rate seen in the 20 years prior to the mid 1990s (OECD 2000c: 9). This has been linked to a surge in growth of the capital stock, particularly the stock of IT products (Oliner and Sichel 2000, Jorgenson and Stiroh 2000).⁵⁹⁸ The OECD (2000c: 3, 37) estimates that America’s potential growth rate has increased to around 3.6 per cent a year from slightly over 2.5 per cent at the start of the 1990s, with the economy ‘having recovered a considerable amount of the dynamism lost in the 1970s and 1980s’.

⁵⁹³ Restructuring in sectors such as real estate and construction remains a drag on the economy and the problems of bad debts and low rates of return still ail the banking sector.

⁵⁹⁴ A 1999 report on *Policy Measures for Economic Rebirth* by former Prime Minister Keizo Obuchi’s Economic Strategy Council laid out a comprehensive reform agenda. This has been followed by specific efforts to enhance Japan’s “new economy” capabilities.

⁵⁹⁵ *Far Eastern Economic Review*, 17 May 2001, p. 14. Mr Koizumi is the ninth Japanese Prime Minister since 1990.

⁵⁹⁶ The governing LDP reflects this absence of consensus where policy interests cut across competing factional affiliations linked with particular powerbrokers.

⁵⁹⁷ Speech by Alan Greenspan, ‘Challenges for Monetary Policy-Makers’, Board of Governors of the Federal Reserve System, 19 October 2000.

⁵⁹⁸ For a sceptical view, see Gordon (2000).

Demographic characteristics, including a high tolerance for immigration, give further cause for optimism about America's long-term economic performance.⁵⁹⁹

The longer-term outlook for the United States will depend, *inter alia*, on whether the optimists or the sceptics are right about future productivity growth. Even so, there is evidence that the ongoing internationalisation of the US economy may not generate the same fractious sectoral trade politics that surrounded the economic imbalances and macroeconomic cycles of previous decades. With the exception of the steel sector and some parts of agriculture, the surge of imports into the United States in the 1990s failed to result in the sort of protectionist response many expected based on earlier experience. Despite record trade and current account deficits, 'traditional protectionism remains surprisingly weak' (Destler and Balint 1999: 1). At the same time, increased cross-ownership and corporate tie-ins between US and Japanese firms in sectors such as automotives and semiconductors have worked to lessen market access tensions between the US and Japan.

To the extent that major structural reform holds the key to Japanese economic renewal, it should also work against a repeat of past confrontations. The political paralysis that generates much of the current pessimism about Japan has not stopped important structural changes driven by market imperatives. One of the notable features of Japan's economic stagnation in the 1990s is that import ratios have increased undermining hardline claims about the Japan problem. The share of manufactures in total imports has continued to rise even while the share of manufacturing in the Japanese economy has declined (Menon 1997, Ostrom 1998).⁶⁰⁰ Also, FDI in Japan has surged in recent years, rising five-fold in the 1990s (De Brouwer and Warren 2001: 8).

This more or less sanguine view of US-Japan trade relations still needs to be tempered by recognition of the forces that can significantly alter the policy environment in the short to medium-term. America's boom has left its own build-up of imbalances – a

⁵⁹⁹ During the next 10 years, the working age population of the United States will expand by at least 10 per cent, while in Europe it will stagnate and decline by 6 per cent in Japan (Hale 2000).

⁶⁰⁰ By 1996, imports accounted for 18.7 per cent of the supply of manufactures in Japan, up from around 10 per cent at the start of the 1990s (Ostrom 1998: 8-9).

negative personal savings rate, high corporate and household debt, excess capacity in some sectors, and a current account deficit of around 4 per cent of GDP (IMF 2001). Weaker profits and a sharp fall in capital spending and industrial production at the end of 2000 may yet foreshadow a US recession. To many critics of Japan, continued large bilateral and global trade surpluses remain a powerful symbol of the failure of US policy to address an unequal economic relationship. Any protracted downturn in the US economy has the capacity to induce renewed trade frictions with Japan, especially if hardliners in Congress and the business community decide once again to make these imbalances the barometer of trade policy success. Drawing on America's particular tradition of economic nationalism, future domestic coalitions will doubtless bring forward new policy entrepreneurs with new or recycled ideas on how to restore fairness and reciprocity to America's trading relationships, including with Japan.

Still, a new era of Japan policy focused on quantitative indicators seems unlikely. Such a radical departure by the United States from the norms of process-oriented negotiations is possible, but it would appear rare. There appear too many variables that are *sui generis* to the US-Japan case of the 1980s and early 1990s.

Some questions for the future

If Japan is not about to blindside the United States, should we expect a new economic challenger to emerge, generating a new era of aggressive bilateralism? For example, will the 21st century throw up a China problem for the United States and unleash a results-oriented market access policy of the sort that characterised the Japan problem in the late 20th century? Although a comprehensive analysis of this issue is outside the scope of this study, America's approach to the Japan problem may provide some lessons for future US-China trade relations.

There would appear to be some key differences in the economic relationship suggesting that a parallel experience to the Japan results-oriented policy is unlikely. First, at least for many years to come, the relative levels of economic development should guard against anxiety that China is about to devastate America's high-technology base. Above all, it was the scale of Japan's high-tech challenge that fed concerns about America's inability to compete in the 1980s. Second, a China market

access problem does not exist in the same way based on the sorts of measures that were used to define America's Japan problem. Manufactured goods dominate China's imports, measures of intra-industry trade are larger than in Japan, and in the last two decades FDI has flooded into China at a rate without precedent in the developing world (Garnaut and Huang 2000: 26).⁶⁰¹ Significantly, China's openness to FDI has established a network of US corporate stakes in China that can strongly influence US government policy. Such interests were all but absent in the case of Japan policy in the 1980s and early 1990s. Finally, the different nature of the US-China relationship may make US policy-makers think twice before embarking on an aggressive market access approach of the sort that characterised the Framework talks with Japan. While it has not be a central focus of this study, the inherently unequal nature of the US-Japan relationship due to Japan's ultimate security dependence on the United States underpinned the Clinton Administration's premise in attempting to deal with economic and political-security issues on separate tracks. A new generation of hardliners may find arguments to justify confrontational economic diplomacy towards China. But the notion that this could be quarantined from political-security relations with China defies credibility (Kunkel 1995: 22).

Other factors have the potential to disrupt US-China trade relations in the future. One can assume that sustained high growth and deeper integration into the world economy will see China play a larger role in global economic affairs in coming decades. Long-range projections suggest that, unlike Japan, China may indeed surpass the United States as the world's largest economy some time this century. Notwithstanding China's embrace of market-oriented reforms, the domestic political institutions of each country embody vastly different belief-systems about the role of the state and its relationship to the individual. And the United States and China carry distinctive views about appropriate norms of behaviour into the international arena (Foot 1995). As such, a myriad of issues make for a delicate bilateral relationship and caution against a reflexive economic determinism based on the inevitability of globalisation and its pacific effects.

⁶⁰¹ See Song (2000) and Zhang (1999) for more detail on trade and investment patterns in China.

Indeed, it is the home-grown backlash against globalisation that throws up perhaps the most interesting question surrounding future US trade policy. The United States has internationalised large parts of its “old economy” and captured the commanding heights of the “new economy”. It is the world’s dominant economic power and it is not about to trade places with anyone anytime soon. Yet its capacity to display international leadership on trade policy appears decidedly feeble. Is this a temporary phenomenon or is the current stalemate surrounding US trade leadership a more permanent condition?

The Clinton Administration’s initial successes on NAFTA and the Uruguay Round masked the emergence of a new era of division over trade.⁶⁰² Since then, America’s role as a leader of international trade liberalisation has remained hampered by politically powerful domestic constraints that have arisen mainly from concerns about the impact of globalisation and increased trade on labour and environmental standards (Destler and Balint 1999). The Clinton Administration remained without fast-track trade negotiating authority after it expired in December 1993. Its initial attempt to secure new authority as part of the Uruguay Round implementing legislation in 1994 foundered and a new fast-track bill was defeated in the House of Representatives in 1998.⁶⁰³ In early 1999, President Clinton flagged his intention to rebuild a domestic consensus on trade and to push for a new round of global trade negotiations. The Seattle Ministerial Meeting of the WTO in late 1999 broke down amidst a lack of international support for a round, but it will be remembered mostly for the tear-gas and violence that spoke to a fractured trade debate in the United States. A number of mini-initiatives marked the final year of the Clinton Administration, but they fell well short of a legacy of trade leadership.

The Republican administration of George W. Bush elected in November 2000 has inherited a policy environment with the same concerns about globalisation, the same divided politics centred on environmental and labour issues, and the same high-level of partisanship in Washington that marked the final years of the Clinton

⁶⁰² NAFTA was the lightning rod for these divisions, setting off ‘the most prominent and contentious debate on trade since the Smoot-Hawley Tariff Act of 1930’ (Destler 1995: 217).

⁶⁰³ The vote was 243-180 with only 29 of 200 House Democrats supporting renewal of fast-track (Baldwin and Magee 2000: 7).

Administration.

At one level, this study points to why America may not easily recapture the mantle of leadership on trade. The state-society framework suggests that the structural position of the United States in the international economy is theoretically permissive. Policy preferences matter and this is especially the case for the largest actor in the international system. The United States can define its policy interests in different ways *because* it is the largest actor.

Inevitably, we are driven towards a more bottom-up approach to shed light on the circumstances and choices that are shaping US trade policy. This study recommends a focus on the key domestic institutions and actors at the interface of American state-society relations to uncover the dominant factors constraining American trade leadership. While the institutions of the American trade policy regime are a source of continuity, as trade has affected more peoples' lives new coalitions have taken advantage of the essential openness of the regime to recast the definitions of America's trade problems. As Destler and Balint (1999: 9) observe, the rise to prominence of labour and environment issues involves 'not the balance to be struck *among* US commercial interests, but the proper balance *between* these interests and others that society values'. The new salience of these issues highlights the importance of having an analytical framework that is open to accommodating the complex ways in which ideas, values and interests are intertwined.

Under this view of politics, the same structures will not necessarily generate the same results. Policy-makers are pushed along particular paths by what they inherit from the past, but they still have choices to make. At the start of the 21st century, policy-makers keen to reassert American international leadership on trade are searching for what choices might lessen the domestic conflicts around labour and environment issues. Highly parsimonious and deterministic approaches to US trade policy are unlikely to tell us what the nature of those choices might be. We are left at what Evans (1995: 2) calls 'the eclectic, messy center' of political analysis, somewhere short of the neat solutions of ahistorical formal models, but with an eye to the analytical lenses that are useful in identifying what is significant about particular cases.

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