

O n the U.S.— Japan Automotive Negotiations



The Japan-U.S. auto talks (Japan-U.S. automotive industry and car parts frameworks talks) wore on for two years. At long last, on August 23, 1995 in Washington, both sides agreed to and signed a final accord.

A discussion with Sakamoto Yoshihiro, Vice-Minister for International Affairs, MITI, and Columbia University Professor Jagdish Bhagwati brings the dynamics of these negotiations and subsequent agreement to light.



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***Sakamoto:** I would like to ask your opinion on various automotive industry issues. First, the Japan-U.S. automotive industry accord has become a focus of debate in Japan and the U.S., as well as internationally. I would like to start with your appraisal of the agreement,*

Professor, and then ask you to sum up reactions in the U.S. and international society from the perspective of international rules, particularly those of the WTO.

Bhagwati: I thought that the agreement was a fairly good one. The process by

which it was reached is another issue, but the agreement in the end was desirable from both sides. And it was from the Japanese point of view, I think, a major success. The United States negotiators unfortunately wound up focusing on import targets in one form or another and

threatened retaliation, which is aggressive unilateralism.

These two features as part of the negotiations were things which Japan managed to resist. Therefore, in terms of what was not accepted I think it was a great success. Not just for Japan, but for the world trading system. I think trade should be conducted according to rules rather than according to quantities. I think there was a great deal of fear that Japan would ultimately give in on the assumption that this is the last of the SII Talks, or the Sectoral Talks; "let us get it out of the way. It is not going to be very expensive because Japanese car firms are going to buy more things, more parts and so on anyway." I think the temptation to settle and get it out of the way, which I think many friends of Japan were also proposing, was very considerable. But I think this was a point of principle where compromise would be harmful.

In any case, I don't think it would have been the last of the talks between Japan and the U.S. if Japan had conceded this principle. Because, as we were just remarking earlier, the United States is subject to intense lobbying pressures and if, in a case that was relatively weak, the United States could get away with targets, then everybody else would want that. And there is no way the USTR could have effectively closed that demand off saying that it was for autos and is not for you. The system doesn't work that way. So I think Japan was wise both in terms of its own interest and in terms of the trading system, playing a social role, to have said no to these particular demands. So in terms of what was excluded, the auto accord was a great success.

In terms of what was included, I think that there are two observations I would like to make. One, along the same lines I was remarking on, I think it was extremely important that the agreement explicitly says no to import target commitments on the Japanese part. From the perspective of an outside observer, as I said on CNN the day after the agreement was announced, "as an American I feel embarrassed and humiliated by what happened, but as an economist I'm happy." The way I interpret what happened was, concerning import targets, if you take the Bush-

Miyazawa Communique, \$19 billion in parts to be purchased by Japanese firms was a figure, but it was neither accepted nor rejected. It was just there in the communique. So the Japanese government had just left it ambiguous. If you take the semiconductor agreement, which you negotiated on, the figure of 20% was in the annex. Again, there was no commitment. But at the same time, there was ambiguity, which led to trouble. The automotive agreement is, in this perspective, the first time that the communique and the agreement say explicitly there is no commitment. So from the U.S. point of view, it was taking a step back, and from the Japanese point of view it was taking a step forward, saying "not ever" to import targets. So, that was an enormous step forward: In place of the ambiguity in earlier communiqués and agreements, Japan this time had *explicitly* rejected the import targets (or what I have called the VIE, Voluntary Import Expansion approach).

The second, equally important, point of interest in the automotive agreement was the way the aftermarkets problem was handled. The concessions made by Japan are fine, as far as I can judge. But what struck me was the fact that, in this area of dispute, the U.S. had passed up the opportunity to abandon the aggressive unilateral approach in favor of what seemed to be a first-rate case before the new WTO. Let me explain.

If, as the U.S. claimed, the inspection system in Japan was rigged by the government to restrict, even to exclude, imports, then this was clearly a case for WTO dispute settlement. Article XXIII (1)(b), on nullification and impairment, could have been invoked. To make the case substantively, the U.S. could have invoked TBT, arguing that the standards of inspection were in excess of internationally prevalent standards and that a case should be made by Japan to justify them; in addition, Article XX could have been invoked, accepting the Japanese inspection standards but arguing that they were being enforced in ways that were not least trade-restrictive. If the U.S. complaints were serious, then I have no doubt that a WTO Dispute Settlement Panels would have found in favor of the U.S. And the U.S. would have gotten sub-

stantive relief; I have no doubt that Japan would have changed the system to be WTO-consistent. It would also have been a blow in favor of the WTO, making it a WTO-strengthening move.

Instead, by using aggressive unilateralism or crude *gaiatsu* and prejudging the issue of Japanese guilt, the U.S. got pretty silly concessions such as the reduction of inspectors from five to three, exclusion of certain parts from the inspection requirements and so on. The threat of 301 tariff retaliations also made the U.S. appear as if it was against the multilateralism embedded in the WTO, sullyng the U.S. image and appearing to emphasize to the world's trading nations that the Clinton administration was willing to sacrifice the most important principles for cheap political advantage at home.

So, the U.S. certainly could have gone to the WTO on the inspection and aftermarkets issue, and the general contention in the USTR and its Japan-fixated supporters in Washington that the WTO had no competence in the car dispute was simply untenable. However, it is true that the deeper questions of competition policy, such as the effects of the *keiretsu* in Japan and of vertical integration in the U.S. on market access, have no currently agreed on rules at the WTO or, indeed, elsewhere. Referring such matters to the WTO would mean that the Dispute Settlement Panels would have to be "making the law." Now, I come from a very distinguished family of judges. My father was a Supreme Court judge and my eldest brother retired recently as the Chief Justice of India and, except for my good fortune in becoming an economist instead, I might have been sitting on India's Supreme Court also if I had accepted my father's wishes. I therefore know that judges will often make law when none exists. But this is not really a satisfactory approach when it comes to making trade law in difficult matters such as competition policy where deeply held differences concerning what sort of "capitalism" you favor are at stake and these can only be resolved through a mix of—in this case, occasionally conflicting—economic principles and politics, in negotiations.

Where the U.S. should have taken these

deeper, unresolved issues of competition policy between itself and Japan (and the EU) is to the WTO in a different way. U.S. Trade Representative Mickey Kantor should have mobilized the brilliant and constructive Sir Leon Brittan of the EU—who saved the Financial Services pact when the U.S. failed to go along with it, striking a forceful blow for multilateralism and the WTO when the U.S. was striking one against both—and gotten the WTO's head on their side to launch a Committee on Competition Policy at the WTO, just as we have done now on Regionalism and earlier on Environment. Japan, I am sure, would have gone along.

Indeed, this two-pronged policy, with an immediate case at the WTO on aftermarkets and a Committee at the WTO on Competition Policy, the U.S. would have gotten much farther on its professed goals than it did in the 301 framework; and it would have emerged as a creative leader of the new world trading regime. Instead, the actual choice of tactics by Washington reflected a lack of vision and a lapse of judgment that caused anguish to experts such as myself who see leadership, a treasured asset of the U.S. in the postwar period, being frittered away.

Your next question related to the way the agreement is viewed in the U.S. The answer depends on which segment of policy opinion you are talking about.

Those who wanted the U.S. to move back to aggressive unilateralism after the fiasco of the Hosokawa-Clinton summit were naturally disappointed that the U.S. had capitulated in the car talks in the sense that import and procurement targets had been repudiated and, despite that, the U.S. had withdrawn its threat of 100% tariffs on Japanese luxury cars. This group of unhappy critics includes the

well-known Professor Chalmers Johnson, and a new set of journalist Japan-bashers, John Judis and Michael Lind of *The New Republic*, who are even more dangerous than the more sophisticated and nuanced James Fallows because they pretend to have a familiarity with economics which is in reality terribly superficial. Judis, for example, wrote an article in *The Washington Post* entitled, 'Clinton's Big Fade,' meaning that Clinton had come in promising a tough line on Japan's predatory trade practices—remember his campaign promise to revive Super 301 against Japan—and had copped out. This group, of course, saw quite clearly that Kantor, despite his pretense that he had won, had actually lost and, indeed, lost terribly.

On the other hand, the general public will swallow the propaganda that claims

victory. The Japanese government would be well advised to let things be, especially now that the election campaign is beginning, so as not to embarrass the Clinton administration into a politically-motivated reassertion of an aggressive disruption of U.S.-Japan trade relations.

But the Japanese government must repeatedly make clear to USTR, Commerce and State that import and local-content targets, whether soft or hard, are WTO-inconsistent and that Japan has categorically repudiated them. Also, that any "monitoring" will necessarily involve looking at statistical information; but that market shares and related data are not to be taken as a guide to, or a substitute for, a hard analysis of the anti-competitive practices of both Japanese and U.S. firms in the car industry. Only Japan can ensure that so-called "monitoring," by being focused only on Japanese firms, and on shares and procurements, turns de facto into quantitative targets politically.

Now, that takes me to the last part of your question: "How do you view the agreement in terms of international rules?" I must say that, while the agreement as drafted—especially with the Japanese rejection of targets—is legally alright, there are two disturbing aspects of the spirit and the process that led to it. And this critique has to be addressed unfortunately to Washington.

First, the tactic of targeting the Japanese car firms with the 100% punitive tariff threat was clearly designed by the USTR as a way of breaking these firms' financial capacity, and hence their willingness, to say "no" to U.S. demands. If these tariffs had been enacted, they would have been clearly GATT-illegal. U.S. car tariffs are bound and cannot be raised summarily. The choice of such a clearly GATT-illegal form of retaliation therefore can be explained only by understanding that the aim was to intimidate the firms, and through them MITI, into accepting the U.S. demands.

But leaving aside the usual criti-



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cisms aimed at 301 tactics by the U.S., this raises an even deeper question; should we tolerate the use of threats by powerful governments against foreign firms, simply with a view to advancing these governments' unilaterally-determined trade agendas? In a world of growing globalization, firms are now transnational, with operations all over the world. The tendency, supported by the U.S. in other areas, is to ensure that firms can operate without arbitrary exercise of political power against them by host governments and, if possible, even with a common set of rules. The U.S. action in the car dispute was directly against that trend and that vision. In my view, it was utterly deplorable and a retrograde step that invited outright condemnation. Indeed, the U.S. Congress would have seen the point immediately if, say, the French government was zeroing-in on IBM or Detroit with punitive threats designed to advance French trading interests!

I should add that this astonishing lapse of good sense by the USTR owed to the general use of images about Japanese firms, even by longtime observers such as Clyde Prestowitz, as using Japan's "closed" market as a "sanctuary" from which to rush out like one of the Seven Samurai and devastate our firms! Such imagery has been extended by many to the notion that their investments and exports in the U.S. market make the Japanese firms "hostage!" And, of course, once you take hostages, you use them to extract your ransom! We should not forget that we are prisoners of our language—it can corrupt our thoughts and our actions.

Second, I (and indeed some international trade lawyers) firmly believe that the U.S. emphasis on procurement of components from U.S. non-Japanese firms by Japanese car firms, both here and in Japan, is fundamentally in violation of the TRIM's agreement and of the GATT's principle of nondiscrimination. If the U.S. wants to invoke principles of competition policy to say that a competition-policy exception should be enacted into the WTO articles on TRIMs, permitting local-content requirements, that is fine. But no nation should be able to unilaterally assert the right to suspend a WTO obli-

gation by invoking arguments not agreed to by trading nations, else the rule of law goes down the tube. Under existing obligations, there is no doubt in my mind that the U.S. demands on Japanese car firms for local content are illegitimate and unworthy of a great trading nation known hitherto for its respect for the rule of law.

Japan could have made this explicit in her part of the communiqué on the car dispute. But it is no use blaming you for this omission. As I have already said, Japan did stand up for basic principles on other important questions and one or two omissions can be forgiven, given the highly-charged conditions under which Japan was forced to negotiate.

Sakamoto: *I think that the point you mentioned earlier about the international debate over competitive policies will be one of the most important future trade policy themes. In this case it is conceivable that there will be elucidation and adjustment of thinking regarding the actual state of trilateral competitive policies among Japan, the U.S., and Europe, followed by harmonization and convergence, and I believe that the next big theme will be an initial trilateral consolidation of thinking, or harmonization, in Japan, the U.S., and Europe, rather than a discussion among all the WTO members. What points occur to you and how do you think it would be appropriate to proceed?*

Bhagwati: I believe that the main divisive issues in competition policy are among the triad: the U.S., the EU and Japan. Having triad talks therefore makes sense: the principal players would then be in the talks. But since Japan has been treated as the major culprit by the U.S., and Japan has the most to gain from a strong multilateral system and a strong WTO, Japan should somehow associate the WTO with the talks, by at least associating Ruggiero with them in his capacity as the Director General of the WTO. Also, Japan could work towards truly multilateralizing the talks under WTO auspices, through a Committee on Competition Policy, on a definite time schedule, so that the developing countries get to be partners in the talks.

Sakamoto: *Now, regarding Japan-US*

issues, I think that it was unfortunate for both sides that the discussions were overly politicized during the latest Japan-US automotive talks. When thinking about future relations between the two I believe that it will be important to investigate how to avoid politicization of trade issues, considering a joint Japan-US commission to look into mechanisms for dispute resolution, for example, or standards for adjudication that accord with WTO rules to fit bilateral issues into the overall context, as you noted earlier with "trims". What is your opinion on this point, Professor?

Bhagwati: In response to your question, I want to make a more radical suggestion. The politicization of the Japan "trade problem" arises because of the institutional framework which puts Japan's trade into unique settings, SII talks, Framework Agreement. These are not institutions which the U.S., to my knowledge, extends to other countries. These become essentially one-way accusatory ways of dealing with trade problems where Japan becomes the exclusive focus of trade demands by the U.S., quite different from the mutually accommodating frameworks as in all other fora like the GATT and APEC. One can see even Japan falling into this trap: the car agreement we have been discussing never makes any mention of the fact that the U.S. itself had VERs for many years and that such VERs should be foregone by the U.S., or that the pressures on transplants are inconsistent with local-content rules and amount to protection and should also be monitored. In short, the institutional framework of trade talks and negotiations between the U.S. and Japan has lent itself to one-way demands and threats. This also makes it tempting for the President's advisers to "use" the trade issue for political purposes.

I would suggest that, more than Joint commissions, the first order of business must be for Japan to say that no more Framework Agreements will be signed, that trade disputes with Japan should be treated exactly the way trade disputes with the EU are handled—in a spirit of give and take and of basic symmetry rather than in the spirit that Japan is some kind of "out-nation" that requires extraor-

dinary, special treatment.

In short, Japan must insist clearly and firmly now on a "normalized" relationship where Japan and the U.S. will deal with the issues of trade as if the two countries were equals, with trade concessions being exchanged rather than one-way concessions being extracted under threats. That is the surest way to eliminate the continuous political hassles that Japan has run into from the trade question.

That should make the car agreement the last of its kind in U.S.-Japan trade history. For each new complaint that comes up, as with Eastman Kodak, just refuse to deal under 301 threats. The proper response is what Fuji did: write a bigger report than Eastman Kodak did, challenging the charges as rewriting history, and let the two giant companies fight it out in appropriate channels such as the Fair Trade Commission or the WTO. And if USTR insists on getting involved, arm yourselves to return the favor in kind as Professor Matsushita and other Japanese trade experts have often advised. None of this means, of course, that bilateral talks, outside of the 301 framework are to be avoided; far from it.

I believe that your success in the car talks, where you stood absolutely firm, and where the U.S. threat was weak because it was WTO-inconsistent and therefore was a paper tiger as long as your own threat to take the retaliation to the WTO was credible, only illustrates the wisdom of what I am suggesting. All this will create, as it did in the car talks, a lot of drama and anguish and a feeling that your relationship with us is being strained. But, in the long run, it will only improve the relationship. It will be yet another example of what we economists call a "J-curve;" a decline and then a huge improvement.

Sakamoto: *Just as you said, one stance, or position, that Japan adopted this time during the automotive talks was that it intended to put a stop to the previous pattern of unnecessary government intervention in market mechanisms such as a voluntary plan for car part purchases, as with the previous semiconductor agreement or restraints on car exports, backed up by the threat of Section 301, to which Japan would then agree. As you*

said in the wake of the auto talks, issues should be resolved in an atmosphere of normal trade relations and that was also our advice. The notorious Japan-US semiconductor agreement will expire in July next year. The American government wants to extend it. So you can see that it is true that an environment is being created in which it is easier for problems to become politicized. As you said, I think that it follows that our future efforts should be directed toward achieving normal bilateral relations.

There are various trade issues, but I believe that, as two major economic powers in the Asia-Pacific Region, future Japan-US cooperation on liberalization in Asia, the issue of cooperation in Asian markets and, although it is outside MITI's area of expertise, Asia-Pacific security issues, will be important themes. I would like to hear your overall views regarding industrial, economic, and security aspects.

Bhagwati: The APEC initiative represents a culmination of several ideas, some of them frankly political. For instance, from the U.S. viewpoint, I have little doubt that the interest in APEC was sparked greatly by the fact that, as the U.S. was planning to extend NAFTA to the South as a "closed" regional FTA Initiative for the Americas, it felt that Asia might respond by embracing Malaysian Prime Minister Mahathir's East Asian Initiatives that would exclude the U.S. (and Australia and New Zealand). U.S. Secretary of State James Baker was quite explicit in his pressures on Japan, as you will recall, not to embrace the Mahathir Initiatives.

But asking Asia not to go regional and to keep its markets open on an MFN basis, while NAFTA and its extension were simultaneously regional and non-MFN in favor of the U.S. itself, was an inconsistent, even hypocritical, position which only a superpower could entertain! In the end, therefore, I believe that APEC was thought of by the U.S. as a geopolitical trade move to break the Mahathir Initiatives. It also came to be accepted eagerly by the ASEAN countries which saw it as a way to engage the U.S. effectively in the region, given their security concerns vis-a-vis Japan and a militarily

rearming China, whereas Japan's support was also motivated by the security dependence on the U.S. as North Korea and China became potentially greater concerns.

But while such political factors, interweaving with the U.S. desire to have MFN treatment in Asia despite her own preferential policies in the Americas, have jump-started APEC, there is still the problem of deciding whether to turn APEC into a truly free trading area with free trade on an MFN basis for all WTO members or into a narrower, preferential trading area which offers, under Article XXIV of the GATT, free trade only to APEC members.

This is where the real debate lies between Japan and the U.S. The U.S. member of the EPG, Fred Bergsten, is well-known to have argued long in favor of turning APEC to the narrower, preferential vision as against the more statesperson-like vision of free trade for all. This reflects, in turn, the desire of some key members of the U.S. administration. It also reflects their sense that the EU needs to be prompted to turn to more trade liberalization and that this can be done by excluding them from the benefits of MFN liberalization under APEC, a silly thought if you ask me, because it is the EU—not the U.S.—that has recently played an important role on Financial Services liberalization! Indeed, Bergsten has even argued that it was the Seattle summit that led the frightened Europeans into settling the Uruguay Round when, I think, the reality is that it was the U.S. which finally decided to close the Round with whatever was on the table from others, especially the French, and then go on to build anew on the fruits of that Round.

I also feel that the Bergsten argument is a foolish one for the Asian members of APEC to embrace—do they really want to get into the middle of these games between the U.S. and the EU?

Therefore, I think I would have told Japan, ASEAN and the other non-Americas members of APEC to stick together and tell their friends across the ocean to opt clearly in Osaka in November 1995, for MFN-based trade liberalization. Leadership on this issue is going to be a test of Japan's ability to

exercise leadership on questions of world trade policy. And, if Japan does provide this leadership, it will be essential for her also to ensure that the intellectual leadership of APEC, including supporting bodies such as the EPG, goes to trade scholars and experts who have a deep commitment to the basic tenets of the multilateral, rules-based trade system centered on the WTO.

Sakamoto: *In closing, the EU is expanding and NAFTA has come into being and will expand into South America. APEC differs from the EU and NAFTA, but has led to the adoption of one regional initiative. How do you think that the relationship between this regional initiative and the multilateral WTO should develop in the future?*

Bhagwati: First, let me repeat that APEC should opt for MFN in its own trade liberalization, rather than for an Article XXIV free trade area. That would be a *unique* contribution since no other "regional" trade arrangement has ever been anything except preferential.

Second, towards this end, I would have endorsed the Japanese concept of announcing "concerted unilateral liberalization" at Osaka last year. These are exactly GATT-type trade concessions which are also made on a concerted basis (i.e. within a round or under GATT auspices, with all acting in concert) and on an MFN basis. These can consist also of accelerated Uruguay Round commitments which are automatically MFN, of course.

But these MFN measures cannot be expected to be very substantial in the nature of the case. In a world of reciprocity, APEC members are unlikely to make big concessions which go without simultaneous trade concessions by non-APEC countries. That can only take place if all nations act in concert (i.e. it requires a WTO Round). So, Prime Minister Murayama, having explained this, should have taken the occasion also to say that Japan endorses the concept of the first WTO Round and that Japan will take the initiative to work with other APEC members in the region to ensure that progress



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towards that objective occurs on the way to, and at, the First WTO Ministerial at the end of next year in Singapore. APEC's role in this would be to provide an occasion to announce this vision and this objective on Asian soil, reflecting Asia's deep and historic commitment to access to worldwide markets as distinct from sub-regional and regional markets.

Also, if the WTO is to play an important leadership role in the world trading system, as Asia must surely want, then its research capabilities must be strengthened. Presently, its Economics division has less than 10 economists; and the new posts sanctioned for it are two! This will totally impair the role that Asia expects WTO to play in shaping the new architecture of the multilateral trading system. Prime Minister Murayama could then take the initiative to announce Japan's

intention to develop a Special Research Facility Fund, much like the ones that exist at the IMF where specific members contribute to specific needs, that would enable the WTO to expand its research capabilities to minimally acceptable levels for its new role. A sum of \$50 million as a target, with Japan announcing, say, \$25 million, would be a great idea and would underline dramatically Japan's support for the WTO and its capacity to play a leadership role. The sum could be an endowment, with almost 20 first-rate economists being hired from its interest proceeds, would triple the research staff, helping the WTO to develop its own ideas and its own vision as led by its director general, instead of its being limited and constrained by governments negotiating agendas.

Indeed, there are many things that Japan could do in this and other ways to turn APEC meetings and fora into platforms for WTO-encouraging and WTO-strengthening measures. In the end, the great exporting nations of Asia, which have shown the world what integration into the

world economy has to offer, have most to gain from a non-preferential MFN trading system, with strong disciplines in matters such as anti-dumping, whereas the U.S. is unfortunately somewhat handicapped in these respects today by a combination of declining commitment to multilateralism and a populist sense that America did much to help others in the last half century and now must "look after itself"—go easy on being the leader, the architect of the trading system, and concentrate on narrow national interests. As Representative Kantor once said, he prefers results to theology. What he was saying in effect was, 'I do not care about jurisprudence; I am interested in litigation.' It is now up to Japan, with Asia, and allied with an EU led with distinction by Sir Leon Brittan, to provide that leadership. Will Japan rise to the occasion? ■