

## Better Economic Relations Toward The New Century (The first of four parts): The Past, Present and Future of Japan-U.S. Trade Friction

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### A new era

The status quo of our modern world has undergone significant changes in the past few years, with the future very much uncertain. Nonetheless, even in these evolving times, certain issues continue to dominate the national consciousness of both Japan and the United States. In this instance, I would like to speak particularly on U.S.-Japan trade relations which, perhaps above all else, remain a virtual powder keg of tension between the two powers. The very nature of this continuing dilemma, in fact the very paradigm it is conducted within, is changing though. With the introduction of the World Trade Organization (WTO), we are entering a new era for negotiation on all levels.

The WTO came into effect on January 1, 1995. Under this new regime, the legal commitments of both Japan and the U.S. vary greatly from those they held under the long-standing General Agreement on Tariffs and Trade (GATT). It is worth noting that the GATT was never legally ratified by the U.S., though the WTO was. From the perspective of U.S.-Japan trade, the most readily evident changes are in the legal status of the U.S. Trade Act provisions. Some tactics of U.S. trade policy have, as a result, been removed from the table. Consequently, negotiations are now to be conducted, or at least attempted, on the basis of the newly-established international rules of engagement.

In light of this, and if you will pardon the term 'new world order,' it is now an apt time to reflect upon the history of U.S.-Japan trade negotiations. By examining the long and winding trail of trade conflict between the two countries, it will be easier to understand how we have reached our current situation. That, along with an understanding of the newly-established WTO paradigm, will allow some foresight as to what is

to come. At present, there are fortunately no serious issues of trade friction between Japan and the U.S. Perhaps with greater understanding will come the ability to maintain peace between the allies. With this optimistic thought in mind, we will turn toward the historical record.

### Megatrends

The chronology of U.S.-Japan trade negotiations can be broken down into five distinct eras, spanning in total almost four decades. Examining these eras independently, it can be seen that each is distinct with its own defining characteristics. However, when viewed as segments of a whole, some clearly discernable recurring themes or 'megatrends' become apparent. Let me begin by enumerating them so that they may be understood within their proper context in the following history.

The first notable megatrend is that negotiations have shifted from ones in which the U.S. took an import-restrictive stance to ones favoring an export-promoting policy. Accompanying this change in priorities has come an alteration in the tone and approach of negotiations.

Early negotiations could be characterized as the "help me" type, which sought to defend domestic industry from destructive competition. This defensive approach was relatively well-understood and accepted by Japanese trade industries and officials. What replaced this approach was harder to deal with. The "you are unfair" style of negotiation was so aggressively accusatory, casting Japan as an 'unfair trader' that both countries had to negotiate not only real issues but also perceptual ones. As a result, negotiations became more complicated and harsh.

Other megatrends can be spotted in the variety of ways in which the scope of trade issues under discussion has expanded considerably over the past

thirty five-odd years. Initially focusing almost exclusively on direct tariffs, the emphases of negotiations moved to the arena of non-tariff barriers and even toward including internal domestic policies and practices. Also during this period, the definition of what constitutes international trade has grown from one that focused solely on imports and exports by domestic firms to one inclusive of the trade conducted by foreign affiliate firms. Under this expansion of scope, the focus has moved from negotiations concerned solely with individual items to those tackling various issues under a comprehensive framework.

### Early history and foreshadowings

In this view of history, the first era of real significance was the 1960s. In retrospect, this decade was definitely the "calm before the storm." Japan's impact on the U.S. economy at the time was minimal, being hardly worth a mention in terms of trade friction. This situation is not exactly surprising, given that during this era, Japan was still exporting comparatively low value-added goods. Nevertheless, the U.S. Government had taken some import-restriction measures which focused firmly on protecting U.S. industry. The most notable agreement from this era related to control of Japan's export of cotton products to the U.S.

By the mid-1970s, the growing shadows of future trouble were beginning to show up. In this period, textile trade conflict was the most notable problem, and it was much politicized in the context of the issue of Okinawa reversion. This friction led to the establishment of a protectionist multilateral trade framework in the textile sector, something which was only recently decided to be integrated into the principal rules of the WTO. Trade friction during this decade was quite sporadic, flaring up only intermittently in response to a combina-



tion of three factors. Along with a surge in Japan's trade surplus, the other required elements for strife were a recession in the U.S., which had a correspondingly higher level of unemployment, and an upcoming presidential or mid-term election. As the decade progressed, the makeup of Japanese exports shifted toward higher value-added products, and it soon became clear to observers that with this new export focus, Japan was likely to have a much greater economic impact upon the U.S. in the near future. The response to this new competition in the U.S. was to request that Japan restrict its exports of higher value-added products such as iron, steel and TVs. Parallel to this, we can also see in this era the beginning of export-promoting behavior on the part of the U.S. In particular, pressure was exerted to reduce import quotas on beef and citrus products, along with tariffs on computers.

A marked shift in trade relations came in the first half of the 1980s, as new import restrictions combined with a growth in "help me"-type demands from U.S. business. The primary trade weapon of this era was Section 201, and it was used quite extensively to protect U.S. business interests. Under Section 201, the U.S. position appeared to be quite protectionist and aimed at restricting imports. This "help me" approach proved to be highly unpopular in U.S. political and press circles, however, because of the underdog image it portrayed. A further problem for the U.S. administration was that the due processes required by the GATT were troublesome and that the non-discrimination rules of GATT safeguards prevented the government from taking selective protectionist action in relation to Japanese products.

It was also during this time that non-tariff barriers started becoming a major concern. Japan had already reduced its tariffs to among the lowest in the world, but U.S. negotiators contended that more subtle protectionism must still exist. Shifting tactics, they began to point toward elements of Japanese non-tariff barriers as the reasons for the unfavorable U.S. trade bal-

ance. Using these claims as a basis for export-promoting policies, U.S. negotiators pushed for changes in some of Japan's domestic regulatory systems, such as safety regulations concerning metal bats. At that time, MITI was willing to change unreasonable regulations, but was of the opinion that the unfavorable U.S. trade balance arose mainly from the loss of competitiveness of U.S. industries which had failed to adjust themselves to changing consumer trends.

Two cases in particular help dramatize the "help me" nature of this era. In 1981, American auto companies filed a petition under Section 201 requesting protection from 'excessive' foreign competition, but were turned down by the International Trade Commission (ITC). However, under pressure from the U.S. Government, Japan did agree to implement 'voluntary' export restrictions on autos. A second defining case occurred when Harley Davidson also filed for protection from Japanese imports, a case that ended up being taken before the GATT. What was interesting to note here was that while the U.S. narrowly won GATT's approval, due to GATT policy, all motorcycle imports had to be restricted, even though the U.S. did not want to block imports from West Berlin, for example, but only from Japan.

### From "help me" to "you are unfair"

The last half of the 1980's marked the beginning of cases filed under Section 301. This represented a marked change from the previous trade instrument, for with the introduction of 301, the stance shifted to a more aggressive, "you are unfair" style of negotiation. The attitude expressed under this approach was initially an easy alternative tactic for import-restricting measures and later on was shifted to one of opening Japanese markets to U.S. producers in the name of fair trade. Unfortunately, some overzealous behavior on the part of the U.S. government led to rather heavy-handed tactics and outright threats, such as in the case of semicon-

ductors, characterizing this era of negotiations. From the U.S. perspective, this type of approach had the advantage of allowing selective targeting, thereby ducking the issue of non-discrimination.

This critical shift, from "help me" to "you are unfair" is exemplified in the epoch-making Bethlehem Steel case. In January of 1984, Bethlehem Steel and other steel makers filed for protection with the ITC under Section 201, asking for higher tariffs and import quotas. In July of that year, the ITC accepted the petition and recommended to the President that tariffs be raised and import quotas be introduced. The president surprisingly rejected the recommendations, and decided instead to hold negotiations with the 'unfair exporters.' What followed provided the U.S. steel industry with essentially the same results as they had demanded initially—the exporters 'voluntarily' cut back their exports. There is a significant difference between the two approaches. The "help-me" approach suggests the image of an underdog, and is administratively time-consuming. On the other hand, if the U.S. can force the other party to submit to its wishes by accusing it of unfair practices, it is able to obtain exactly the same result without looking like an underdog. Hence, this quick and easy "you are unfair" approach has become a first resort tactic. However, for the party accused of unfair practices, the situation is serious. Disaffection spreads around the world. The Uruguay Round marked the convergence of this disaffection, as explained further later on.

Aside from a change in stance, the new focus on "you are unfair" negotiations expanded from import-restriction measures to export-promoting ones, with Japan being pushed for numerical import targets, which meant export sales quotas for U.S. industries. This could be seen in the shrewdly-documented old cases of semiconductor and auto parts. Additionally, and in a manner quite different from previous arrangements, products were judged by the nationality of their company, not by their place of origin.

The final pre-WTO era was the early



1990s. This was an era marked by an end to import-restricting measures under the name of self-restraint in such traditionally controlled markets as textiles in 1991 and steel in 1992. Even the much-criticized 'voluntary' export restraints on autos ended in 1994. Matching this, however was a spread of export-promoting "you are unfair" style of negotiations in such diverse areas as paper, glass and construction. Of particular note is that after 1993, the Clinton Administration aggressively sought numerical targets with strictly-defined objective criteria for trade agreements, which were criticized by Japanese negotiators as "sales quotas" or "export protectionism," and did not lead to satisfactory results.

### Building a better trade order

The WTO itself arose out of the inefficiency displayed by the GATT and the mounting frustration many countries felt toward it. Consider as one case the ever-growing number of "you are unfair" type approaches to trade. Countries affected by these policies

became increasingly upset by the U.S. taking the roles of both prosecutor and judge. During the Uruguay Round, when the WTO was being hammered out, there was a definite push to put an legal end to unilateral action by any country. According to the rules of the WTO, such sanctions cannot be instigated without international due process. This was but one of many structural improvements that were incorporated into the WTO charter. In virtually every way, the WTO charter was a far more comprehensive and sweeping document. It's scope included not only the areas covered by the GATT, but also trade in services, intellectual property such as trademarks and patents (TRIP) and Trade-Related Investment Measures (TRIM).

This new wider vision can be seen in all aspects of the WTO charter. Areas that had previously been excluded, such as fibers and agriculture, are now integrated into the main body. Pre-existing goals, such as tariff reductions were pushed even further, while standing rules were strengthened. Among other measures, the WTO also strengthened enforcement mechanisms and stream-

lined the dispute-settlement agreement. An example of the latter is the introduction of negative consensus. This is in contrast to the extremely inefficient GATT system under which a motion could be blocked by a single disputing country, thus holding the process hostage. As a further measure, time limits are set for each process and an appellate body is established. The cumulative effects of these measures are far faster settlement mechanisms along with the strengthening of measures which prevent the larger powers from abusing their authority.

At this point, it would seem appropriate to analyze some recent negotiations under the newly established system. Unfortunately, the issues that ended up being the first major cases were highly inappropriate in my view. The issues of autos and semiconductors are old, long-running topics under the old paradigm that should have been avoided. Unfortunately, they were not. It would perhaps be best if we could think of them as unfortunate incidents that happened during the transitional period from the GATT to the WTO. Still, they occurred under the WTO and should be

treated as such. The irony is that neither of the superpowers won these negotiations. Rather, it was the WTO that demonstrated its authority and ability to force major economic powers to abide by the rules. For this reason alone, these negotiations, slightly anachronistic though they are, remain a valid subject for examination.

The negotiations over autos and auto parts in early 1995 were based on the U.S. contention that Japan represented a closed market. In the interest of fairness the U.S. trade negotiators contended that governmental intervention in the form of numerical targets on imports was necessary. Japanese officials countered that their market was open and as such, forcing sales quotas



Advent of the age of competition: MITI Minister Tanaka and U.S. Ambassador Kennedy put an end to the textile trade conflict in 1971

Photo: Kyodo News Service



was not only beyond the government's authority, but a violation of market principles. U.S. rumblings of retaliation smacked of unilateral behavior that was in no way permissible under the WTO. When on May 16, 1995, the U.S. announced its intention to impose a 100% tariff on Japanese luxury cars, the reaction was immediate: Japan brought the case before the WTO the very next day. In the Japanese view, the ruling handed down was quite clear—even an announcement of such a nature was not permissible, since it could do damage by itself. An additional ruling reaffirmed the unacceptability of unilateral action. Fair to say, the U.S. action was not supported by many countries, which contended that it was a clear case against the WTO and that it should not be the first case to go before the newly-created body. In a less dramatic way, the semiconductor case showed the continuing differences in how the U.S. and Japan approached trade negotiations. While Japan proposed a multilateral arrangement without any numerical targets and a three-year duration, the U.S. pushed for a bilateral, five-year, target-focused agreement. Semiconductor negotiations had two aspects. One was a similar numerical target issue as in auto negotiations, which eventually had the same results as the auto case. Another aspect was a not-so-confrontational discussion on which is better—a bilateral or a multilateral approach. The facts have shown clearly that the era ended when Japan and U.S. supplied semiconductors to the world market in a virtually monopolistic manner. And this multilateral approach will be much more meaningful and beneficial to both countries in the future.

### A future vision

In light of this new order coming into being, what shape might future trade negotiations take? With the continuing expansion of trade between Japan and the U.S., in both terms of volume and numbers of affected sectors, trade friction will inevitably increase. At the same time, conflict-resolution measures will shift from such domestically-based measures such as Section 301 to inter-

national mechanisms. This new framework for negotiation will help to defuse and depoliticize the currently quite tense nature of U.S.-Japan trade relations.

As for international trade issues, Japan and the U.S. now have many common items on their agendas to deal with. In the realm of the WTO, the remaining issues such as ITA should be solved steadily, environment issues related to trade should be addressed and China's accession to the WTO is one of the most important trade issues. Along with common interests, both economic powers will have to deal with various WTO-related problems, raised by emerging nations such as Brazil and Indonesia, in the auto sector.

The two countries have a joint interest in the Asian Pacific Economic Community (APEC), especially in its trade-liberalization process.

International trade, with rapidly growing overseas investment, has been and will also increase much more, but in a more complex manner, so that the two economies will have to address various trade issues to attain common goals. We can only hope that these common threads will draw out a cooperative, rather than a confrontational spirit between the U.S. and Japan.

On the other hand, it can not be stressed highly enough that a new trade negotiation paradigm cannot solve all existing economic problems. To truly lay lingering friction to rest, there must be further and more far-reaching discussions of macro-economic policies which are crucial factors in deciding the magnitude of each international trade account. Although the trade imbalance between the two countries has been a underlying problem, there has been no serious discussion on which factors, foreign or domestic, macroeconomic or trade policy, are the dominant ones. In the actual scene of negotiation, each party makes full use of the other's bad image. The U.S. negotiators explain to the public that Japan's large trade surplus comes from unfair practices in Japan. The Japanese negotiators accuse U.S. industries of lack of competitiveness and sales efforts. Both sides make a compromise to reach an agreement,

but in these kinds of solutions, without any discussion of macroeconomic issues, they do not get to the main issue of how to resolve the trade imbalance. An inappropriate solution and its unsatisfactory outcome naturally makes the other's bad image worse. This vicious cycle should be cut as soon as possible.

The entire history of active U.S. trade negotiation with Japan and others has seen much done to change unfair trade practices which prevent the countries in question from modernizing, but has seen little done to reduce the U.S. trade deficit. I do not mean to appear accusatory merely by suggesting that perhaps the U.S. has put greater emphasis on international trade negotiations, instead of explaining to the public that the real cause of the trade deficit is that the U.S. simply consumes more than it produces. What is most worrying now is that U.S. society, while enjoying long-lasting economic prosperity, will shift to inward-looking inclination or protectionism due to frustrations based on misperceptions.

Those who would continue to look east for the answers may keep in mind that Japan's trade and current account surpluses have decreased dramatically in recent years, a trend I believe will continue in the long run, with short-period fluctuations. Yet, in spite of this, the U.S. trade deficit remains high. Therefore, perhaps it is time for the U.S. to look inward for a lasting solution to its continuing dilemma, and reconsider its priorities.

However, this should not distract us from the fact that Japanese-U.S. economic relations are so interlaced and complementary with each other that whatever problems we may face in the future, the situation will remain one of great mutual benefit. In choosing a path for the future, this is the one fact that must not be forgotten.

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