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U.S. Political Pressure and Economic Liberalization in East Asia

Takatoshi Ito

9.1 Introduction and Summary

The objective of this paper is twofold, first, to evaluate U.S. pressure for economic liberalization in Japan; second, to discuss its implications for economic and political aspects of the East Asian regional future.

I argue that there have been three types of U.S. pressure on Japan: (1) the traditional type with voluntary export restraints (VERs) and other export-limiting measures on Japan; (2) the Structural Impediments Initiative (SII) type in which market access of Japan improves the Japanese consumers' welfare; and (3) the super 301 type in which unilateral U.S. gains are sought (see table 9.1).

Although various administrations of the United States have put pressure on Japan to limit exports (starting with cotton textiles in 1956), the efforts by the Reagan-Bush administration throughout the 1980s have been marked by widened coverage of issues and heightened political tensions. Rather than more import quotas and VERs, the United States demanded market access and market shares in Japan. The logic was clear. It is better to increase U.S. exports to Japan, achieving an equilibrium with higher volume, than to limit Japan's exports to the United States, achieving an equilibrium with lower volume.

Financial deregulation in Japan was explicitly mentioned in the Yen-Dollar Agreement in May 1984. More liberalized financial markets were supposed to invite foreign investment and financial companies to Japan, thus correcting for

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Table 9.1 Types of Trade Conflicts between the United States and Japan

	Winners	Losers	Examples
Export-limiting measures: VERs and OMAs	U.S. producers	U.S. consumers	Textiles, color TVs, steel, machine tools, autos
	Japanese producers (long run)	Japanese producers (short run)	
Market access measures: MOSS-SII type	Japanese consumers U.S. producers	Japanese producers	Large retail store law, rice, deposit interest deregulation, antimonopoly law enforcement, satellite procurement
Revisionist measures: results-oriented type	U.S. producers	Japanese producers Japanese consumers	Semiconductor agreement, super 301, January 1992 agreement on U.S. autos

Note: Winners and losers can be verified using a standard partial equilibrium model.

the dollar overvaluation at that time. The Market-Oriented Sector Selective (MOSS) talks targeted several products. Beef and citrus became symbolic issues of the mid-1980s. In 1987, the SII started to address many issues in the Japanese economy. Among others, the large retail store law in Japan was heavily criticized by the United States. The law, the United States contended, prevents an expansion of the number of large retail stores (such as discount stores), which carry more imports than do traditional corner stores, thus contributing to lower imports of manufactured goods. The single most important issue concerning import restrictions and market access of Japan at present is how to liberalize rice imports. At the Uruguay Round, the United States insisted that Japan move to the tariff system and gradually reduce the tariff rate, while Japan insisted on exceptional treatment of rice for Japan.

The pattern of the United States' pressuring Japan and Japan's conceding to U.S. demands is best understood as a reflection of domestic politics in the two countries. In the United States, with the split government in the 1980s, external economic issues, especially mounting trade deficits, were used, or exploited, as effective political charges and countercharges. Congress tends to blame the president for lack of a program to reduce the current account deficits, and attempts to take matters into its own hands, as in the Omnibus Trade Bill with super 301. The administration, especially the U.S. Trade Representative (USTR), trying to head off congressional meddling, pushed Japan to agree on a series of "liberalizations."

In some quarters in the Japanese government, the U.S. demands were seen

as "foreign pressure," which would help dismantle vested interest with minimal political costs. The U.S. pressure was perceived as something beyond the Japanese government's control, so that no one, neither government officials nor politicians, had to assume responsibility for taking away vested interests and oligopolistic rents from producers and big corporations.

In summary, U.S. pressure of the SII type was used to liberalize and deregulate the Japanese economy, benefiting Japanese consumers and foreign producers. It recently backfired, however, because the ritual of U.S. "bullying," if not "bashing," Japan and Japan's giving "concessions" produced anti-Japan sentiment in the United States and dislike of the United States in Japan. The relationship in the 1990s will be much more strained than before.

The new type of U.S. pressure is unilateralism, pursuing U.S. unilateral gains. U.S. demands became more results oriented; that is, the United States defines a market share in Japan in an agreement and has Japan commit to it under threat of retaliatory measures.

The target of U.S. demands has not been limited to Japan but includes other Asian countries, such as Korea and Taiwan. Textile VERs were also applied for these countries in the 1960s and 1970s. In the 1980s, Korea and Taiwan were accused of artificially pegging their currencies to the U.S. dollar so that their exports to the United States did not decrease after the sharp yen appreciation triggered by the Plaza Agreement.

U.S. demands for economic liberalizations in Japan and other Asian countries have several implications. First, if the current tendency of U.S. demands cum Japanese concessions continues, Japanese resentment against the United States may turn into a desire to have stronger relations with Asian neighbors. However, this possibility is limited by lack of political leadership in Japan and by suspicious reactions to Japanese overtures by Asian neighbors. Second, fast-growing intraregional trades have been rather specialized. Typically, Japan exports parts and intermediate goods, and newly industrialized economies (NIEs) export final goods to the United States. Unless Japan imports much more from Asian neighbors, it would not replace the United States as an absorber of Asian goods. Hence, the link between Japan and the Asian countries remains weak. In other words, Japan is not ready to take a leadership role to replace the United States in the Asian region as a nexus of political and economic links.

Signs of change, however, are abundant. Japan for the first time sent mine sweepers to the Persian Gulf, though after the war. This is regarded as a sign of change in Japan's commitment to political change. Japan's trade structures are rapidly changing, partly due to U.S. demands. The share of manufactured imports now reaches almost 50 percent. Japan may increase imports from Asian neighbors in the future.

The biggest stumbling block to Japan's becoming a regional economic and political leader is lack of principles. Would Japan tolerate political suppression to achieve an economic order? Would Japan help technological transfers with direct investment? Would Japan continue saving a large portion of income even

if the standard of living were sacrificed? Asian neighbors will not fully trust Japanese leadership, unless the principles of the Japanese political economy become clear. If Japan cannot project its economic-political principles, then Asian neighbors will remain suspicious of its hegemony in the region.

9.2 United States–East Asian Countries Conflicts, 1956–81

9.2.1 Conflicts of the Traditional Type

U.S.-Japan Conflicts, 1950s–1970s

Traditional conflicts between the United States and Japan (and other East Asian countries) originate from sharp increases in export of a particular product. Producers in the United States bring complaints to the U.S. government, sometimes with formal antidumping charges but most often with political pressures. Complaints might start when the market share of imports increases sharply. As long as an “injury” is felt, the level of market share might be as little as 5 percent, as in the case of cotton. The U.S. government negotiates with the exporting country. With political pressures and threats, sometimes also linking other issues, the United States always succeeds, if with a long delay, in negotiating some kind of export-limiting measures, VERs and orderly marketing agreements (OMAs).¹ This pattern was repeated in cotton, synthetics, color TVs, steel, and automobiles, for example (table 9.2).

The textiles issue was the first trade conflict between the United States and Japan in the mid-1950s, and resulted in the first VER between the two countries in 1957.² The textile issue, changing the focus of particular products, remained a major issue between the two countries until the 1970s.

Hence, the traditional U.S. pressure on East Asian countries was a measure to limit exports, burdening the exporting countries, such as VERs or OMAs. The political process is like that summarized above.³

Yoffie (1983) analyzed the dynamics of U.S. pressures and responses by

1. See Hillman and Ursprung (1988) for why VERs could be politically preferable to tariffs. In the GATT framework, tariffs were not an option. Yoffie (1983) contrasts VERs of the 1950s through the 1970s with tariffs in the 1930s.

2. In 1956, the United States tried to limit Japanese exports. “Although Japanese textile imports represented a small portion of American consumption (approximately 2 percent), in a few categories such as gingham, velveteen, and women’s blouses, Japanese sales were reaching two-thirds of apparent consumption and putting some American producers out of business” (Yoffie 1983, 45). After several rounds of negotiation (described in Yoffie 1983, 44–58), “on January 16, 1957, the Departments of State, Commerce, and Agriculture released a joint statement concerning the ‘details of the Japanese program for the control of exports of cotton textiles to the United States’” (58). This set the precedent for VERs.

3. This section is in broad agreement with opinions in Yoffie (1983), Destler and Sato (1982), Destler, Fukui, and Sato (1979), and Destler (1986). Yoffie (1983, 4–5) pointed out three characteristics of VERs and OMAs, as opposed to the interwar tariff war: (1) they are negotiated and bargained between two countries; (2) they use quantitative limits; (3) they are selective and so discriminate among exporters.

Table 9.2 Historical Overview of U.S.–Japan Trade Conflicts

1957, Jan.	Cotton textiles, VER.
1958	Japan “voluntarily” restricted woolen fabric export (Yoffie 1983, 124). Negotiations started for short-term agreement under President Kennedy’s initiative.
1961	initiative.
1962–63	One-year short-term agreement on cotton textiles.
1963	Long-term agreement on cotton textiles.
1966	Steel, VER (until 1974). Negotiations for multifiber textile arrangement started. “Textile wrangle.” Linkage to Okinawa and to Nixon shocks. ^a
1969	The United States announced new bilateral accords with each of the four Asian exporters and the removal of the 10 percent surcharge on textiles.
1971, Oct. 15	
1977	Color TV, OMA (until 1980). Steel, trigger pricing (until 1982).
1981, May	First automobile VER.
1983	Yen-dollar working group started.
1984	Yen-dollar working group final report. Steel, VER (renewed in 1989).
1985, Jan.	MOSS talks.
1985, March	Senate resolution.
1986	Machine tools, VER.
1986, Sept.	Semiconductor agreement.
1987, March	Findings on semiconductor agreement violation.
1988	Super 301 signed into law.
1989, May	Designation of Japan as an unfair trading partner.
1989	SII started.
1990	SII final reports.
1992, Jan.	Bush-Miyazawa agreement on United States automobiles and parts.

^aPresident Nixon announced on July 15, 1971, that he would be the first American president to visit Beijing and on August 15, 1971, that he would suspend the convertibility of the dollar and introduce a 10 percent import surcharge.

Japan, Korea, Taiwan, and Hong Kong from the mid-1950s to the early 1980s. The U.S. government aimed to maximize a political effect in appeasing domestic interest groups (complaining industry) while “minimizing” the damage to the international relationship. Given U.S. pressures, exporting countries are faced with two choices: to resist pressures or to accept VERs and OMAs. By resisting VER demands initiated by the administration, exporting countries run the risk of being restricted by even more severe measures, such as unilateral quotas and high tariffs initiated by Congress. On the other hand, by accepting VERs and OMAs too quickly, exporting nations lose export revenues. Even though limited by VERs demanded by the United States, Japan, Korea, Taiwan, and Hong Kong have managed to prosper in the long run. Their success comes from (1) pursuing long-run gains by upgrading products and shifting targeted markets; (2) negotiating for delay, ambiguity, and flexibility; (3) demanding compensation for restriction (linkage); (4) cheating outright and exploiting loopholes; and (5) aiming at bureaucratic splits in the United States (Yoffie 1983, 37).

Automobiles

Let us first examine the automobile VER between the United States and Japan, which is in fact a traditional type of conflict. The automobile VER began in 1981, limiting the number of exported passenger automobiles to 1.68 million per year. This restraint was not really voluntary, but was requested by the United States and negotiated and agreed upon between the two countries. The agreement was extended for a one-year period, from April 1984 to March 1985, with a higher limit of 1.85 million. In the spring of 1985, President Reagan announced that he would not seek an extension of the VER, putting the Ministry of International Trade and Industry (MITI) in a difficult position. If the limit were lifted, MITI feared that Japanese automobile companies would increase exports sharply, almost certainly causing a backlash; maintaining the VER lends itself to managed trade. MITI chose a new, “truly voluntary” export restraint with a 2.3 million limit. The increase in the number angered Congress (Ito 1992, 370–71).

The ceiling was binding (that is, the actual number of exports was 2.3 million cars) only in 1985 and 1986. The number of cars exported from Japan to the United States declined steadily from 1987 to 1991, reflecting an increasing number of Japanese cars produced in the United States. Throughout the 1980s, the quota encouraged Japanese automakers to build factories in the United States, which became operational in the late 1980s. In fact, the market share of “Japanese brands”—a total of those exported from Japan and made in the Japanese factories in North America—steadily increased to 30 percent in the early 1990s. In 1992, MITI announced that the quota was lowered to 1.65 million.

In summary, upon the introduction of VER, prices of Japanese cars were raised, which benefited Japanese automakers as well as U.S. automakers, and direct investment by the Japanese makers in North America circumvented the restriction.⁴

Japanese automakers proved to be competitive even in making cars on U.S. turf. The fact that VER does not hinder growth of Japanese (or East Asian countries’) products is very familiar. The episode shares features with events in the textile and steel industries, described by authors such as Yoffie and Destler.

9.2.2 Consequences

Yoffie (1983) emphasizes the importance of dynamic responses of the Asian countries, quickly upgrading products and moving into the area not restricted by the VER, for the success of their economic growth.⁵ With few exceptions,

4. Throughout the 1980s, direct investment by Japanese automakers in the United States was encouraged and welcomed by the United Auto Workers and local communities as job creation.

5. When cotton textiles were restricted in the 1950s, Japan, Korea, and Taiwan moved into synthetics. At the time, the United States basically outbargained Japan in bilateral negotiations for VERs to obtain rather restrictive numbers. Japan lost cotton market share to other Asian countries, especially Hong Kong. “Ironically, the VER accelerated the movement toward synthetics, which was indeed the most dynamic market segment” (Yoffie 1983, 63). In the 1960s, a similar trend

Asian countries successfully pursued long-run gains over short-run sacrifices.⁶

He also points out the Asian countries' success was not matched by the promotion of domestic industry by the United States. The U.S. government lacked a coherent policy to protect or promote the domestic industry. Protected industries in the United States could not convert the short-run gains obtained by VERs and OMAs into long-run investment. The U.S. government tried but failed to revitalize industries already in trouble, focusing only on providing domestic makers with protection from imports, without measures to increase competitiveness.

Another interpretation, a more cynical one, of the last aspect is that the U.S. government did not seriously intend to protect the domestic industry, in favor of consumers' interests and commitment to the free trade principle. Hence, the negotiations with Japan, Korea, Taiwan, and Hong Kong were more for politically appeasing than for helping (in the industrial policy sense) the domestic industry. If this interpretation is correct, the outcome of Asian countries' economic success is not surprising. (This interpretation is more likely to be the case in Republican administrations.)

9.3 U.S.-Japan Bilateral Relations in the 1980s

9.3.1 The New Type of U.S. Pressure and Japan's "Concessions"⁷

As summarized above, U.S.-Japan trade conflicts have been commonplace since the late 1950s. Textiles, color TVs, and steel are famous cases of quotas and price controls from the late 1950s through the 1970s. The conflicts took a

continued. The long-term agreement (LTA) was on "*quantities of cotton* textiles. An exporting country could increase export *earnings* by upgrading existing product lines and diversifying into synthetics. The irony behind the LTA was that it provided Japan, as well as other exporting nations, with an additional incentive to move into synthetics, which was fast becoming the most lucrative textile market" (Yoffie 1983, 105).

Hong Kong was a different case. Its hard bargaining apparently defeated the U.S. attempt to restrict cotton exports in the late 1950s. The apparent short-run success had long-run costs. The United States had more severe restrictions under the STA and LTA in the early 1960s, and Hong Kong fell behind in the movement toward synthetics (Yoffie 1983, 64-79, 110-13). "An ironic twist in Hong Kong's success was that it did not move into synthetic textile fibers as quickly as Japan, Taiwan, or Korea" (112).

The U.S. nonrubber footwear OMAs with Korea and Taiwan in 1977 resulted in upgrading Korean and Taiwanese footwear from low-price footwear into middle-price footwear, which was the only category in which the U.S. producers had a competitive advantage (Yoffie 1983, chap. 5).

6. One of the mistakes Japan made, according to Yoffie's evaluation, was the "textile wrangle" of 1969-71. Japan should have compromised earlier for better terms for an industry that was losing overall importance for Japan and competitiveness against other Asian countries. Japan "had no long-run future in the sector, yet it promoted confrontation for the sake of short-run gains. . . . Japan jeopardized the return of Okinawa to Japanese sovereignty, and only narrowly escaped passage in the United States Congress of a highly restrictive trade bill. . . . While textiles may not have directly contributed to the Nixon 'shocks'—the overtures to China and the monetary declarations—they played a major role in disrupting the alliance" (Yoffie 1983, 155).

7. This section is partly based on Ito (1992, chap. 12).

different form in the 1980s. The Republican administration, with its philosophy of free trade, did not want to push protectionistic measures. Except for the first four years of the automobile VER, the Reagan-Bush administration avoided attempts to limit imports from Japan (see below). Instead, much more effort was given to opening up Japanese markets.⁸ The 1980s were a decade of U.S. demand for market access, and sometimes a market share, in Japan. U.S. officials correctly argued that correction of trade imbalances by increasing Japan's imports is far better than by limiting Japan's exports to the United States. On the Japanese side, U.S. pressure was largely effective in persuading vested interest groups that obviously oppose less protection from imports, or in dismantling regulations that increase oligopolistic rents. This section summarizes the history of the U.S.-Japan trade conflict before the 1980s, foreign pressure (*gaiatsu*) from the United States, and Japan's response in liberalization (*jiyuka*) or deregulation (*kisei kanwa*) of various markets in the 1980s.⁹

9.3.2 The MOSS-SII Conflicts of the 1980s

1. The yen-dollar group meeting of 1983–84 and follow-up meetings illustrate essential features of the pattern of the United States' demanding liberalization and Japan's responding to it.¹⁰ The United States demanded, among other things, deregulation in Japan's domestic financial market. As a result, foreign trust banks entered the market; a direction, if not a schedule, of deregulation of deposit interest rates was decided; and Euroyen markets were deregulated. A rationale for the U.S. demands was that to liberalize Japanese financial markets would invite foreign financial services into Japan, and foreign funds would be attracted to the Japanese stock and bond markets, thus putting pressure to appreciate the yen, the agreed objective at the time. However, as Frankel (1984) forcefully argued, negotiated measures included steps to lower barriers for Japanese capital to flow abroad (that is, purchasing Treasury bonds), putting pressure to further appreciate the dollar, contrary to the stated objectives. Perhaps a posture of being tough was more important than substance;¹¹ or perhaps the Republican administration was just trying to export deregulation.

8. This evaluation is in accordance with Destler (1991, 252): "There was, over the decade, a significant shift in policy emphasis. Both branches became much more aggressive in pressing for the opening of foreign markets."

9. There may be a subtle difference between liberalization and deregulation. Liberalization may include cases of interpreting and implementing regulations "liberally" so that market forces can work within the framework of regulation. For example, the deposit interest rate for money market certificates in Japan is set by a formula tied to the market rate. Deregulation usually refers to dismantling regulations completely. For example, the deposit interest rates on money market saving and checking accounts in the United States have been deregulated since the beginning of 1983, as have large time deposits in Japan since 1985.

10. See Frankel (1984) and Rosenbluth (1989, chap. 3) for background and detailed items of the yen-dollar working group negotiation.

11. It is well publicized that the Japanese side was not particularly happy about American theatrical toughness, such as Treasury Secretary Don Regan pounding a table to demand concessions from the Japanese.

2. Beef and orange (juice) imports into Japan were intensively negotiated from 1985 to 1987. According to the agreed-upon schedule, the import quota was raised in steps and was finally replaced by a tariff in 1991. The tariff rate for beef stood at 70 percent in April 1991 and was scheduled to decrease by 10 percent each year for the next seven years. (It became 60 percent in April 1992.) The switch from quota to tariff is significant. Under the quota system, a government agency (*Chikusan Shinko Jigyodan*) was the sole agency that could import beef, through the Japanese large trading houses. Although the quota was increased, no one could import directly from producers. The agency bought beef at the world price and "stabilized" the domestic price, that is, did not sell under a certain price. As a result, the agency accumulated beef and kept it literally frozen in the warehouse, instead of lowering the domestic price.¹² Since April 1991, wholesalers, trading houses, and large retail stores have directly imported from foreign producers, with a 70 percent tariff. Although increased consumption of beef certainly improves the utility of an average Japanese, a contribution to the trade balance is minimal. If every Japanese suddenly consumed twice as much beef and all the increase came from abroad, it would reduce Japan's trade surpluses by \$2 billion.¹³

3. The construction business was targeted by the USTR. The USTR has demanded on many occasions that a government procurement procedure should be changed to allow bidding from foreign companies. The New Kansai Airport became a focus of attention. The design of a freight terminal and the construction of a passenger terminal were won by a consortium including U.S. companies.

Another aspect of the construction issue is bid rigging (*dango*) by construction companies, which has long been suspected. It came under scrutiny when

12. The Sumitomo Trading Company published a survey of various retail prices as of late July 1990 (with conversion at 150 yen/dollar). Beef (medium quality) cost 3,900 yen per kilogram in Tokyo, while comparable beef in New York cost 1,088 yen (that is, \$3.25 per pound) (*Toyo Keizai Statistics Annual*, 1991, 374). The Economic Planning Agency's survey (in February 1990) put the beef (clod) price in Tokyo at 3,790 yen per kilogram, while it is 980 yen per kilogram in New York (Bank of Japan, *Comparative Economic and Financial Statistics*, 1991, 103). Yet another survey by the Ministry of Agriculture, Forestry, and Fisheries (which has a conflict of interest in conducting a survey) showed the beef (clod) price at 1,300 yen per kilogram in New York, while it was 3,830 yen per kilogram in Tokyo in November 1990 at 145.83 yen/dollar (*Toyo Keizai Statistics Annual*, 1991, 258).

The beef price seems to have come down in 1991, after retailers directly imported beef from the United States and other countries. On October 1991, a well-advertised sale at Ito-Yokado (a supermarket chain) priced a 250-gram steak from Nebraska at 1,000 yen (about \$13.85 per pound at 130 yen/dollar), still about two to three times the U.S. retail price. Allowing for the 70 percent tariff, the beef price is judged to be converging to a reasonable range.

13. The following estimating method was employed in this statement. An average employee household spent 32,675 yen on beef consumption in 1989. There were 3.72 persons per employee household. Since the Japanese retail price was about four times the U.S. retail price, the imported beef price would be as little as one-fifth of the Japanese domestic price. This gives an estimate of 1,756 yen per person for beef at an import price of one-fifth of the Japanese retail price. The population in Japan was about 123 million in 1989. Hence, with 150 yen/dollar, this translates into \$1.4 billion for beef imports.

the U.S. military base in Japan sued for damages and won a large settlement for construction work on the base.

4. In 1985, negotiations between Japan and the United States started on the access of specific products to Japanese markets.¹⁴ The initial MOSS talks took up four products: electronic communication service and products, pharmaceuticals and medical equipment, electronics, and lumber products. For these products, the United States felt that U.S. firms had a competitive edge and that the Japanese markets were closed by unnecessary regulations. For example, the definition of "electronic communication products" included satellites, and of "electronics" included supercomputers. Procurement procedures of the Japanese government and its agencies for computers and satellites became a focus of discussions resulting in an agreement satisfactory to the United States.¹⁵ Import procedures and license applications for pharmaceutical products have also been simplified, resulting in high marks from U.S. firms and trade organizations.

Imports of satellites, service of cellular phones, and a license to trans-Pacific cables were negotiated from 1985 to 1987. Motorola applied to introduce cellular phones in Japan. The Japanese government divided Japan into half and gave the less-populated western half to Motorola's joint venture and gave the eastern half, inclusive of Tokyo, to NTT. After much protest from Motorola and the USTR, the Japanese government finally gave a five-megahertz band in Tokyo to Motorola.

The Japanese government has been developing satellites domestically. Under pressure from the U.S. government, it agreed to purchase U.S.-made satellites. When two companies applied for transpacific cables, the Ministry of Posts and Communications decided to allow only one company, possibly a merged consortium. British Cable and Wire protested in vain in 1985.

5. The large retail store law in 1989 and 1990 came under attack in the SII talks.¹⁶ The law itself, and ministry guidance in conjunction with the law, practically prohibited a large retail store from constructing a new branch without consent from the neighboring retail business.¹⁷ Hence, the law, which essentially limits and discourages construction of department stores, discount stores, and large supermarkets, was heavily criticized by the United States during the SII. The United States contended that large stores carry more imported goods than do smaller stores; thus the law was an impediment to more imports. An application of Toys "R" Us became a symbol of the case. In 1990, MITI changed the procedure of the law, so that it became easy to open a large store.

14. The MOSS talks started as a result of the summit between Prime Minister Nakasone and President Reagan in January 1985.

15. In 1991, supercomputer procurements at Tohoku University and Kyoto University resulted in sales of Clay computers, because NEC withheld a bid.

16. For detail on the large retail store law and its impact on the Japanese distribution system, see Ito (1992, chap. 13).

17. "Large retail store" is defined as any retail store with 3,000 square meters or more in large cities, or 1,500 square meters in smaller cities. See Ito (1992, chap. 13).

The law remained intact but was revised in 1991 to speed up the license examination. The quantitative impact on trade balance is not known. What is certain is that Japanese consumers will benefit from more large retail stores with reasonably priced goods, and traditional corner-store owners are losers in the relaxation of the law. The SII talks certainly tipped the scale in the debate.

Other issues covered in the SII had implications, namely, to change the Japanese industry structures to allow more imports.¹⁸

6. Rice imports to Japan have been banned. The reason given by the Ministry of Agriculture, Forestry, and Fisheries is that a country has a right to "national security in food," that is, to produce basic staples (*kiso shokuryo*) 100 percent domestically. Moreover, GATT has allowed the ban on imports for a food item that is under a domestic production quota. Dependence on imported "basic food" is considered dangerous.¹⁹ The Japanese Diet unanimously passed a resolution opposing rice imports.

The Rice Miller Association (RMA) twice brought the case to the USTR, on the basis of article 301 of the Omnibus Trade Act, and each time it was rejected. The second time it was rejected with a condition that rice imports to Japan would be discussed in the Uruguay Round. So far, the Uruguay Round has not produced a comprehensive agreement on agriculture in general. Japan is in no hurry for the talks to move toward agreement.

From late 1990 to the spring of 1991, some leaders in the Liberal Democratic party (LDP) floated the idea of an import quota, or minimum access, for rice. The idea was heavily criticized by the agricultural lobby in Japan, how-

18. See Sheard (1991) for the viewpoint of industrial organization on the SII issue in general.

19. A favorite example that illustrates the dangers of depending on imported food is the case of the U.S. soybean embargo in 1973 (and in the same line of reasoning, but less well known in Japan, the wheat embargo to the USSR after its invasion of Afghanistan). Japan heavily depended on American soybeans for tofu and soy sauce production in 1971, and the announcement shocked Japan.

There are several problems with "national security in food" arguments, however. First, processed rice, for example, rice mixed with shrimp for pilaf, can be and has been imported. This may be a logical inconsistency. Second, dependence on imports may be dangerous, but if the sources are diversified, it is much less dangerous. The wheat embargo of 1979 against the USSR was not effective because the USSR could purchase wheat in the world market, in particular from Argentina. It is much more dangerous to be isolated in the world community. How could Japan function without oil, for example, even if rice is abundant? Third, by importing the goods, Japan can have a lobby in the United States, namely, U.S. farmers will protest an export embargo, as they did the soybean embargo of 1971 and wheat embargo of 1979. The soybean embargo lasted for only three months. Fourth, suppose for the moment that it is dangerous to depend on food imports. How would the Ministry of Agriculture, Forestry, and Fisheries explain the rising trend in the import-dependency ratio for food other than rice? Japan depends on imports for most of its grain and a large part of its fish. The import-dependency ratio based on calories is more than 60 percent, among the highest in the OECD countries. Is it safe to have 100 percent self-sufficiency on rice alone? Strong national security should be based on efficient production, that is, minimizing costs, given consumption. (Rice consumption is considered to be price inelastic.) However, the production quota is decided, not by cutting off the least efficient producers, but by cutting across the board. Scale economies exist in farming but are not exploited in Japan. Driving up production costs, how could one argue the security benefits? (The cost argument is painfully familiar to the U.S. defense industry, although the situation is slightly different.)

ever, and by U.S. officials who insisted on a tariff instead of a quota.²⁰ The rice farmers are very cautious, for beef and orange imports were liberalized despite the earlier pledge from LDP officials not to liberalize imports. The rice farmer learned that, if a partial import quota, or minimum access, is allowed, complete liberalization (zero tariff) will arrive sooner or later.

The rice issue again is politically very sensitive in Japan, and consumers are unlikely to lobby for import liberalization. Corporations tend to favor minimum access because they fear some kind of retaliatory backlash in automobiles and semiconductors if rice ignites protectionism in the United States. Again, foreign pressure might be working, but it may take a while to settle the rice problem.

9.3.3 Analysis and Evaluation

Reviewing issues discussed between the United States and Japan (summarized in section 9.3.2), one might wonder how much of a dent these measures made in the (bilateral) trade balances. The expected small effect has always been questioned by the Japanese in negotiations. The Japanese government maintained that the major cause of the U.S.-Japan trade imbalance rested on the large U.S. fiscal deficits and consumers' impatience (spending instead of thriftiness).²¹ U.S. policymakers tended to respond either that these liberalization and deregulation measures are for the benefit of Japanese consumers or that deregulation and free trade should be defended as a matter of principle. More succinctly, many members of Congress and business leaders felt Japanese firms have unfair advantages in getting government help (subsidies) and protection (nontariff barriers for foreigners). Correcting the imbalance requires prying open the Japanese markets. Moreover, the United States should push Japan, so that Japan becomes "more like us," that is, run under perfect competition and free trade.

In any case, the particular size of an expected correction for a single negotiated item was not the major concern. It may be that what was at stake was the principle of less government intervention and free trade, the Republican economic agenda, rather than maximizing deficit reduction.

A more likely explanation of the U.S.-Japan trade conflicts in the 1980s is that the White House used Japan as a scapegoat for domestic conflicts, while

20. Many politicians and bureaucrats feel that the effective tariff rate that would minimize imports would be embarrassingly high, because Japan's rice price is said to be eight times the world price. Japanese prefer short grain, however, and comparison may be difficult. The Forum for Policy Innovation (*Seisaku Kohsoh Forum*) estimated, taking into account transportation and warehouse costs, that a tariff of about 164 percent would make Kokuho Rose, a top-brand (short-grain) Californian rice, as expensive as the government sale price of domestic rice, and of 269 percent would make Kokuho Rose as expensive as the top-brand Sakanishiki (Forum for Policy Innovation 1990).

21. It can be easily shown from the GNP identity relationship that a trade deficit must result if domestic private saving is short of domestic private investment and the government runs fiscal deficits.

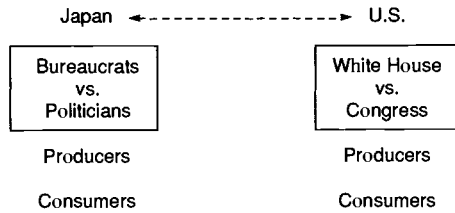


Fig. 9.1 Conceptual framework of domestic and international conflicts

the Japanese government in some quarters used foreign pressure to achieve an agenda of deregulation and to increase the slice of economic pie for consumers. In addition to the U.S.-Japan negotiations that take place officially, domestic negotiations and games are played within each country. In the United States, the White House and Congress often oppose each other, and in Japan, bureaucrats and politicians often argue over the issues. In each country, various political groups represent various producer and consumer groups, according to their political orientations and electoral needs.²²

Figure 9.1 shows a conceptual framework for this type of two-level game: first a struggle between domestic players, bureaucrats versus politicians in Japan and White House versus Congress; then an international negotiation between Japan and the United States. Domestic players represent consumers' and special producers' interests. What follows is a detailed elaboration of this hypothesis.

The U.S. Domestic Situation and Its Reflection in Trade Issues

When a protectionist request is presented by a special interest group, the U.S. government weights several economic and political trade-offs. In those calculations, arguments against protection come from domestic users of imported products as well as from exporting countries' government and consumer groups.²³

Another important ingredient of this scenario is that the United States was under a divided government for most of the 1980s.²⁴ The House, and the Senate

22. See Weingast and Marshall (1988) for an attempt to analyze legislatures (Congress) in an industrial organization framework. See McCubbins, Noll, and Weingast (1987) for how administrative procedures, such as rules of who bears the burden of proof, could be used politically. Hillman and Ursprung (1988) show that trade policy can be understood as a tool for gaining domestic political support. A VER is used to please a specific interest group, while tariffs may be divisive, so that no candidate has an interest in formulating a trade policy position using a tariff if a VER is a policy option.

23. See Destler and Odell (1987) for an analysis of domestic antiprotection activities.

24. Divided government has become more common in American political history, according to Alesina and Carliner (1991). It may be "the result of a conscious attempt by the voters to achieve moderate policy. . . . Voters in the middle of the political spectrum desire policies in between those advocated by the median members of the two parties" (2-3).

also after 1986, wanted to criticize the administration for its lack of trade policy.²⁵ On the other side, the executive office tried to deflect protectionist pressure and, sometimes, to steal the opportunity to initiate pressures on other countries, in order to score points domestically. The executive office may be unenthusiastic in obtaining protectionistic concessions from other countries, but is certainly not reluctant to press for opening markets for U.S. goods. In order to preempt a criticism from Congress, the White House wanted to appear tough on Japan.

One of the obvious issues in the 1980s was trade deficits. Over 30 percent of trade deficits were against Japan. Hence, Japan was chosen as an instrument for congressional criticism of the administration. This instrument is quite useful and effective, because the Japanese economy seems to behave differently than other economies.

Traditionally, Republicans advocated smaller government and fewer regulations, compared to the Democrats. The administration's stated goal was to make trade free and to let the market determine the outcome. Hence, whenever Congress threatened to pass protectionistic bills and to promote imports and put surcharges on imports, the Republican administration tried to focus on the issue of opening the Japanese market. A tough posture was maintained by the administration in order to outdo Congress. The Republican administration was interested in scoring domestically by criticizing Japan rather than by reducing the deficit, although the latter was always a pretext for negotiation. The administration was willing to take up issues that fit the Japanese agenda, so long as they also fit the Republican agenda. In that sense, Japan was a scapegoat, but a fortunate one: the scapegoat was not for sacrifice, but for window dressing.

Of course, U.S.-Japan conflicts have a long history (as shown in table 9.2) and occur even in the period without a divided government. During the last twelve years when divided government prevailed, the conflicts developed a distinctive MOSS-SII feature. MOSS-SII negotiations attempted to open Japanese markets instead of closing the American market, in order to remedy the trade imbalance. This fit the Republican White House agenda and acted to counter congressional pressure. By using MOSS-SII negotiations, the Republican administration took an initiative in domestic politics on the international trade front.

Hence, it is fair to say that the divided government in the 1980s likely explains the Republican administration's adoption of MOSS-SII demands on Japan, as opposed to the traditional VER type (which is more of a Democratic party approach).

However, it also spawned congressional counterattacks using the results-oriented pressure, because the MOSS-SII negotiations were seen as insuffi-

25. It is not important in this context whether Congress is truly interested in protectionist measures, as often charged by the conservative press and the Republicans, or is interested in appearing tough rather than passing tough legislation with teeth, as suggested by Destler (1991).

cient to remedy the imbalance in merchandize trade with Japan. The new approach also is employed to seize the initiative in domestic politics from the White House.²⁶

The Japanese Domestic Situation and Its Reflection on Trade Issues

The Japanese economic and political system has produced remarkable economic development and progress. Elements that produced 10+ percent high-speed economic growth (*kodo seicho*)²⁷ included high saving rate, high fixed investment rate, export subsidies, and import restriction. Even after the first oil crisis, the Japanese economy overcame two oil crises and the yen-appreciation recessions (1978 and 1986) to maintain 5 percent growth rates. During all these years, what occupied the minds of Japanese business leaders, political leaders, and bureaucrats was how to cut costs, how to earn foreign currencies (dollar), how to improve quality of goods, and how to produce goods better. Economic growth, with the balance of payments constraint, was the "principle" used to evaluate funding and political priority. If cost-benefit analyses for exports and growth did not justify projects, they were not funded.

Of course, political priorities have shifted from agriculture to heavy industrial products and to high-technology products. Unfortunately, when an entire process is geared toward production as opposed to consumption, it is difficult to switch priorities.

In fact, Japan has not seriously switched its economic goal for more than forty years. The political process *added* objectives but did *not switch* objectives. Shifting weights among priorities was not a hard choice, when the entire pie, to be sliced and distributed among participants, was inflating at 10 percent per annum.²⁸ This is partly because severe political resistance arises when the

26. If this working hypothesis is correct, dissolving a divided government by electing a Democratic president would make the U.S.-Japan conflict less confrontational (less use of results-oriented pressure), hence more productive for the U.S.-Japan relationship. This contradicts a popular notion in Japan that a Democratic president would be a protectionist and a disaster for Japan.

27. The era of high-speed economic growth is defined as 1955-73, when real GNP grew on average at more than 10 percent a year, doubling income every seven years. See Kosai (1986).

28. Of course, some items are rigid even in their share, instead of the budget amount. The shares among different uses (ministry turf) of public works in the national general budget was surprisingly stable. For example, see Sakakibara (1990, 87):

Public works budget share		
	1979	1987
Agriculture infrastructure	14.11	14.13
Irrigation	13.55	13.72
Road	30.77	28.92
Housing	11.25	12.44
Sewerage	10.71	10.91
Forestry	4.53	4.56
Fishery	2.87	2.95
Seaport infrastructure	4.20	4.17

absolute value of the budget declines, and partly because the Japanese electoral system favors vested interest groups. The downward rigidity of the budget may be not a result of "rational choice," but a reality.²⁹

Under slow growth, it is much more difficult to add a new agenda (say, sewerage, city parks and playgrounds, or even airports), because it means cutting a stale agenda (say, irrigation or seaports for commercial fishing). But when "better quality of life" has clearly overtaken "more exports" as the national priority, why does a new agenda not arise?

Who steers the ship in Japan? How is the social consensus on priorities determined? This may be a mystery. There is no clear leadership. Important policy items seem to be decided behind closed doors. Politicians cannot ignore business lobbyists; business leaders are subject to ministry guidance; and bureaucrats seem to be influenced by politicians' needs.³⁰ No one seems to be in charge, but somehow a group of powerful players form a consensus.

It was clear by the mid-1980s that the traditional value of maximum growth did not fit contemporary Japan. Foreign countries, the United States and Europe alike, criticize Japan for working too hard and exporting too much.³¹ American and European economists, as well as government officials, argued that if Japan invested more on infrastructure for improved life, such as parks, sewerage, roads and sidewalks, and public transportation, then it would increase the standard of living, or quality of life. Domestic demand expansion would reduce exports to foreign countries, reducing trade conflicts. The current account surplus/GNP ration exceeded 4 percent in 1986, which was not sustainable from the international political point of view.

The difficulty in shifting political priorities in Japan has two main causes

However, other means of budget allocation, especially through the Fiscal Investment and Loan Program (FILP), have changed their priorities. See Ito (1992, chap. 6).

29. Myopic or uninformed voters may justify this. Suppose that farmers would not resist if the subsidies or public work budget (after inflation adjustment) did not decline, while the agricultural share in the budget did.

30. This nontransitive relationship among politicians, bureaucrats, and business is commonly nicknamed in Japan the "stone, paper, scissors" (*jankenpon*) structure. It is also known as a "truncated pyramid" (van Wolferen 1989, 5): "Today, the most powerful groups include certain ministry officials, some political cliques and clusters of bureaucrat-businessmen. . . . There is, to be sure, a hierarchy or, rather, a complex of overlapping hierarchies. But it has no peak; it is a truncated pyramid." See Sakakibara (1990, 71–88) for the way the Ministry of Finance and the ruling party have to negotiate the budget.

31. In 1985, the average number of working hours for manufacturing production workers in Japan was 43.2 hours per week, while it was 38.3 hours per week in the United States.

	Japan	U.S.	U.K.	Germany	France
1985	43.2	38.3	41.8	42.0	38.6
1990	42.3	38.2	41.6	40.7	38.8

Source: Bank of Japan, *Comparative Economic and Financial Statistics* (1991, 109, 111).

Notes: Japan in 1985 and 1990 has a discontinuity in statistical method. Germany (West) in 1990 is actually 1989.

connected to the electoral system. First, the House of Representatives electoral system, that is, the single nontransferable vote, multimember district system, makes interest groups very important. The ruling LDP candidates in the same district usually divide their support bases through trade groups. (Another way is to divide their support bases by subdistricts.) For example, votes are strongly tied to small and medium-sized shops in commercial districts, to the construction industry, and to farmers.³²

Second, it is well known that apportionment is seriously behind reality in Japan. In an extreme case, the number of registered voters per representative in a rural district is about one-third of that in a metropolitan area. Political interests of the agricultural and fishery businesses are overrepresented in the House of Representatives.

“Quality of life giant” (*seikatsu taikoku*) became a code phrase of the Miyazawa cabinet for changing a national priority away from investment toward consumption, and away from exports toward infrastructure for a better standard of living. Indeed, a desire among the Japanese for higher satisfaction with life grew rapidly in the second half of the 1980s, because the citizens, as portrayed in the mass media, started to realize the gap between the standard of living, especially the poor quality of housing, and macroeconomic strength, such as Japan’s new status as the world’s largest creditor. The Maekawa report (April 1986) clearly stated that one of the national priorities is improving the quality of life.

However, concrete steps toward better life have come very slowly. There were two kinds of problems. First, it was difficult to divert resources from, say, agricultural infrastructure to that related to quality of life, especially under relatively slow growth. This pitted farmers against a silent mass of consumers. Second, increasing consumers’ welfare often involves deregulation, while Japanese government officials and business leaders tend to rely on a plan and coordination between business and the government.³³

A big push from influential foreign countries was much needed in the mid-1980s. Foreign pressure (*gaiatsu*) is most effective when it funds a big, though silent, constituency in Japan. Successful liberalization, as for beef and oranges, and deposit interest rates fit into this pattern. Japan used foreign pressure to take steps toward a new national priority, better quality of life.

There are two reasons why the MOSS-SII pressure of the 1980s has worked in Japan. First, the U.S. list of demands was in accordance with the new emphasis on better quality of life (increasing consumers’ surplus, instead of pro-

32. The importance of the electoral system in making political decisions in Japan was mentioned and emphasized by my discussant, Frances Rosenbluth, at the conference. This paragraph was added to incorporate her comments.

33. The concept of “excess competition” (*kato kyoso*), which is analogous to destructive, cut-throat competition, is used as a rationale for regulation in Japan. Many government officials and business leaders think perfect competition, or *laissez-faire*, does not necessarily optimize social relations.

ducers' surplus); second, those who lose vested interests or oligopolistic rents in the wake of liberalization had a political and psychological bias in favor of the United States. They felt that if the U.S. government wanted liberalization, they could give in (*shoganai*).

Those who suffer from regulatory changes are traditional supporters of the LDP and friends of the United States: they feel grateful to the United States for successful help, during the occupation period and later, in various economic and political areas. With U.S. pressure, Japan could achieve liberalization that accords with a shift in priority at minimal political cost.

In summary, giving in to U.S. demands was a face-saving excuse that could be used by bureaucrats to politicians, and by politicians to voters. Leaders in big business did not bark at deregulation because they were afraid of being squeezed out of the U.S. market in retaliation.

U.S. pressure (the MOSS-SII type) and liberalization benefited Japanese consumers most. To a lesser extent, U.S. firms and Japanese new entrants received benefits. Losers were mainly those who had been protected by regulation. Politically, both the U.S. government and the Japanese government used foreign pressure for their benefit: the United States used it as a scapegoat for the inability to manage the size of fiscal and trade deficits, while the Japanese used it to minimize political damage caused by deregulation and liberalization.

9.3.4 Signs of a Dangerous Current: Unilateralism and Resentment

U.S. Unilateralism

A turning point for U.S. frustration came in 1985, after the administration lost its grip on Congress (see Destler 1986, appendix). In the spring of 1985, the Senate passed, 92–0, a resolution condemning Japan as an unfair trading partner. In September 1986, a semiconductor agreement was signed by the U.S. and the Japanese governments, only to result in a U.S. finding of Japan's violating the agreement in 1987. The Congress finally passed the Omnibus Trade and Competitiveness Act of 1988 with the super 301 clause.

Let us call this kind of approach U.S. unilateralism: (1) the issue (or the product) is singled out without being considered in a broader framework; (2) the United States unilaterally determines whether a trading partner is engaged in unfair trade (dumping, market closed to American products); and (3) the United States unilaterally imposes retaliatory fines (or tariffs) if it determines that the country violates a United States-imposed rule. The super 301 is a perfect example of U.S. unilateralism.³⁴

U.S. frustration was compounded by a series of MITI mistakes and miscalculations. In the spring of 1985, President Reagan announced that he would not seek the continuation of the automobile VER. MITI, however, opted to continue the VER with a higher ceiling.³⁵ The ceiling was increased from 1.85

34. See Bhagwati and Patrick (1990) for discussions among economists in the United States.

35. See Ito (1992, 381–82, n.4) for a detailed account of this episode.

million cars to 2.3 million cars. This infuriated the president and Congress. Reagan denounced the decision because he had not asked for another VER, and the Congress was upset because of the 24 percent increase in the number of exports. Congressional frustration contributed to the passage in March of the resolution denouncing Japan. Faced with U.S. criticism, Prime Minister Nakasone admitted that MITI's decision to increase the number was a mistake. MITI also miscalculated the significance of the semiconductor agreement in July 1986. MITI thought that signing the agreement would alleviate pressures for Japanese purchase of American-made semiconductors. However, the United States found that Japan violated the agreement on two counts in March 1987, transshipping with a lower price through Hong Kong and failure to increase imports to Japan (Prestowitz 1988, 61–70). The MITI miscalculated the seriousness of the United States about the market share target (or commitment) in the agreement.

Hence, the second half of the 1980s was characterized by a mix of two types of conflicts, market access such as SII, and U.S. unilateralism such as super 301 and the semiconductor agreement.

Revisionist Influence

The so-called revisionists argue that Japan operates in a different economic system. Since the Japanese economy is different, different rules should be applied. For example, in order to open the Japanese market, normal negotiation is inadequate, because even if one barrier to imports (say, quota) is removed, another problem (say, procurement procedure and *keiretsu* trading) emerges to keep imports out. Hence, the most effective measure against Japan is to have it commit to a concrete number, such as the market share in Japan, and have it figure out how to carry out the commitment.

Revisionists think that in traditional trade negotiations, the Japanese bureaucrats outmaneuvered the American counterparts through delaying tactics and by not understanding the spirit of an agreement. The Japanese took advantage of a Republican government that promoted free trade, by exporting more to the United States while not lowering import barriers. Some go on to argue that Japanese manufacturers engage in “adversarial exports,” maximizing the market share by exporting products without importing.³⁶

Revisionists emphasize Japan's preference for in-group trading, such as *keiretsu* trading, as a source of low import ratio. The rules of the game are different in Japan: *keiretsu* trade, low capital costs (due to high saving rate and a capital market closed to foreign firms), long working hours, low wage, low-quality social infrastructure (such as sewerage), and low quality of housing. Essentially, the Japanese firms can take advantage of these characteristics to enhance international competitiveness.

36. See Drucker (1986). A similar line of argument, considering Japan as “Japan, Inc.,” a big, social, conspiratory entity, is common from Prestowitz to Cresson. However, this kind of conspiratory argument would not stand up to a close scrutiny of the Japanese political and economic system. See Krugman (1990, 120) for a similar assessment.

There are possibly three arguments that, I think, could barely justify the revisionist policy recommendation (from the U.S. point of view), which essentially advocates an expanded import commitment (quota) for Japan. I discuss the arguments and then the Japanese reactions to them.

First, some policymakers and critics in the United States, who emphasize domestic interests (America first), finally realize that traditional types of pressure (that is, VERs and OMAs) give oligopoly rents to foreign producers as well as to domestic producers. The new market-access types (SII) mainly enhance the Japanese consumers' welfare, with little gain to the U.S. producers. Hence, the "fruits" did not come from political shows of beating Japan using the traditional or the new type of pressure. It is now time to seek U.S. interests aggressively. (Recall table 9.1.) The revisionist side, of course, would not present the argument this way. (However, implications are clear from what they advocate, that is, "import this much or retaliate.") They argue that the Japanese are restricting imports by broadly defined nontariff barriers. An extraordinary low ratio of manufactures imports proves the point, and no further pinpointing of the problem is necessary, according to revisionists.³⁷

Second, a more sophisticated theory could be used to justify the market access negotiations. New trade theory states that pursuing the market share may pay off in the long run, if the market for the product expands in the future. In the same logic, export subsidies may be justified as a strategy. The new theory possibly justifies industrial policy and infant industry protection. When there are scale economies in technology, it is important to get the market share first, by securing the domestic market by protection or by expanding into foreign markets by subsidies or by thin margins (if not by dumping). Revisionists in this vein regret that the United States allowed Japan's infant industry protection for automobiles, shipbuilding, and other products that later dominated the world market. They also believe that the best chance for the United States would be to aggressively promote industries with a competitive, technological edge in the 1990s. This is managed trade, but it is better than free trade.³⁸ The best chance for the United States is to pry open the Japanese market, denying MITI's infant industry protection. Products in this category include satellites, aircraft, supercomputers, some types of chemicals, and pharmaceuticals.

Third, the logic of affirmative action, which is an application of Spence's signaling theory, may justify a line of revisionist argument. Suppose that, whatever the reason, American products are perceived to be of inferior quality. Consumers would not buy American commodities (say, automobiles) if their prices

37. See Dornbusch (1990) for this kind of argument: "Japan actively participated in the GATT tariff-cutting rounds but avoided opening its market through keeping in place a second layer of trade restriction" (Dornbusch 1990, 108). "Japan seems to be somewhat of an onion with multiple layers of protection of one kind or another" (Dornbusch 1990, 120). Dornbusch does on to cite a low "intra-industry" trade index for Japan as an evidence of closed Japanese market. However, Dornbusch himself points out that the number is consistent if the Japanese consumer has a "preference" for the Japanese goods (buy Japanese) without formal import barrier. You cannot blame preference.

38. I classify Tyson (1990) in this category.

are similar to those of comparable Japanese commodities. This is discrimination by the origin of manufacturing. American producers would not make efforts (investment and concentration) to make high-quality goods, because efforts would not pay off. The result would be that American products *are* of inferior quality. Hence, this is the case of self-fulfilling perceptions. The American commodities are trapped in a low-reputation equilibrium. If the perception changes, Americans would respond by changing the quality, moving to a high-quality equilibrium. This kind of multiple equilibrium justifies the use of quotas both in affirmative action of racial preferences and in international trade.

Japan's Resentment

Japanese reactions to U.S. pressure have changed gradually through the 1980s. To traditional U.S. pressure say, the automobile VER, the reaction was like making a deal with a bully. Although it was not optimal to “concede” to a U.S. demand, it was not a “resentment.” For MOSS-SII pressure, the Japanese reaction was mixed. One group of Japanese thought that SII pressure was interference in internal affairs, while another group welcomed it as foreign pressure, which improves the welfare of the Japanese consumers. However, there is little sympathy in Japan for the super 301 pressure. It is clear that more people were offended by SII pressure than by VER pressure; and still more people were offended by super 301 pressure than by SII. The United States is losing its friends and constituents in Japan very quickly with super 301 pressure.

Japan's resentment at result-oriented demands is threefold. First, the Japanese, especially business leaders, tend to think that they earned their competitiveness by hard work and endless innovations. The Japanese saved a lot of household income and reinvested saving into machines, structures, and R&D. As a result, Japanese products have become better and have won a high market share in the United States and in the world. That is nothing to be ashamed of. In fact, Japanese products have overcome a reputation, or “signaling,” problem, described as a possible justification of the revisionist argument.³⁹ Moreover, automobile and consumer electronics industries were not actively helped by government industrial policies: no export subsidy, no low-interest rate loan programs, and no depression cartels to allow oligopoly rent.⁴⁰ Meanwhile, the United States consumed a lot and failed to save. It is a U.S. management problem that U.S. manufacturers could not keep up with technological innovations by investment, the Japanese argue.⁴¹ As for the current account imbalance in

39. It took more than ten years after its first export attempt for Toyota to make a successful entry into a U.S. market.

40. In the 1960s, the automobile industry fought off the MITI attempt to merge several automakers into two or three, and to restrict a passenger model to a particular type, “Folkscar,” (*kokuminsha*). See Yakushiji (1984) for this episode.

41. At this point, many Japanese recite a well-known Aesop fable, “The Ant and the Grasshopper.”

the 1980s, many economists point out that it was mainly caused by U.S. fiscal deficits.

Second, many Japanese resent most unilateralism, that is, the United States telling Japan “import this much or we retaliate.” This treats Japan not like an important ally of the Western world, but almost like an enemy. In fact, a retaliatory measure was taken after the United States found Japan guilty of violating the semiconductor agreement. An implicit agreement, believed by MITI, during the market access negotiations was that Japan should suggest topics fit to talk about, while the United States took opportunities to pretend to be tough on Japan. Hence, real bashing, or retaliation with teeth, was seen as violating the rules of the game. The super 301 was also intensely disliked by the Japanese, because it did not enhance Japanese consumers’ welfare, and it appeared much more unfair to the Japanese because the United States played both prosecutor and judge.

Third, some Japanese feel that Japan is singled out as a villain (not just a scapegoat). For example, when Fujitsu had to stop its take-over of a Californian semiconductor company that is owned by a French firm because of opposition from the U.S. government on national security grounds, many Japanese felt that they were not regarded as a friendly nation. Similar resentment was registered when U.S. pressure halted a Japanese plan to develop its own design for the next generation of the Japanese fighter jet, FSX.⁴²

Morita and Ishihara (1989) were the first among influential Japanese who recorded the resentment in a dramatic way. They advocated that Japan say no to U.S. pressure. Morita’s and Ishihara’s work got high praise from those who did not see that U.S. pressures of the MOSS-SII type worked for Japanese consumers and became increasingly irritated by U.S. “interference in internal affairs” of Japan.

The Gulf War

The Gulf War tested the relationship between the United States and Japan. Many Americans were predictably upset with countries, such as Germany and Japan, that did not help fight Iraq.

The Japanese government, on the one hand, explained that the constitution prohibits the self-defense force to go abroad to engage in fighting; on the other hand, it unsuccessfully tried to send some personnel as a support (nonfighting) team.

A new word was created in Japan to express this feeling: *Ken-bei*, or “dislike the United States.”⁴³ This is different from the anti-United States feeling that

42. With pressure from the United States, the United States and Japan decided to develop jointly the new fighter jet in October 1987. In November 1988, the two countries signed an agreement for a joint development, with Japan paying for the entire development cost, \$165 billion. In 1989, however, Congress pushed for a revision of the plan in order to minimize technological transfer to Japan.

43. *Ken* (with a particular Chinese character) means to “dislike,” or “disapprove,” but it could go as far as “abhor” or “hate.” *Bei* (with a particular Chinese character) is an acronym for the

is typically expressed by the socialists and the communists. *Ken-bei* people may be quite knowledgeable about the United States. Yet they are either disillusioned by the United States' being unable to solve domestic problems—crimes, drugs, homelessness, education, twin deficits, S&Ls, and so forth—or frightened and alienated by a seemingly trigger-happy attitude against Iraq. Many Japanese observers took the January 15 deadline as a bluff; few predicted an immediate attack. Even after the success of the attack, many Japanese did not approve of the attack, for pacifist reasons.⁴⁴

A fiasco over contribution to the Gulf War chest from Japan did not help sentiments in both countries.⁴⁵ The same pattern was repeated. The United States asked for action (in this case, monetary contribution), and Japan delayed a decision. When Japan decided to contribute \$9 billion, in addition to \$4 billion pledged earlier, it was considered to be too late. Then the Japanese side felt that Japan's contribution was not appreciated enough. Moreover, currency depreciation made actual payments short of \$9 billion. Apparently, the finance minister pledged in the dollar denomination, while the budget was made in yen.⁴⁶ After a protest from the United States, Japan made up the difference, with a lot of reluctance.

9.4 U.S. Pressure and Regional Implications

This section examines what kind of implications U.S. pressure has for the relationships among nations in the Pacific region.

9.4.1 The U.S.-Japan Conflict and Japan's Attitude toward Asia

Will U.S.-Japan conflicts make Japan turn to the East Asian countries, possibly as a market or as a diverted export base? There have been strong economic relations between Japan and the East Asian nations. It has been established that Asian countries provide high-quality labor for assembly and component production. They have become an important production base for U.S. as well as Japanese companies.

Although Asia has not reached the point of replacing North America as a market for Japan, its importance as a market has grown substantially. During the first half of the 1980s, China looked like a new frontier for Japanese exports, but the export amount decreased substantially during the second half. Instead, the Asian NIES and other ASEAN countries became important mar-

United States. The *ken-bei* became popular in 1990–91. In 1992, another word was created, *en-bei* (avoid or despise the United States), and a most recently created word is *bu-bei* (contempt of the United States).

44. These pacifists ignored the fact that the United States carefully crafted the consensus in the United Nations, to which Japan has always pledged strong support. In fact, Japan's diplomacy is said to give most weight to the United Nations.

45. See Inoguchi (1991) for analysis of Japan's response to the Gulf crisis.

46. News of the United States' asking Japan to make up the exchange rate loss contributed to *ken-bei* feeling.

kets for Japan. In 1990, the United States and Canada combined absorbed about \$100 billion (up from \$70 billion in 1985) of Japanese goods, while East Asian countries absorbed about \$80 billion (up from \$30 billion in 1985). See table 9.3 for details.

The pattern has been that Asian countries run trade deficits against Japan while exporting final goods to the United States to keep net trade surpluses (table 9.3). Typically, Asian NIES import technology and parts from Japan and manufacture reasonably priced consumer electronics goods and automobiles for export to the United States, but not to Japan. For Asian NIES, Japan was a good source of parts, but not a good customer. In 1981, Asian NIES imported about \$81 billion from Japan and exported only \$9 billion to Japan, and eight to one ratio. In 1990, however, Asian NIES imported \$57 billion from Japan, while they exported \$26 billion to it, a close to two to one ratio. The gap is still large, and even if the trend continues, it would take another decade or more, until the Asian NIES–Japan trade balance would break even.

Table 9.3 Exports and Imports of Japan, by Region (in millions of dollars)

	1981	1985	1990
Export from Japan			
United States	38,609	65,278	90,322
Canada	3,399	4,520	6,726
NIES	20,841	22,493	56,667
Thailand	2,251	2,030	9,126
Malaysia	2,424	2,168	5,511
Philippines	1,928	937	2,504
Indonesia	4,113	2,172	5,040
Europe (west)	23,748	25,199	63,332
China	5,095	12,477	6,130
USSR	3,259	2,750	2,563
Total	152,030	175,638	286,947
Import into Japan			
United States	25,297	25,793	52,329
Canada	4,464	4,773	8,392
NIES	8,524	9,838	25,973
Thailand	1,061	1,027	4,147
Malaysia	2,927	4,330	5,401
Philippines	1,731	1,243	2,157
Indonesia	13,305	10,119	12,721
Europe (west)	11,541	12,356	42,617
China	5,292	6,483	12,054
USSR	2,020	1,429	3,351
Total	143,290	129,539	234,799

Source: Ministry of Finance, Customs Bureau, cited in *Toyo Keizai Statistics Annual* (1991, 231–32).

Note: Based on customs figures. NIES = Korea, Taiwan, Hong Kong, Singapore.

Since much of Japanese exports to Asian countries have been components and parts that are used for goods destined for the United States, one might suspect the U.S.-Japan conflict would cause Japanese companies to set up a diverted base of exports from Asian countries. It is difficult to speculate how much of Asian exports to the United States are by subsidiaries of Japanese companies. Much of the increase in Korean and Taiwanese exports to the United States comes from their own companies, though parts might come from Japan.

Worsening of the U.S.-Japan relationship at this point would not promote more intraregional trade, for two reasons. First, such a conflict would likely spill over to other Asian countries. The United States became extremely cautious toward Asian NIES, for fear of a repetition of the success of Japanese penetration into the United States. The United States has been tough on Korean trade surpluses against the United States, considering that Korea only recently paid back foreign debts. Second, the size of markets for final products such as automobiles is still small in Asia. Unless China with its large population changes its regime and continues to grow quickly, or the CIS turns to Asia for trade relations, markets are simply not present. (There is a limit how many cars and VCRs one family wants. Population is an important factor.)

However, if the political integration of the European Community results in an economic fortress and if the North American Free Trade Agreement (NAFTA) becomes a reality, the Asian nations may have no choice but to unite as a regional trading bloc.⁴⁷

In summary, the trend shows signs of Japan's becoming mature enough to absorb Asian goods, and Asian nations' becoming mature enough to export to Japan. But it is too soon to expect intraregional trade to dominate U.S. trade with Asian countries (including Japan). The heightened tension between Japan and the United States would be counterproductive at this point for regional trade and relationship. The Pacific Asian intraregional trade is not an alternative to Asian-North American trade, unless North American and European markets become closed against Asian products.⁴⁸

9.4.2 U.S. Pressures on Asian Countries

As explained in section 9.4.1, U.S. traditional and SII pressures on Japan have worked (or worked until recently) because of Japan's domestic political situation. That is, those who had vested interests to be lost in liberalization are those who sided with the LDP and the United States in its ideology. Moreover,

47. Such a regional trading bloc was first proposed by Prime Minister Makathir of Malaysia in 1990 by the name of East Asian economic grouping (EAEG), including Japan, Korea, China, Taiwan, Hong Kong, Vietnam, and the ASEAN-Six (Singapore, Thailand, Burnei, Indonesia, the Philippines, and Malaysia). The United States insisted that it be included in the bloc. With U.S. pressure, Japan is hesitant to commit to the EAEG plan.

48. This assessment should not give the United States a free hand to put more pressure on Japan and other Asian countries. The strain from pressure is already too much, so that resentment might become overwhelming.

internal pressure was already mounting for a better life. U.S. pressure only tipped the balance.

As explained in section 9.2, similar pressures have been applied to Korea, Taiwan, and other Asian nations.⁴⁹ However, the impacts of U.S. protectionistic measures are more serious on Korea and Taiwan than on Japan, because of their relatively lower GNP and relatively higher dependence on the U.S. market.

There is a strong tradition in economic policy and economic management, that government planning and regulation would be good for economic growth. Government intervention for infant industry protection (and more generally, for progress from import substitution to export substitution) is considered to be desirable. Until the economy becomes mature, government is unlikely to give up economic planning to maximize growth.

In summary, U.S. pressure for liberalization would not work unless the receptive environment is already there. The time is too soon.

9.4.3 Problems of Japan's Relationship with Asia

Political Aspects

A stable U.S.-Japan political relationship is no less important than export-import ties. Many Japanese and Asians feel that Japan has not apologized enough for its behavior before the Second World War. Unless Japan as a nation is accepted by its Asian neighbors, the United States is needed as a countervailing power. However, feelings toward Japan vary among the Asian nations.

Lack of Principles in Japan

It is extremely difficult to read the positions of leaders in various Japanese groups and parties. It is rare to see potential leaders compete for a top post with principles and positions. It is rare that different projects and ideas are evaluated in public, with different executives taking positions.

Is it culture? Or does it derive from an economic structure? The Japanese are known for their group orientation and consensus building. Japanese students and office workers are trained not to express opinions and not to debate with logic over different positions in public. A durable leader in a Japanese hierarchy is the one who does not reveal his position (in extremely rare cases, her position), having subordinates and colleagues debate and fight over positions, and having them turn to him for a decision that prevails as a "consensus" of the group. Minority opinions should not be revealed once the group makes the decision. Since it is a consensus, the leader does not have to take the blame even if the project fails, at least from internal pressure. Leadership may be lethal because it comes with conflicts. Is this a unique culture? Perhaps. Education contributes heavily to homogeneous thinking.

49. For the Korean case, see Nam (1991).

The Japanese hierarchy in big corporations, government, academics, and political parties is extremely rigid in promotion. It goes by age.⁵⁰ Unless one goes to a top post, a good retirement is not guaranteed. Hence, people become extremely cautious in taking sides and expressing opinions in public. There is no fast track, so group discipline works.⁵¹

Assertiveness

Taking positions and debating over ideology were much more common in the 1950s and 1960s. Labor-management conflicts and left-right political conflicts were common. However, as the fruits of high-speed growth trickled down to all participants of the society, different agents seem to have engaged in a truce. The turf is defined, and they agree to fix the border.

To take just one example, the LDP proposed in 1991, in the wake of political corruption cases, to reform the electoral system. The draft included introduction of the one representative per district (*sho senkyoku sei*) system, along with proportional representation. The former works for the LDP, while the latter works for smaller opposition parties. The pretext was to reduce the need for fund-raising. But the proposal favored the LDP as a whole. The other parties opposed it for good reason. What was unusual was the opposition within the LDP, and the proposal was abandoned. If the LDP were serious about attracting voters and dominating the majority, it would have persuaded the members to adopt the proposal.

9.4.4 Japan's Agenda for Leadership in the Region

Japan has not projected what kind of role it would play in the Pacific region or in the world. The lack of principles in the international context is not unrelated to the lack of positions in the domestic environment. This would not change even with U.S. pressure. It is deeply rooted in the Japanese society and workings of hierarchy.

Without projecting a position and an agenda, Japan will not be able to become a regional superpower.⁵² Possible scenarios for Japan's taking leadership are described here.

50. In many cases, *age* means natural age. To be precise, however it is the years since an individual joined the bottom of the hierarchy. Corporations hire students fresh out of college, and promotion, through screening and attrition, goes with age. Government hierarchy (in the fast track) goes with years since joining the ministry. Academic promotions in universities depend on criteria 99 percent dominated by age, not by merit or publication. Probably 90 percent of positions for ministers are allocated by number of reelections to the House of Representatives. No one is supposed to slide into the top or the middle of Japanese hierarchy.

51. Literature in labor economics shows that shirking among workers could be avoided by an incentive structure. One solution is deferred payments, such as higher wages with longer tenure and pensions, with a threat of dismissal. This works in extreme form in a Japanese hierarchy.

52. Of course, there are costs and benefits to being politically assertive. Gilpin (1981) discusses this point. His assumption states: "A state will seek to change the international system through territorial, political, and economic expansion until the marginal costs of further change are equal to or greater than the marginal benefits" (106). In this section, my working hypothesis is that it

East Asian model of development. The World Bank and International Monetary Fund, with influence from the United States, have promoted a free market approach to developing countries. The approach emphasizes deregulating import controls, price controls, and other restrictions right from the beginning. However, the Japanese model of economic development seems different from this approach. The development strategy carefully nurtures infant industries by protecting domestic markets from imports and by giving tax breaks or preferential government loans or subsidies. The pattern has been repeated by Korea and Taiwan in developing export industries. The strategy appears to be successful in transforming low-income countries into newly developed nations. It is crucial to those countries to have markets for their exports to earn foreign currency. If Japan could stand up and defend the economic policies of up-and-coming nations, such as Thailand and Malaysia, from the U.S. assault on regulations and import restrictions as well as pressure on export restraints, this would be leadership. There is some sign of change in Japan's attitude toward a development strategy, especially in World Bank policymaking. However, it remains to be seen how strong Japan's challenge to the traditional approach would become.

Human rights. Human rights violations occur periodically in Asian countries, as in any other region in the world. Until now, the United States responded to human rights violation quickly and decisively. Japan and some European countries are reluctant to take measures against human rights violations. Japan responded very late to the Tiananmen Square incidents, compared to the United States and Europe. Japan was the first to resume aid to China after the incident. Japan did little against the Myanmar government for its house arrest of San Suu Kyi, the Nobel Peace Prize winner of 1991, or Indonesia for its killings in the East Timor incident. In either case, Japan could have used its official development assistance (ODA) muscle to press for democracy. However, this does not seem to be Japan's style so far.

Antiweaponry policy. A principle that Japan could embrace more easily than human rights is an ODA for peace enforcement. As its constitution dictates, Japan has a clean record for not exporting weaponry. In order to enforce regional stability, Japan may take up a principle of not providing ODA for countries that export or import weaponry.

Regional bloc. In a sense, Japan could respond to the call from Mahathir for forming the EAEG. It could be a regional counterproposal to the European Community (EC) and NAFTA. If this regional development takes place, Japan

is neither sustainable nor desirable in the long run to have a strong economic presence without political assertiveness.

will have to play a significant role, whether it likes to or not. Given that the United States firmly opposed a move such as the EAEG, this will be on Japan's agenda only when the EC and NAFTA are closed to Asian nations. I consider this to be only remotely possible.

9.5 Concluding Remarks

In this paper I have argued the following points: First, U.S. pressure in the past can be classified into three types. Second, the traditional and market access pressures on Japan and other East Asian countries were not necessarily resisted, though neither were they welcomed, by Asian countries, because of some domestic merit to the pressure. Third, the results-oriented pressure has been intensely hated by Japan and others because it unilaterally benefits U.S. producers. Fourth, resistance to pressure is not likely to turn Japan away from the United States in favor of Asian countries, because the trade relationship needs the United States as an absorber of Asian countries' products and Japan lacks leadership in the region.

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Comment Frances McCall Rosenbluth

I commend Takatoshi Ito for taking seriously the charge of the conference organizers to integrate politics and economics in his analysis. He examines the

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history of United States–Japan economic relations and looks for ways macro-economic forces and micropolitical incentives interact. I agree with much of the paper. But as the designated political scientist kibitzer, I would like to focus on Ito's characterization of Japan's political system. A more complete model of Japanese politics will allow us to understand Japan's actions better and therefore to predict Japan's responses to pressures from the United States more accurately.

Ito's characterization of Japan's political system is perhaps best illustrated by a subtheme running through his paper, decrying Japan's lack of political leadership. Ito raises the leadership issue in the introduction and returns to it again periodically, concluding that the "biggest stumbling block to Japan's becoming a regional economic and political leader is lack of principles." Ito seems to suggest that this stems from a domestic political system that deters decisive action, hence robbing Japan of important opportunities to assert itself on the international stage.

Although Japan's political system has difficulty acting speedily, as I will argue later, this depiction of an indecisive and clumsy Japan tripping over its own feet is not entirely convincing. Japan has good reason, in fact, to maintain a low international profile. Even in a post–Cold War world, Japan continues to rely on the United States for much of its defense. Second, as long as Japan's exporters rely disproportionately on U.S. markets for their viability, it is unrealistic to assume Japan could improve its welfare by asserting itself more forcefully. Japan's leadership still sees the country's interests served better by supporting than by challenging the United States.

Japan is not likely to deviate substantially from its tried-and-true course of action, short of important changes in the benefits and/or the costs of the status quo. True, the benefits of strong ties with the United States could decline, particularly if the United States begins to close its markets to Japanese products. Alternatively, the costs of challenging the United States could decline, due to a diversification of export and investment patterns away from the United States. But neither of these has yet occurred to a significant degree.

To call Japan, as does much of the popular press, a "headless monster" incapable of concerted action is misconceived. Japan has a unitary, parliamentary system of government that is more streamlined in many ways than the U.S. system, where power divides vertically between federal and state governments and horizontally between the executive and legislative branches. That Japanese bureaucrats rather than elected officials appear to handle many important decisions is precisely what one should expect in equilibrium in a parliamentary system. Politicians *prefer* to delegate routine policy decisions, and need to monitor and intervene extensively only when they face competition from an executive branch controlled by a different political party.

However streamlined, Japan's political system is incapable of moving quickly for other reasons. Japan's electoral rules amplify the importance of blocs of votes and hence delay decisions that could hurt any group of constituents. It is commonly assumed in any representative government that, because

of collective action problems, organized groups are more advantaged than unorganized voters or consumers. But collective action problems operate with a vengeance in Japan. Japan's single nontransferable vote (SNTV), multimember district electoral system pits members of the ruling Liberal Democratic party (LDP) against *each other*. This forces members of that party (or any party seeking to gain a majority) to supply private goods—budgetary and regulatory favors, for example—to mutually distinct groups of voters rather than to appeal to a common party platform or label.

Given the importance to LDP members of personal support networks and of campaign financing to nurture these blocs of votes, the party leadership faces ferocious opposition from within the party's own ranks to policy measures—trade liberalization, for instance—that alienate groups of supporters.¹ Because Japan's government is a parliamentary system, the LDP leadership hypothetically could force its backbenchers to support policy decisions that are in the party's overall best interests. But the LDP leadership also has to ensure the reelection of a Diet majority. As long as the LDP faces a vote-division problem, the party cannot shift from a private goods, favor-based electoral strategy to a public goods strategy that emphasizes the interests of the unorganized populace. Until the LDP undertakes electoral reform, Japan's political leadership will liberalize Japan's markets as little as possible but as much as necessary to avoid a showdown with the United States.

In conclusion, I return to policy implications of Japan's political system for the United States. I was intrigued by Ito's open-minded attitude toward the "revisionists," which separates him from most of his economist brethren. I agree that Japan's markets are not open. But it is important that the United States pursue policies that will not backfire.

I share Ito's profound skepticism about the wisdom of a Fallowsian economic containment strategy against Japan. The LDP is slowly opening Japan's markets because of pressure from Japan's exporters, for whom the probability and expected costs of U.S. trade retaliation have risen steadily in recent decades. Demographic change, in particular the rising proportion of urban salaried workers as a proportion of voters, is also forcing the LDP to reconsider its proproducer policies.

The United States would do well to support the voices in Japan that favor market opening by pressing for greater access to foreign competitors, without alienating the Japanese public through unilateral market closure or high-profile posturing. But the United States should be prepared to be patient in the short run. Only when the LDP manages to jettison farmers and other uncompetitive sectors from its coalition—which it is attempting to do through electoral reform—can the United States expect to see dramatic changes in Japan's trade policy.

1. Note that the LDP would have little incentive to retain the malapportionment of districts in favor of farmers were it not for the farmers' organizations that help the LDP divide the vote in rural districts.